



**House
Legislative
Analysis
Section**

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HOME HEATING PACKAGE

House Bill 4411 (Substitute H-1)
Sponsor: Rep. David Woodward

House Bill 4476 (Substitute H-1)
House Bill 4478 (Substitute H-2)
Sponsor: Mike Kowall

House Bill 4477 (Substitute H-1)
Sponsor: Rep. Paul Wojno

House Bill 4479 as introduced
Sponsor: Rep. Patricia Birkholz

House Bill 4480 (Substitute H-2)
Sponsor: Rep. Ken Bradstreet

**House Bill 4481 with committee
amendments**
Sponsor: Rep. Nancy Cassis

House Bill 4482 (Substitute H-1)
Sponsor: Rep. Gary Woronchak

House Bill 4483 (Substitute H-1)
Sponsor: Rep. Gerald Van Woerkom

Committee: Tax Policy
First Analysis (3-27-01)

House Bills 4411 and 4476-4483 (3-27-01)

THE APPARENT PROBLEM:

Most residential consumers of natural gas in Michigan have yet to feel the impact of the recent dramatic increases in the price of that commodity. This is because the rates for the customers of the two largest distributors, Consumers Energy and Michigan Consolidated Gas (MichCon), have been frozen by the Michigan Public Service Commission as part of a plan that is gradually changing the natural gas market from a regulated monopoly to a consumer choice system. The rates of the largest companies, which have about 87 percent of the Michigan residential market, are currently set below \$3 per thousand cubic feet but are expected in the not-too-distant future to rise to over \$5 per thousand cubic feet. (These rates are for the price of the natural gas; there are additional charges for transmission and distribution, as well as additional monthly customer charges.)

According to a paper by the House Fiscal Agency, Michigan natural gas suppliers whose rates were not frozen increased rates to residential customers by more than 70 percent in 2000. The current PSC regulatory scheme anticipates new rates for Consumers Energy on April 1 of this year and for MichCon by January 1, 2002. A Consumers Energy spokesperson has said that a typical residential customer can expect to pay \$20 to \$30 per month more when the rate freeze is lifted. A MichCon executive has said that its typical residential customer will be paying roughly \$40 to \$60 more next January than in the previous four Januaries.

Obviously, these energy price increases will hit hard those households already having difficulty paying their home heating bills, particularly low-income

families and senior citizens. Since 1978, Michigan has provided home heating assistance to low-income households through an income tax credit that targets households with incomes below 110 percent of the federal poverty level. (See [Background Information](#).) A special separate tax form is required, which can be filed along with the state income tax form or can be filed separately. The majority of claimants file only for the home heating credit and do not file a state income tax return. The deadline for filing for the 2000 credit is September 30, 2001. This program is primarily funded by a grant from the federal government, although some state funds are used each year. The federal program is known as LIHEAP, for low-income home energy assistance program. The credit amount is based on household income and the number of exemptions. (Calculation of the standard credit does not make use of actual heating costs, although a little-used alternative method of calculating the credit does.) Renters whose heat is included within rent can claim an amount equal to one-half of the normal credit. In 1999, over 300,000 claimants received more than \$50 million in home heating credits, with the average credit pegged at \$163.85, according to the Department of Treasury.

In response to the anticipated dramatic increases in residential utility bills, legislators have introduced a package of bills aimed at increasing the home heating assistance available. The proposals include an expansion of the current home heating credit; new weatherization credits; reduced taxes on natural gas above certain price levels; and increased shut-off protections.

THE CONTENT OF THE BILLS:

House Bills 4480, 4411, and 4481 would amend the Income Tax Act (MCL 206.527a) to extend the home heating tax credit indefinitely and to expand the size of the credit and the number of people eligible for the credit for tax years beginning after December 31, 2000. House Bill 4479 would amend the same act to allow a new weatherization and energy efficiency credit for taxpayers eligible for the home heating tax credit.

