Senate Fiscal Agency
P. O. Box 30036
Lansing, Michigan 48909-7536

SFA BILL ANALYSIS

Telephone: (517) 373-5383
Fax: (517) 373-1986
TDD: (517) 373-0543

House Bill 5315 (Substitute S-1 as reported)
Sponsor: Representative Kirk A. Profit
House Committee: Tax Policy
Senate Committee: Finance

Date Completed: 6-15-98

RATIONALE

In the annual budget process, to ensure that the State will have sufficient revenues to fund its expenditures, policy-makers must estimate the amount of revenue that will be generated by the State's tax base pursuant to existing tax laws. At times, changes in tax laws may cause deviations in the tax base. When a change is made, policy-makers want to know how much the revenue base will be increased or decreased. The effects of a tax law change on revenue can be estimated using a "static" or "dynamic" method. The static method estimates the direct impact that a tax law change will have on revenue, while the dynamic method estimates the direct impact and attempts to determine the effects the change will have on taxpayer behavior and overall economic activity.

In March 1997 the House Fiscal Agency, the Senate Fiscal Agency, and the Department of Treasury issued a joint report entitled Dynamic Revenue Estimating: Will It Work For Michigan? This report summarizes the findings of a research study on dynamic forecasting conducted by the three entities; explains the advantages and disadvantages of static versus dynamic analysis; contrasts the estimating procedures currently used in Michigan with those in states using dynamic analysis; and discusses other related issues, including the availability of models for use in dynamic analysis. According to the report, tax analysts in Michigan "currently prepare static revenue estimates and adjust the static estimates for the effects of policy-induced changes in taxpayer behavior. The adjustments are based on standard price and income elasticity estimates. For proposed changes to the Single Business Tax or the Individual Income Tax, micro-simulation models that use a sample of actual taxpayer returns are used to produce a static estimate. When appropriate, static estimates derived from the models are also adjusted for policy-induced changes in taxpayer behavior." It has been suggested that, after some time for preparation, the Department of Treasury be required to provide a dynamic revenue estimate for legislation that would alter the State's major taxes.

CONTENT

The bill would amend the revenue Act to require the Department of Treasury provide an analysis of the dynamic revenue impact for all proposed changes in tax policy that would have a static impact of at least $20 million annually, and that were to be taken up in a legislative committee. The analysis would have to be provided to the appropriate House and Senate committees and the House and Senate Fiscal Agencies in a timely manner. A dynamic analysis would have to include estimates of changes in employment attributable to the proposed changes in tax policy. ("Dynamic revenue impact" would mean the direct impact of a tax law change on revenues and the indirect effects on revenue of a tax law change due to the effects of the proposed change on taxpayer behavior and overall economic activity.)

The Department also would have to operate microsimulation models that would produce estimates of the revenue impact and the incidence of the revenue impact for proposed changes in the personal income tax, the sales tax, the use tax, the ad valorem property tax, and the single business tax. ("Incidence of the revenue impact" would mean the impact of a tax law change on various income groups and upon various business sectors.)

In addition, the Department would have to make available to the House and Senate Fiscal Agencies data sets sufficient for use in microsimulation models that measured the static impact of changes in State tax policy on revenues. Suitable data sets would have to be made available for analysis of the personal income tax, the sales tax, the use tax, the ad valorem property tax, and the single business tax. (A static impact would assume no changes in taxpayer behavior or other economic activity.)

The Department would have to comply with these requirements beginning January 1, 2003.

MCL 205.18

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

Some people believe that the current static revenue estimating method, while a useful tool, fails to produce an accurate long-term view of the impact of tax law changes. Tax law can have a powerful effect on taxpayer behavior and overall economic activity, and these factors should be measured as much as possible when the implications of those changes are estimated. The bill would require the expanded use of dynamic models that can improve estimates of the revenue impact of proposed major changes in the State's major taxes, including the personal income tax, single business tax, property tax, and sales and use taxes. The Department of Treasury also would have to make information available to legislative fiscal agencies so that they could use the models in doing revenue forecasting. This would provide policy-makers with more valuable information than currently exists regarding the effect of changes in the State tax system.

Opposing Argument

Some people believe that attempting to produce accurate revenue estimates based on taxpayer behavior may, at this time, yield inaccurate data. The report from the Senate and House Fiscal Agencies and the Department of Treasury states that while it is technically feasible to produce dynamic estimates with an appropriate model, "...there is still very limited experience with developing and operating a dynamic revenue estimating model". The report points out that only three or four states have any experience in building and operating these types of models. The report further states that dynamic analysis is not yet "at a place where reliable long-run estimates of the impact of dynamic feedback effects on revenue are feasible". The report concludes that, "...it must be understood that because dynamic revenue estimating models are not simple, easy-to-use models, they cannot provide accurate instant analyses. Because of the complexity and time required to perform dynamic analyses, the models may only be appropriate for major tax policy changes with significant static revenue impacts."

Response: Under the bill, the Department would not have to comply with the requirement to provide dynamic revenue impact analyses until 2003. Further, only those tax changes that had a static impact of at least $20 million would require further analysis. The bill would give the Department plenty of time to develop a reliable model, and available models may be much improved by that time.

Legislative Analyst: G. Towne

FISCAL IMPACT

The requirement for the Treasury Department to conduct dynamic revenue estimates and have in operation microsimulation models for each of the major State taxes, as well as provide the Senate and House Fiscal Agencies detailed taxpayer return data files, would cost an estimated $1 million. In addition, it would cost $100,000 to $200,000 to maintain and operate these models annually. In fact, the art of creating a true dynamic model is still being developed, and therefore, it may be prudent first to develop the microsimulation models for each of the major taxes and then develop a dynamic revenue estimating model at a later date when more experience and information will be available. In addition, there may be some taxpayer confidentiality issues that would have to be resolved, possibly by means of additional legislation, regarding the requirement that the Treasury Department provide taxpayer data to the Senate and House Fiscal Agencies.

Fiscal Analyst: J. Wortley