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INCOME TAX CUT PROPOSALS

Senate Bill 1036 as passed by the Senate
Sponsor: Sen. Bev Hammerstrom

Senate Bill 1038 with House committee amendment
Sponsor: Sen. Mike Goschka

Senate Committee: Finance
House Committee: Tax Policy

First Analysis (3-8-00)

THE APPARENT PROBLEM:

In his 2000 State of the State speech, Governor Engler proposed a number of income tax cuts that the state can afford "with our economy strong and our revenues up." The tax cuts are incorporated into the governor's budget recommendations for fiscal year 2000-2001. Legislation was subsequently introduced to implement these tax proposals in each house of the legislature, and both the House and Senate have passed five similar bills reducing individual income tax liability.

THE CONTENT OF THE BILLS:

Senate Bills 1036 and 1038 are part of a package of bills that would reduce individual income tax liability. They have the same content as House Bills 5390 and 5392 as recently passed by the House of Representatives. The analysis describes the overall package of bills of which the two Senate bills are a part. All of the bills would amend the Income Tax Act (206.30 et al.).

Senate Bill 1036 would provide a $600 per child deduction for children under 19 years old (rather than the current $600 per child for children under 7 years old and $300 per child for children 7 through 12). Senate Bill 1038 would provide a definition of "dependent" to accompany the bill in the package (House Bill 5391) that would increase the additional exemption from taxable income available to seniors and certain persons with disabilities from $900 to $1,800 and also make the exemption available for dependents of taxpayers (rather than only to filers and their spouses).

The other bills in the income tax reduction package would:

– – Reduce the tax rate for the year 2000 to 4.2 percent (from 4.3 percent); and

– – Allow a person who is deaf or totally and permanently disabled the same level of homestead property tax credit now available to senior citizens, quadriplegics, hemiplegics, and paraplegics.

Following is further explanation of the bills.

Rate Cut. Currently, the Income Tax Act provides for an income tax rate of 4.3 percent in 2000; 4.2 percent in 2001; 4.1 percent in 2002; 4 percent in 2003; and 3.9 percent in 2004 and thereafter. The rates were put in place by Public Acts 2-6 of 1999. House Bill 5389 would reduce the rate of income tax in the year 2000 from 4.3 percent to 4.2 percent. The rates for the other years would remain the same.

Child Care Deduction. Currently, the act provides a $600 per child deduction for children under 7 years old and a $300 per child exemption for children 7 through 12 years of age. Senate Bill 1036 would amend the Income Tax Act to provide a deduction from taxable income of $600 per child for children who are under 19 years old on the last day of the tax year. This would be effective for tax years beginning after 1999.

Additional Exemption. The Income Tax Act provides a taxpayer a personal exemption (currently $2,800) on the state tax form for each personal and dependency deduction allowed on the federal income tax form and also allows a taxpayer an additional exemption of $900 for each of the following three categories that applies: 65 years of age or older; paraplegic, quadriplegic, hemiplegic, blind, or totally and permanently disabled; and deaf. However, a taxpayer cannot claim both the 65 and older exemption and the totally and permanently disabled exemption. (A "taxpayer" is both the person filing and his or her spouse, if filing a joint return. That is, a person and his or her spouse can each claim each applicable exemption.)

House Bill 5391 would 1) increase the additional exemption to $1,800 from $900; and 2) permit the taxpayer to claim the additional exemption if a dependent of the taxpayer was included in one of the eligible categories. However, if a dependent of the taxpayer filed an annual return, the taxpayer and the dependent could not both claim the additional exemption for the dependent. Senate Bill 1038 would specify that the term "dependent" would mean an individual for whom the taxpayer could claim a dependency exemption on the taxpayer's federal income tax return. The bills would apply to tax years beginning after 1999.

Also under House Bill 5391, the additional exemption for being deaf would be included within the larger category of blind, paraplegic, quadriplegic, and hemiplegic, and totally and permanently disabled rather than being a separate additional exemption. A person whose return includes unemployment compensation amounting to 50 percent or more of adjusted gross income can currently claim an additional exemption of $900. That would also be increased to $1,800.

Homestead Property Tax Credit. House Bill 5393 would amend the Income Tax Act to allow a person who is a totally and permanently disabled person or a deaf person the same level of homestead property tax credit currently available to a senior citizen, or a paraplegic, hemiplegic, or quadriplegic person. The bill would apply for tax years beginning January 1, 2000.

Those persons are entitled to a refundable credit against the income tax for 100 percent of the amount by which property taxes exceed a certain percentage of household income based on the household income of the claimant. The act specifies the percentage of household income that is not refundable, as follows: for an income not over $3,000, zero percent; for household income from $3,001 to $4,000, one percent; for household income from $4,001 to $5,000, two percent; for household income from $5,001 to $6,000, three percent; and for household income of $6,001 and over, three and one-half percent. In calculating the credit, a renter can substitute 20 percent of the rent paid during the year for property taxes. (This means, for example, that a person in one of these categories with $3,000 or less in household income receives a credit equal to 100 percent of property taxes paid.)

Currently, a person who is totally and permanently disabled uses the same income scale in determining the credit, but the credit is equal to 60 percent of the amount by which property taxes exceed the specified level of income rather than 100 percent.