House Bills 4476 and 4477 would remove the sales and use tax from sales of natural gas, propane, and fuel oil at prices above certain levels, and House Bill 4478 would impose instead a lower replacement tax on those sales, the proceeds of which would go to a Home Heating Credit Fund to cover the cost of home heating credits not covered by federal funds. House Bill 4483 would create the new fund. House Bill 4482 would put a new checkoff on the state income

tax form to allow taxpayers to contribute to the new fund.

A more detailed description of the bills follows.

House Bill 4480 would expand the eligibility standards to make the home heating tax credit available to a claimant with a household income of less than 125 percent of federal poverty income standards (rather than 110 percent, as now); would increase the credit for claimants 65 years of age or older by allowing them an additional exemption for credit calculation purposes; and would increase the value of the credit for the 2001 tax year by using 3.8 percent of household income in the credit calculation (rather than 3.5 percent of income) and then would adjust the credit in later years by basing that percentage on the price of natural gas. The bill would also eliminate the alternative method of computing a credit. Further, the bill would not allow any portion of the credit to be used to pay any delinquent tax liability or any arrearage or other debt of the claimant. (Currently, claims are "intercepted" by the Department of Treasury for such purposes.)

The percentage of income to be used in calculating the credit would be 3.5 percent if the weighted total price for natural gas for the tax year was less than \$3.26 [per thousand cubic feet or Mcf]; 3.55 percent if the weighted total price was \$3.26 or more but less than \$3.51; 3.6 percent if the price was \$3.51 or more but less than \$4.26; 3.56 percent if the price was \$4.26 or more but less than \$4.51; 3.7 percent if the price was \$4.51 or more but less than \$5.26; and 3.8 percent if the price was \$5.26 or more.

The weighted total price for natural gas for the tax year would be determined by the Department of Treasury by taking the average price for natural gas on February 1 and November 1 of the calendar year in which the tax year begins.

House Bill 4411 would make the credit available to claimants with household incomes up to 130 percent of federal income poverty standards for tax years beginning after December 31, 2001.

House Bill 4481, in addition to extending the credit indefinitely, would render ineffective for tax years after 2000 the provision that reduces the amount of the credit (that is, prorates the credit) if federal home energy assistance funding is reduced below anticipated levels, and instead would allow a credit [without reduction] for tax years beginning after December 31, 2000, if federal low income home energy assistance block grant funds had been appropriated in any amount.

[Note: House Bills 4411, 4480, and 4481 all amend the same section of the Income Tax Act in conflicting ways and will need to be made to conform if all of the provisions described above are to be enacted.]

House Bill 4479 would amend the Income Tax Act (MCL 206.269) to allow a low-income taxpayer to claim a refundable credit for 1) 10 percent of the cost of purchasing and installing an appliance with an “energy star label” under the voluntary labeling program operated by the federal Environmental Protection Agency and the federal Department of Energy; and 2) 100 percent of the cost of weatherization of the taxpayer’s home. To be eligible for the credit, the taxpayer would have to be eligible for a home heating credit. The credit would be refundable; that is, if the amount of the credit allowed exceeded the tax liability of the taxpayer, then the portion exceeding tax liability would be refunded. The term “weatherization” would refer to the modification of a home or a home’s heating systems to improve heating efficiency, including caulking and weather-stripping, insulation of ceilings, attics, walls, floors, or water heaters, and the installation of furnace ignition systems, clock thermostats, storm windows, or storm doors.

House Bills 4476 and 4477 would amend the General Sales Tax Act (MCL 205.54aa) and the Use Tax Act (MCL 205.94w) respectively, so that the taxes would not be levied on the portion of the price of natural gas greater than \$3 per thousand cubic feet or on the portion of the purchase price of propane or fuel oil greater than \$1.40 per gallon. The term “purchase price” would refer to the price of the natural gas, propane gas, or fuel oil being delivered and would not include the price of the transmission and distribution of those commodities. Currently, the sales and use tax are levied at the rate of four percent on residential sales and six percent on sales to other than residential customers. The two bills would take effect October 1, 2000 and both are tie-barred to House Bill 4478.

