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Senate Bill 791 (Substitute S-3 as passed by the Senate)
Sponsor: Senator Van Woerkom
Committee: Finance

Date Completed: 4-23-08

CONTENT

The bill would amend the Income Tax Act to do the following:

- Allow a taxpayer to claim an income tax credit equal to the difference between the property tax on a parcel before and after a transfer of ownership.**
- Increase the household income ceiling for the homestead property tax credit, and increase the total credit that a taxpayer may claim.**

Pop-Up Tax Credit

Under the State Constitution, the taxable value of a parcel of property (adjusted for additions and losses) may not increase from one year to the next by more than 5% or the increase in the consumer price index, whichever is lower, until there is a transfer of ownership. At that time, the assessment is "uncapped" and the parcel is taxed upon its State equalized valuation (50% of its true cash value). (In other words, the taxable value "pops up" upon a transfer of ownership.) These provisions are reflected in Section 27a of the General Property Tax Act, which provides that, upon a transfer of ownership of property, the property's taxable value for the calendar year following the year of the transfer is the property's State equalized valuation for that year.

Under the bill, if a taxpayer purchased a parcel of property after April 1, 2008, and before January 1, 2011, that resulted in a transfer of ownership of that property and as a result the taxable value of that property were adjusted under Section 27a of the General Property Tax Act, the taxpayer could claim a credit against the income tax for each tax year that the taxpayer owned the property and claimed an exemption for it as a principal residence under Section 7cc of the General Property Tax Act following the year of the transfer. The credit would be equal to the difference between the taxes calculated on that parcel of property using the taxable value after the adjustment and the taxes calculated on that parcel using the taxable value before the adjustment. If the credit exceeded the tax liability of the taxpayer for the tax year, the excess would have to be refunded.

(Under 7cc of the General Property Tax Act, a principal residence is exempt from the tax levied by a school district for school operating purposes to the extent provided under the Revised School Code. To claim the exemption, an owner of property must file an affidavit by May 1 with the local tax collecting unit in which the property is located. The affidavit must state that the property is owned and occupied as a principal residence by that owner of the property. A person may not claim the exemption if certain factors apply.)

Homestead Credit

Subject to certain limitations, Section 520 of the Income Tax Act allows a taxpayer to claim a credit against the income tax for the property taxes on the taxpayer's homestead that are deductible for Federal income tax purposes under the Internal Revenue Code (or that would have been deductible if the claimant had not elected the zero bracket amount or if the claimant had been subject to the Federal income tax). The property taxes used for the credit computation may not be greater than the amount levied for one tax year.

A person who rents or leases a homestead may claim a similar credit computed under Sections 520 and 522 based upon 20% of the gross rent paid.

If the credit claimed under Sections 520 and 522 exceeds the tax liability for a tax year or if there is no tax liability, the amount of the claim not used as an offset against tax liability is payable to the claimant.

The credit must be reduced by 10% for each claimant whose household income exceeds \$73,650 and by an additional 10% for each increment of \$1,000 of household income in excess of \$73,650. The total credit allowed may not exceed \$1,200.

Under the bill, these amounts would apply for tax years that began before January 1, 2008. For tax years beginning on or after January 1, 2008, the credit would be reduced by 10% for each claimant whose household income exceeded \$83,650 and by an additional 10% for each increment of \$1,000 of household income in excess of \$83,650. The total credit allowed could not exceed \$1,300 for tax years beginning after December 31, 2007.

Under Section 522, a claimant is entitled to a credit against the State income tax equal to 60.0% of the amount by which the property taxes on the homestead, or the credit for rental of the homestead for the tax year, exceeds 3.5% of the claimant's household income for that tax year. Specific provisions apply to a taxpayer who is a senior citizen; a paraplegic, hemiplegic, or quadriplegic; totally and permanently disabled, deaf, or blind; or an eligible serviceperson, eligible veteran, or eligible widow or widower. The total credit allowed under Section 522 may not exceed \$1,200 per year.

Under the bill, the credit could not exceed the amount determined under Section 520.

MCL 206.520 et al.