All other taxpayers are eligible for a homestead property tax credit equal to 60 percent of the amount by which property taxes exceed 3.5 percent of income. The credit for all taxpayers is reduced for people with household income over $73,650 and is not available to those with household income of $82,650 or more. The credit is capped at $1,200.

HOUSE COMMITTEE ACTION:

The House Tax Policy Committee adopted an amendment to Senate Bill 1038 to alter a tie-bar provision. Otherwise, the two Senate bills are in the form in which they passed the Senate.

FISCAL IMPLICATIONS:

The following fiscal information has been provided by the House Fiscal Agency and the Department of Treasury.

House Bill 5389 (reducing the tax rate) would reduce income tax revenues by $134.7 million in fiscal year 1999-2000, according to both the Department of Treasury and the House Fiscal Agency, and by $46.9 million (Treasury) or $48.4 million (House Fiscal Agency) in fiscal year 2000-2001.

Senate Bill 1036 (child care exemption) would reduce income tax revenues by $20.3 million in 1999-2000 and $26.5 million in 2000-2001, according to the Department of Treasury's estimates. The House Fiscal Agency estimates the reductions at $19.9 million and $26.5 million, respectively.

The House Fiscal Agency estimates that House Bill 5391 and Senate Bill 1038 (increase and expansion of the additional exemption) would reduce revenues by

$24.9 million. The Department of Treasury estimates reductions at $20.6 million in 1999-2000 and $27.5 million in 2000-2001. The department told the House Tax Policy Committee that the amendment doubling the additional exemption for unemployed persons would cost about $150,000 annually at current unemployment levels (and obviously would go up if unemployment rates went up).

The House Fiscal Agency estimates the revenue reductions from House Bill 5393 (homestead credit) at $6 million. The Department of Treasury's estimate is $4.8 million in 2000-2001.

The House Fiscal Agency estimates are found in separate fiscal notes dated 2-17-00. The Department of Treasury estimates can be found in the Review and Analysis of the Governor's FY 2000-01 Budget Proposal issued by the House Fiscal Agency in February 2000.

ARGUMENTS:

For:

Governor Engler's budget proposal for fiscal year 2000-2001 recommends a number of tax cuts in response to the healthy tax revenues being produced by today's robust economy. The administration estimates the proposals will reduce income taxes by over $280 million in the 1999-2000 and 2000-2001 fiscal years. These are prudent, affordable tax cuts that allow the state to continue to fund essential public services while returning money to taxpayers. In times of prosperity, with state revenues growing rapidly, it makes sense to return surplus revenue to the taxpayers who earned it and let them decide how to use it. The rate cut benefits all taxpayers and simply skips a step in the steady five-year reduction of the rate; the increase in the child care exemption benefits families with children; and the other cuts target seniors and people with disabilities. These are administratively simple tax cuts that build on current provisions in the Income Tax Act. Proponents say they will have a beneficial effect on economic growth.

Against:

Some supporters of public education on principle oppose tax cuts that reduce school aid revenue, unless replacement funds are provided. The expansion of the child care deduction and the increase and expansion of the additional deduction for special categories of taxpayers will directly affect school aid revenues by decreasing the income tax base. (The school aid fund is held harmless from reductions in the tax rate, but increases in personal exemptions, deductions, and credits reduce school aid revenues.)

Against:

Among the concerns expressed about the income tax rate cut are the following:

** Wouldn't an increase in the personal exemption be more beneficial to moderate and lower income taxpayers than an accelerated rate cut?

** Wouldn't a better alternative be to grant low-income workers with children a state credit that piggybacks on the federal earned income tax credit? This credit promotes the movement from welfare to work.

** Should the state continue to cut taxes when its bonded indebtedness has increased significantly over the last decade and when there are so many programs that could use the funds? Reducing the state debt load or spending on urgent public needs, such as education or health care, would each be preferable to a one-year speed up of the income tax rate reduction costing over $180 million. State debt per capita has more than doubled from 1990 to 2000. And there are, to cite just one example, a great many infrastructure needs in local school districts. It seems logical to tackle such problems in boom times, when the resources are available.

** Some persons, who otherwise support the package of bills, would like to see the $1,200 cap on the homestead property tax credit lifted. Lifting the cap would help seniors and others who are at the credit limit. Proponents say that if the longstanding cap had been regularly adjusted for inflation, it would now be $3,500. Even a small increase would help seniors struggling to remain in their homes or trying to move to new, more practical, housing.

Response:

Treasury officials say that the state's debt levels are below national per capita debt medians, ranking 17th lowest nationally. And the administration's new budget recommendations would already increase spending by 3.7 percent (with a 5.1 percent increase for school aid) over the previous year.

POSITIONS:

The state treasurer testified in support of the bills on behalf of the Engler Administration. (2-22-00)

The Michigan Education Association opposes the bills increasing or expanding exemptions (Senate Bill 1036 and House Bill 5391). (2-22-00)

Analyst: C. Couch

■This analysis was prepared by nonpartisan House staff for use by House members in their deliberations, and does not constitute an official statement of legislative intent.