Senate Fiscal Agency
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SFA BILL ANALYSIS

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Senate Bill 1079 (as reported with amendment)
Senate Bills 1080 through 1083 (as reported without amendment)
Sponsor: Senator Loren Bennett (S.B. 1079)
Senator Joel D. Gougeon (S.B. 1080)
Senator Dale L. Shugars (S.B. 1081)
Senator Mat J. Dunaskiss (S.B. 1082)
Senator Bill Bullard, Jr. (S.B. 1083)
Committee: Finance

Date Completed: 5-4-98

## RATIONALE

In recent years the State's tax structure has undergone fundamental change, with many taxes being reduced and some increased. According to the State Treasurer, since 1991 these tax increases and tax decreases have resulted in a net tax reduction of approximately $11 billion. In his 1998 State of the State address the Governor, citing the strength of the Michigan economy, an unemployment rate below the national average for four consecutive years, an improved bond rating, and the net tax cut, recommended that taxes be reduced again. Along with the many other changes in Michigan's tax structure that occurred with the passage of Proposal A in 1994, the income tax rate was reduced from 4.6% to 4.4%, where it stands today. The Governor has recommended that, beginning in the year 2000, the income tax rate be reduced again, over a five-year period, to 3.9%.

## CONTENT

**The bills would amend the Income Tax Act to reduce the State income tax from the current rate of 4.4% to 3.9% over a five-year period. The rate would be reduced by .1% each year beginning in 2000, as follows:**

- **Senate Bill 1079 provides that the income tax rate would be 4.3% in 2000.**
- **Senate Bill 1080 provides that the income tax rate would be 4.2% in 2001.**
- **Senate Bill 1081 provides that the income tax rate would be 4.1% in 2002.**
- **Senate Bill 1082 provides that the income tax rate would be 4.0% in 2003.**
- **Senate Bill 1083 provides that the income tax rate would be 3.9% in 2004 and thereafter.**

Further, currently under the Act 23% of gross income tax collections before refunds must be deposited in the State School Aid Fund. Senate Bill 1079 provides that the portion of gross revenues collected before refunds and dedicated to the Fund would have to equal the amount that would result if the tax rate were 1.012%. (This amounts to 23% of 4.4%, meaning that revenue dedicated to the Fund would not be reduced, even though the overall tax rate was lower.)

The bills are all tie-barred to each other.

MCL 206.51 et al. (S.B. 1079)
Proposed MCL 206.51c (S.B. 1080)
Proposed MCL 206.51d (S.B. 1081)
Proposed MCL 206.51e (S.B. 1082)
Proposed MCL 206.51f (S.B. 1083)

## ARGUMENTS

*(Please note: The arguments contained in this analysis originate from sources outside the Senate Fiscal Agency. The Senate Fiscal Agency neither supports nor opposes legislation.)*

### Supporting Argument

In the past few years, Michigan has undergone fundamental change in its taxation and spending policies; overall taxes have been reduced and spending has been restricted. This has resulted in good news for both the taxpayers and the State. After more than 25 consecutive years in which the State's unemployment rate exceeded the national unemployment rate, the State now has gone four years with an unemployment rate below the national average. According to the State Treasurer, Michigan is the only state in the nation to receive an upgrade in its bond rating from the three major rating agencies in the last 15 months. Reducing taxes and restricting spending can be credited with drastically improving the State's economy, improving its credit rating, and letting its taxpayers retain more of their money. The bills would, over time, substantially reduce taxes, and thus would further stimulate the State's economy for years to come.

**Supporting Argument**

The bills would continue to erode the taxpayers' burden, thus increasing individual spending and/or saving. Over the five-year period from 2000 to 2004, the bills would result in the taxpayers' keeping approximately $2.6 billion of their money, compared with what they will pay to the State if the income tax rate remains at 4.4%. Put another way, by 2004 taxpayers would experience a total reduction in their State income tax liability of 11.4%, compared with their liability under the current income tax rate. The State has been a leader among the other states in the nation in cutting taxes in recent years, and this has had a powerful effect. While taxes were being cut, the State's economy has had continued strong growth; the State's overall employment is at an all-time high, and the unemployment rate in 1997 reached its lowest level since 1969. With lower taxes and more jobs, the State's residents have a much improved chance of obtaining a good job and retaining the money earned from it, and thus are better able to provide for the needs of their families and for the future.

**Opposing Argument**

It is estimated that the tax cuts proposed in the bills would reduce revenue by $2.6 billion to $3 billion, a significant amount of money. If the State found itself with substantial revenue shortages, presumably it would have to make large cuts to maintain a balanced budget.