House Bill 4478 would create the Home Heating Energy Assistance Act and enact a replacement energy tax to be levied on that portion of the purchase price of natural gas that exceeded \$3 per thousand cubic feet. The replacement tax rate would be three percent for residential sales and five percent for other than residential sales. Revenue from the tax would be deposited in the Home Heating Credit Fund (to be created by House Bill 4483). (The bill also contains provisions aimed at making exemptions and exclusions in the sales and use taxes also apply to the replacement tax.) The bill would take effect October 1, 2001 and is tie-barred to House Bills 4476 and

4478. The bill contains an “intent” statement as follows: “The purpose of this act is to lower the total tax burden on consumers of energy that is purchased to heat homes and businesses. It is also the purpose of this act to assure that any person that sells energy that is used to heat homes and businesses pass on any tax savings . . . to the ultimate user of the energy.”

House Bill 4483 would create the Home Heating Credit Fund Act. Money in the new fund would be used to pay home heating credits to the extent that credits were not fully funded under the federal low income home energy assistance program. Money from the new fund could not be used to replace those federal funds. The fund would be a separate fund in the Department of Treasury, and its money would be invested by the state treasurer in the same manner as other funds are invested, with interest and earnings credited to the fund. Money in the fund at the close of a state fiscal year would remain in the fund and not lapse to the general fund.

House Bill 4482 would amend the Income Tax Act (MCL 206.438) to create a checkoff on the first page of the annual state income tax return that would allow an individual to designate a contribution of \$5 or more to the Home Heating Credit Fund. The contribution would be made from a taxpayer’s refund or, if there were no refund, would be added to a taxpayer’s tax liability. The bill would apply to tax years beginning after December 31, 2000.

BACKGROUND INFORMATION:

**The current home heating credit is available to a claimant with a household income of less than 110 percent of federal poverty income standards. The credit can be claimed in one of two ways. The standard credit computation is based on the claimant’s income and number of exemptions, with actual heating costs not part of the calculation. A “standard allowance” is established by the Department of Treasury each year for six categories of claimants (at an amount that guarantees a credit to any claimant with a household income of less than 110 percent of federal poverty income standards for the number of exemptions). Then, a claimant subtracts from the relevant standard allowance an amount equal to 3.5 percent of household income. For a renter whose heat is included in rent, the credit is reduced by 50 percent. An alternative method of computation (said to be used by fewer than 10 percent of claimants) bases the credit on heating fuel costs. For those who meet eligibility criteria, the alternative credit is equal to 70 percent of the amount by which heating costs exceed 11 percent of

household income. (The package of bills would eliminate this alternative calculation.)

** The current credit can be understood, generally, to be equal to the difference between 3.5 percent of 110 percent of the federal poverty standard (plus one dollar) minus 3.5 percent of the claimant's household income. So, for example, for 2000, the standard allowance for a family of four or for a senior citizen couple (both households with four exemptions) would be \$658 and the income ceiling for the credit would be \$18,800. If the household income was \$15,000, the credit would equal \$133 (\$658 minus \$525). If the household income was \$10,000, the credit would equal \$308 (\$658 minus \$350).

If the eligibility limit is set at 125 percent, obviously the standard allowance increases and the credit increases. Similarly, the credit would increase if the calculation uses 3.8 percent of household income rather than 3.5 percent. Using current poverty levels, the standard allowance for a four-exemption household at 125 percent of poverty would be about \$747 (an additional \$89) using 3.5 percent of income. A household with a \$10,000 income could claim a credit of \$397. Using 3.8 percent of income, the standard allowance would be about \$811 (from which, then, 3.8 percent of the claimant's household income would be deducted.) For a household with a \$10,000 income, the credit would be \$431. Further, the federal poverty guidelines used in the credit calculation will increase for 2001. For the four-exemption household, the federal poverty level will increase from \$17,050 to \$17,650. [Note: all of the figures used in the credit examples are estimates and used for purposes of illustration only.]

