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SFA BILL ANALYSIS

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Senate Bills 1036, 1038, and 1040 (as enrolled) **PUBLIC ACTS 42-44 of 2000**
House Bill 5389 (as enrolled) **PUBLIC ACT 40 of 2000**
House Bill 5393 (as enrolled) **PUBLIC ACT 41 of 2000**
Sponsor: Senator Bev Hammerstrom (S.B. 1036)
Senator Mike Goschka (S.B. 1038)
Senator Philip E. Hoffman (S.B. 1040)
Representative Jim Howell (H.B. 5389)
Representative Judson Gilbert II (H.B. 5393)
Senate Committee: Finance
House Committee: Tax Policy

Date Completed: 8-14-00

RATIONALE

In recent years, the State's tax structure has undergone fundamental changes, with many taxes being reduced and some increased. From fiscal year (FY) 1991-92 through FY 1998-99, the net result of these changes was a tax reduction of approximately $11.7 billion. In response to continuing growth in State revenue, in 1999 the Governor recommended and the Legislature adopted legislation to reduce the income tax from 4.4% to 3.9% over a five-year period. Further, in addition to eliminating the single business tax (SBT) over a 23-year period, amendments to the SBT Act allow firms to claim an investment tax credit (ITC). In his 2000 State of the State speech, the Governor stated that, "With our economy strong and our revenues up...", the State could afford to accelerate the scheduled income tax rate cuts. The Governor also recommended other proposals to reduce income taxes, and to increase the ITC for certain taxpayers. In order to provide additional tax relief, it was suggested that the Governor's recommendations be enacted.

CONTENT

Senate Bills 1036 and 1038, and House Bills 5389 and 5393 amended the Income Tax Act to reduce the State income tax rate, expand the exemption for child dependents, expand the homestead property tax credit for disabled persons, and extend the credit to deaf individuals. Senate Bill 1040 amended the Single Business Tax Act to increase the investment tax credit for certain taxpayers. Senate Bill 1038 is tie-barred to House Bill 5391 (which has not been enacted).

Senate Bill 1036

The bill increased and expanded the extra exemption that a taxpayer may claim for child dependents.

Previously, a taxpayer could deduct from taxable income $600 for each dependent younger than seven years old, and $300 for each dependent at least seven but younger than 13 years old. (This exemption is in addition to the standard dependency exemption allowed under the Act.) The bill provides that for tax years beginning after 1999, a taxpayer may deduct from taxable income $600 for each dependent who is younger than 19 on the last day of the tax year.

Further, the bill contains a statement of legislative intent that, "...this amendatory act shall not reduce the amount that would have been available for deposit to the school aid fund under section 51 of the income tax act..." if the bill had not been enacted. (Section 51 of the Act requires that a percentage of revenue collections be deposited in the School Aid Fund.)

Senate Bill 1038

The bill provides that, as used in Section 30(3) of the Income Tax Act (which House Bill 5391 proposes to amend), "dependent" means an individual for whom the taxpayer may claim a dependency exemption on the taxpayer's Federal income tax return pursuant to the Internal Revenue Code. (House Bill 5391 (H-3) would amend Section 30(3) to increase the special exemption for seniors and disabled persons from $900 to $1,800; allow taxpayers to claim the exemption for dependents who are senior citizens or disabled; and increase from $1,000 to $1,500 the amount a dependent may deduct from taxable income. Since House Bill 5391 has not been enacted as of the date of this analysis, Senate Bill

1038 has not taken effect at this time.)

House Bill 5389

The bill amended the Income Tax Act to reduce the income tax rate by .1% in calendar year 2000, by providing that the rate is 4.2% on and after January 1, 2000, and before January 1, 2002. The bill repealed a provision that set the income tax rate at 4.3% in 2000.

The income tax rate will continue to be reduced to 4.1% in 2002; 4.0% in 2003; and 3.9% in 2004 and thereafter.