**Response:** The full impact of the tax cuts would not be felt until 2004, as they would be gradually phased in over a five-year period. Of course, it cannot be speculated as to what the State would cut in the event of a revenue shortage, because there are no budgets available for those years and no data to show how much of a shortage there would be, if any. In fact, the record shows that as the State has cut taxes in recent years, the State's economy has continued to grow and has produced more tax revenue. One thing that can be said with certainty is that the amount of income tax revenue dedicated to schools would not diminish with the proposed tax cuts, as Senate Bill 1079 would lock in the amount of income tax sent to the School Aid Fund.

**Opposing Argument**

If cutting the income tax is considered desirable, then it should be done now, and the cuts should be targeted toward families and not to individuals. In addition, increasing the personal exemption would be a better way to target tax relief to families, particularly those that have several dependents and modest household income. Increasing the personal exemption would put more money in the hands of those taxpayers who need a tax break.

**Response:** Cutting the tax rate would cut the taxes of every taxpayer earning taxable income; in other words, the benefits of tax reduction would be enjoyed by all those who make tax contributions, including every family that has income. As for the contention that the tax should be cut immediately, it must be pointed out that there are already in place tax cuts scheduled to take effect in tax years 1998 and 1999, but none for 2000 and beyond. (Tax cuts already in place for tax years 1998 and 1999 include a personal exemption increase; personal exemption inflation indexing; college tuition tax credit; an additional child exemption; an increase in the senior interest and dividend exemption; further phase-out of the intangibles tax; and single business tax cuts.) Making the tax cuts in the bills effective immediately would endanger existing programs, because cuts would have to be made immediately. The bills offer a responsible approach to continuing tax relief, by phasing-in the tax cut over five years, thus giving the State ample time to plan.

Legislative Analyst: G. Towne

**FISCAL IMPACT**

The income tax rate reductions proposed in these bills would lower income tax revenue by an estimated $124 million in FY 1999-2000 and $307 million in FY 2000-01, compared with the revenue that otherwise will be generated at the current rate of 4.4%. By FY 2004, when the income tax rate would decline to 3.9% effective January 1, 2004, income tax revenue would be reduced by an estimated $968 million. The cumulative reduction in income tax revenue from FY 1999-2000 to FY 2003-04 would total an estimated $2.63 billion. This entire loss in income tax revenue would affect the General Fund/General Purpose budget. Under current law, the School Aid Fund receives 23% of gross income tax collections and the remaining income tax revenue, after refunds, goes to the General Fund/General Purpose budget. Senate Bill 1079 is designed to hold the School Aid Fund harmless by earmarking an amount equal to what is earmarked under current law. This would be accomplished by changing the earmarking to the School Aid Fund to the gross income tax revenue generated by 1.012 percentage points of the tax rate, which is equal to 23% of the current 4.4% tax rate. The estimated loss in revenue for FY 1999-2000 to FY 2003-04 is summarized in the following table.

**Estimated Fiscal Impact of Senate Bills 1079, 1080, 1081, 1082, 1083**
(dollars in millions)

| | FY 2000 | FY 2001 | FY 2002 | FY 2003 | FY 2004 |
|---|---|---|---|---|---|
| Current Law Tax Rate | 4.4% | 4.4% | 4.4% | 4.4% | 4.4% |
| Proposed Income Tax Rate Reduction: * | | | | | |
| Incremental Reduction | -0.1% | -0.1% | -0.1% | -0.1% | -0.1% |
| Cumulative Reduction | -0.1% | -0.2% | -0.3% | -0.4% | -0.5% |
| Proposed Income Tax Rate | 4.3% | 4.2% | 4.1% | 4.0% | 3.9% |
| Estimated Reduction in Revenue: | ($123.9) | ($307.2) | ($507.9) | ($727.6) | ($967.8) |
| % Reduction in Income Tax Revenue | -1.9% | -4.5% | -7.0% | -9.6% | -12.2% |
| Cumulative Tax Reduction | ($123.9) | ($431.1) | ($939.0) | ($1,666.6) | ($2,634.4) |
| Estimated Impact by Fund: | | | | | |
| General Fund/General Purpose | ($123.9) | ($307.2) | ($507.9) | ($727.6) | ($967.8) |
| School Aid Fund | 0.0 | 0.0 | 0.0 | 0.0 | 0.0 |

* Income tax rate reductions would be effective January 1 each year from 2000 to 2004.

Fiscal Analyst: J. Wortley

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This analysis was prepared by nonpartisan Senate staff for use by the Senate in its deliberations and does not constitute an official statement of legislative intent.