FISCAL IMPLICATIONS:

The House Fiscal Agency has estimated the cost of the home heating credit as found in House Bill 4480 at \$100 million for fiscal year 2001-2002 (assuming no proration of the credit). In fiscal year 2002-2003, there would be an additional cost of \$5 million (with the increase in eligibility standards found in House Bill 4411.) The HFA notes that if the home heating credit was continued with no changes to eligibility and no changes to the method of the calculation of the credit and with no proration, the fiscal impact would be \$55 million in fiscal year 2001-2002. (This means the package as proposed would result in a \$45 million increase in the cost of the credit in the first year.) This cost would be offset by the amount of federal funding from LIHEAP, the low income home energy assistance program. The funding for fiscal year 2001-2002 has yet to be determined. The HFA notes that in fiscal year 1999-2000, the state received

\$100.3 in LIHEAP funds, including \$67 million as an initial allocation, \$24 million as a contingency, and \$9.3 million in emergency assistance. In fiscal year 2000-2001, the state received a total of \$93.2 million in LIHEAP funds, including \$75.2 million as an initial allocation and \$18 million as a contingency. The HFA points out that the only LIHEAP funds the state receives each year is the initial allocation. LIHEAP funds pay for three programs, the tax credit, state emergency relief, and weatherization services.

The HFA estimates that House Bills 4476 and 4477 would reduce sales and use tax revenues by \$64.7 million in fiscal year 2001-2002. Of that, there would be a reduction of \$41.1 million in School Aid Fund revenue, a \$21.4 million reduction in revenue sharing revenue, and a \$2.2 million loss in general fund revenue.

House Bill 4478, which creates a replacement tax, would generate an estimated \$40.8 million, according to the HFA. (This would go to a new fund for home heating credit purposes.) The income tax weatherization checkoff that would be created by House Bill 4482 is estimated to produce \$365,000 in revenue for the new fund.

House Bill 4479, which creates a weatherization income tax credit, would reduce income tax revenues by an estimated \$212.5 million. (This is an average of two estimates, says the HFA, using a low figure of \$65 million and a high figure of \$360 million.) This revenue would be a reduction almost entirely in general fund revenue.

(The information in this section was derived from a draft memo provided by the House Fiscal Agency dated 3-26-01).

ARGUMENTS:

For:

This package will extend and expand the home heating credit program in anticipation of dramatically higher residential utility bills. The credit, which would otherwise expire after the 2000 tax year, will be extended indefinitely. More households will be eligible for a credit and the credits will be larger. Bills for some natural gas and propane fuel customers in the state have already risen significantly, more than 70 percent in some cases. The vast majority of natural gas customers are enjoying lower frozen rates, but in the near future those rates will increase as well. Proponents expect the package of bills to result in an additional 56,000 households taking advantage of the credit in the first year by increasing the eligibility level to 125 percent of the federal

poverty level from 110 percent (and some estimates put the number of new credits much higher). Proponents also say that the average credit will be increased substantially. For example, a family of four with an income of \$18,000 would currently qualify for a credit of \$28, but under this package will be eligible for a credit of \$128. A senior citizen couple with an income of \$10,000 would see its credit increase from \$308 to \$432, say the package's designers. The lowest income households will see the largest increases. Moreover, the level will be raised to 130 percent of poverty for 2002 and years thereafter, as the package is currently written, making even more households eligible.

The package also will increase the value of the credit as the cost of natural gas increases, through a formula that ties the two together. This will help soften the blow from the anticipated price increases.