House Bill 5393

The bill amended the Income Tax Act to allow a taxpayer who is totally and permanently disabled or deaf to claim the homestead property tax credit that may be claimed by a senior citizen, paraplegic, hemiplegic, or quadriplegic taxpayer.

Under the Act, a taxpayer may claim a homestead property tax credit against the State income tax equal to 60% of the amount by which the taxpayer's homestead property tax, or the credit for rental of the homestead, exceeds 3.5% of the taxpayer's household income. A taxpayer who is a senior citizen, paraplegic, hemiplegic, or quadriplegic with household income over $6,000 is entitled to a credit equal to 100% of the amount by which the taxpayer's homestead property tax or rental credit exceeds 3.5% of household income. A taxpayer who is a senior citizen, paraplegic, hemiplegic, or quadriplegic, with household income of $6,000 or less, is entitled to a credit equal to the amount by which the homestead property tax or rental credit exceeds between .0% and 3.0% of household income; the credit increases as household income decreases.

Previously, the credit for a totally and permanently disabled taxpayer with household income of $6,000 or less was 60% of the amount allowed for a senior citizen, paraplegic, etc. with household income of $6,000 or less. The credit for a totally and permanently disabled taxpayer with over $6,000 in household income was the same as that allowed for nondisabled taxpayers (60% of the amount by which the homestead property tax or rental credit exceeds 3.5% of household income). Under the bill, for tax years after 1999, a totally and permanently disabled or deaf taxpayer is entitled to the same credit as a senior, paraplegic, hemiplegic, or quadriplegic taxpayer may claim.

Senate Bill 1040

The bill amended the Single Business Tax Act to increase the investment tax credit for taxpayers with adjusted gross receipts of $5 million or less. Under the Act, the SBT rate is 2.1% for the 2000 tax year, and is scheduled to be reduced by .1% each January 1 (if there is a balance of at least $250 million in the Budget Stabilization Fund). A taxpayer may claim an ITC for a percentage of the costs paid or accrued in a taxable year for tangible assets physically located in Michigan. Essentially, the credit equals a percentage of the amount a firm invests in tangible assets in Michigan, for a tax year beginning after December 31, 1999; for subsequent tax years the percentage will be reduced each year the tax rate is reduced. The ITC is calculated as follows:

$$\frac{(\text{Current Year Tax Rate x .85\%})}{2.3\%} \text{ x } ([A+B+C] - [D+E+F])$$

> Under the formula, A, B, and C represent the costs paid or accrued in a taxable year for tangible assets and mobile tangible assets as provided in the Act; D, E, and F represent the gross proceeds of the sale or other disposition of assets A, B, and C, and the transfer out of State of those assets that are not mobile tangible assets.

The bill provides that for taxpayers with adjusted gross receipts for the tax year of $1 million or less, the multiplier of .85% in the formula will be replaced with 2.3% (thus increasing the value of the credit). For taxpayers with adjusted gross receipts over $1 million but not more than $2.5 million, the multiplier will be 1.5%; and for over $2.5 million but not more than $5 million, 1.0%. Taxpayers with adjusted gross receipts over $5 million must use the original formula.

For purposes of the ITC calculation, the bill defines "adjusted gross receipts" as gross receipts apportioned or allocated to Michigan with the apportionment fraction calculated under the Act; plus the gross proceeds or benefits derived from the sale or disposition of assets that had previously been claimed as a deduction as provided in the Act; plus the gross proceeds of the sale or other disposition of tangible assets and mobile tangible assets obtained after 1999, and assets purchased or acquired after 1996 that were transferred out of the State.

In addition, the bill provides that a member of an affiliated group, a controlled group of corporations, or an entity under common control must determine adjusted gross receipts, for purposes of the ITC, on a consolidated basis.

MCL 206.30d (S.B. 1036)
206.30e (S.B. 1038)
208.35a (S.B. 1040)

206.51c (H.B. 5389)
206.522 (H.B. 5393)

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
Citing the continuing robust economy and the strong performance of State revenues, the Governor, in his 2000 State of the State speech, recommended acceleration of the scheduled income tax rate reduction, further income tax cuts, and an increase in the ITC for smaller businesses. In the past few years, Michigan has made fundamental changes 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 rate, Michigan now has gone since 1994 with an unemployment rate below the national average. Reducing taxes and restricting spending can be credited with drastically improving the State's economy, enhancing its credit rating, and letting its taxpayers retain more of their money. The bills will, over time, substantially reduce taxes, and thus will further stimulate the State's economy for years to come.

Supporting Argument
The bills offer prudent, affordable tax cuts that will allow the State to continue to fund government services. In times of prosperity, with State revenues growing, it makes sense to reduce the burden that taxpayers carry. The income tax rate cut benefits all taxpayers and, under House Bill 5389, simply skips a step in the scheduled five-year rate reduction. The other changes in Senate Bills 1036 and 1038, and House Bill 5393, target and benefit families with children, and disabled and/or deaf individuals.

Supporting Argument
Prior to 1999, the SBT Act allowed a business to claim a capital acquisition deduction (CAD) which, essentially, was designed to provide tax relief to business by allowing a firm to deduct capital investments made in Michigan. The CAD was the subject of several court challenges through the years by out-of-State firms that claimed that the SBT unfairly burdened them compared with in-State firms, and thus violated the Commerce Clause of the U.S. Constitution. Public Act 115 of 1999 eliminated the CAD and replaced it with the ITC, which has been used successfully in several other states. The ITC allows a taxpayer to claim as a credit a percentage of the costs paid or accrued in a tax year for tangible assets physically located in Michigan, according to a formula in the Act. While the change from the CAD to the ITC was designed to be revenue neutral, some small businesses contended that the switch to the ITC resulted in increased tax liability for them, particularly those that conduct the bulk of their business in the State. Senate Bill 1040 expands the ITC to provide relief to these small businesses so that they are not harmed by the change from the CAD to the ITC.

Opposing Argument
The tax cuts made by the bills will result in significantly reduced State revenue, on top of the substantial cuts that already have been made and those scheduled to take effect in subsequent years. If the State finds itself with substantial revenue shortages, presumably it will have to make large cuts to maintain a balanced budget. The State must have enough resources to handle certain basic needs, such as protecting the public's health and safety, educating its young, incarcerating criminals, and providing a workable, efficient infrastructure. If significant cuts must be made because of revenue reductions caused by the bills, the provision of these necessities will be placed at risk.

Response: It cannot be speculated as to what the State would cut in the event of a revenue shortage in future years, 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, Michigan's economy has continued to grow and has produced more tax revenue.

Opposing Argument
Accelerating the reduction of the income tax by .1% will have little benefit for most individual taxpayers, but will have a significant impact on State revenue. In these good economic times the State should be directing its resources toward paying down its long-term debt, ensuring access to quality health care, investing in much needed infrastructure, and investing in education, particularly in districts that have old or run-down school buildings. These investments would have a much greater public benefit than will be provided by reducing an individual's annual income tax by a few dollars.

Legislative Analyst: G. Towne

FISCAL IMPACT

Senate Bill 1036

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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.

The bill will reduce income tax revenue an estimated $20.3 million in FY 1999-2000 and $26.5 million in FY 2000-01. This loss in revenue will affect General Fund/General Purpose revenue.

Senate Bill 1038

The bill will have no direct fiscal impact.

Senate Bill 1040

The bill will reduce single business tax revenue by an estimated $12.4 million in FY 1999-2000 and $16.7 million in FY 2000-01, according to the Department of Treasury. This loss in revenue will affect General Fund/General Purpose revenue.

House Bill 5389

The bill will reduce income tax revenue an estimated $134.7 million in FY 1999-2000 and $46.9 million in FY 2000-01. All of this tax reduction will affect General Fund/General Purpose revenue.

House Bill 5393

The bill will reduce income tax revenue an estimated $4.8 million in FY 2000-01, according to the Department of Treasury. This loss in revenue will affect General Fund/General Purpose revenue.

Fiscal Analyst: J. Wortley