For:

In past years, the amount of the home heating credit available to Michigan households has been reduced if federal funding for the program fell below certain anticipated levels. This package would remove the proration feature and allow a full credit regardless of the amount of federal funding. Otherwise, the more people that apply for assistance, the less that is available per household. A special new fund would be created to cover any additional state costs, with the money to come from a mechanism that captures the sales and use taxes on natural gas when gas prices rise above a given level. The proposal also envisions a checkoff on the state income tax form so that taxpayers could make donations to the fund. The package also contains a provision that prevents state tax officials from continuing to intercept the credit and using it to pay back taxes, overdue student loans, or other debts and arrearages. This ensures that the home heating assistance money goes where it was intended - - to pay heating bills.

For:

The proposed weatherization credit will encourage conservation measures that will over time help to reduce demand for home heating fuel and help to lower heating bills. Reportedly, some senior citizen households will not seek out help in weatherizing their homes from social service programs (considering them to be "welfare" programs) but would file for a tax credit. This credit would help make many older homes more energy efficient.

Response:

The Department of Treasury generally discourages the proliferation of income tax credits because they add to the complexity of the tax law and to state tax forms. (Moreover, the weatherization credit could

prove very expensive, particularly if businesses began marketing weatherization programs based on the availability of 100 percent state financing.) Besides, the state already has a weatherization program in place for low-income households administered by the Family Independence Agency. Direct assistance is available through that program. Treasury representatives have said that in general they would prefer to see home heating assistance provided through means other than increasing the existing credit or adding new credits, and is willing to work with the legislature toward that end.

Against:

Treasury officials argue that it is not good public policy to establish a tax rate based on the price of a good or product, as the sales tax cap would do. That is, the rate of a tax should not go up and down with prices. Sales and use taxes are levied uniformly on goods without regard to increases and decreases in the prices of those goods. To do otherwise would set a bad precedent. Further, the sales tax cap diverts money from public schools. Under the state's new school financing system, local schools are restricted in their ability to raise their own tax rates but are supposed to enjoy a stable source of state funding. The sales tax cap violates that understanding and deprives public schools of funding they otherwise would have received. An increase in the price of a good or commodity is not by itself justification for diverting money from earmarked purposes. Increasing home heating assistance is a worthy goal, but it should not come at the expense of the state's schoolchildren.

Response:

Proponents of the tax cap and replacement tax say that the intention is to treat the increase in state revenue that will result from higher natural gas prices as a "windfall" to help fund increases in the home heating credit. The schools will continue to receive tax revenue from natural gas sales at current levels.

Against:

Putting charitable contribution checkoffs on the state income tax form is not a good idea. They add complexity to tax filing without raising large amounts of money. Indeed, the Department of Treasury has only recently succeeded in getting two previous checkoffs (for special funds related to children and the environment) off the tax form and it would be setting a bad precedent to begin adding new ones.

Against:

Some people say this package, while obviously an improvement, does not go far enough. Under federal guidelines, the state could extend this credit to

households with incomes up to 150 percent of poverty. Also, in previous years, some have argued in favor of some form of direct home heating assistance because many households eligible for the income tax credit do not in fact file a claim. Filing such a form may be a daunting task, particularly to households that do not typically file a tax form.

POSITIONS:

A representative of Consumers Energy testified in support of the package. (3-21-01)

The Michigan Consolidated Gas Company has indicated support for the package. (3-21-01)

SEMCO Energy has indicated support for the package. (3-21-01)

The Michigan Electric Cooperative Association has indicated support for the package. (3-21-01)

The Michigan Catholic Conference has indicated support for the package. (3-21-01)

The Michigan League for Human Services/Michigan Advocacy Project has indicated support for House Bill 4480 and the provision prohibiting the interception of home heating credits. (3-21-01)

The Environmental Council supports House Bill 4479 but would like the package to do more to encourage other residents and businesses to conserve energy. (3-21-01)

The Department of Treasury is opposed to the package. (3-21-01)

The Michigan Education Association is opposed to House Bills 4476 and 4477. (3-23-01)

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.