Legislative Analyst: Craig Laurie

FISCAL IMPACT

This bill would reduce income tax revenue an estimated \$60.0 million in FY 2008-09, \$90.0 million in FY 2009-10, \$130.0 million in FY 2010-11, and \$180.0 million in FY 2011-12. This overall loss in income tax revenue can be broken down into the following three distinct components:

- 1) Increasing the level of household income at which eligibility for the homestead property tax credit begins to be phased out, from the current level of \$73,650 to \$83,650, would reduce income tax revenue an estimated \$37.0 million beginning in FY 2008-09;
- 2) Increasing the maximum homestead property tax credit from \$1,200 to \$1,300 would reduce income tax revenue an estimated \$23.0 million beginning in FY 2008-09; and

- 3) Creating a new refundable property tax credit that would be administered through the income tax would reduce income tax revenue an estimated \$30.0 million in FY 2009-10, \$70.0 million in FY 2010-11, and \$120.0 million in FY 2011-12.

The proposed new property tax credit would equal the amount property taxes increase when a parcel's taxable value reverts to its State equalized value (SEV) following a change in ownership (commonly called the "pop-up" tax). This proposed new credit would be available to taxpayers who 1) purchase a parcel of property after April 1, 2008, and before January 1, 2011, and 2) claim and receive a homestead exemption on this property.

Lag between the "Pop-up" Tax and Credit. There would be a lag between when the "pop-up" tax would be incurred and when the credit would be claimed and received by the taxpayer. The taxable value of an existing house that changes ownership on April 2, 2008, would not be adjusted up to equal the property's SEV until 2009. As a result, the new homeowner would experience the pop-up tax in his or her 2009 property taxes and would claim this credit in FY 2009-10 when filing his or her 2009 annual income tax return. The timing of these events is summarized in Table 1. Taxpayers could attempt to accelerate when they received the benefit of the credit by reducing the amount of income tax being withheld from their paychecks, and thus increasing their take-home-pay, during the tax year they incurred the pop-up tax, which would reduce the net income tax refund they would receive in the following year. However, based on past taxpayer behavior, it is not likely that many taxpayers would adjust the amount of income tax being withheld from their pay.

Table 1
Timing of Proposed New Property Tax Credit in SB 791 (S-3)

Year Property Changes Ownership	Year "Pop-Up" Tax is Assessed	Year Credit is Claimed/Received
2008	2009	2010 (FY 2009-10)
2009	2010	2011 (FY 1010-11)
2010	2011	2012 (FY 2011-12)

Cost of the Credit. Based on the likely timing of the proposed new credit, as described above, it would reduce income tax revenue an estimated \$30.0 million in FY 2009-10. This is a much lower cost than would have been the case if the credit had been in effect just a few years ago when the housing market was much stronger; however, at the present time, sales of both new and existing houses are at historical low levels due to the very weak housing market. It is estimated that the cost of this credit would increase to \$70.0 million in FY 2010-11 and \$120.0 million in FY 2011-12, due to two major factors: 1) The level of activity in the housing market is expected to increase, which will help stimulate more sales of existing houses, and 2) over time, the number of homeowners who would be eligible for this credit would increase because once a person purchased a house between April 1, 2008, and January 1, 2011, and qualified for this credit, he or she would continue to receive the credit each year that he or she owned the house and received the homestead exemption. In subsequent years, the cost of the credit would decline because no new taxpayers would qualify for it and those already eligible for the credit would lose the credit as their situations changed and they sold their houses or became ineligible for the homestead exemption.

New Credit vs. Existing Homestead Property Tax. Many of the taxpayers who would qualify for the proposed new credit also would qualify for the existing homestead property tax credit. A person who qualifies for the existing property tax credit would realize an increase in this credit equal to 60% of the pop-up tax if he or she is not a senior citizen, or 100% of the pop-up tax if the person is a senior citizen, assuming he or she does not bump up against the maximum credit level. As a result, the total amount a taxpayer would qualify for under this new credit together with the increase he or she would realize under the existing homestead property tax credit would exceed the total increase in the person's taxes

due to the pop-up tax. For example, if a taxpayer (not a senior) with household income of \$50,000 purchases an existing house for \$150,000 and its taxable value increases from \$60,000 to \$75,000 after the ownership change, the taxpayer would experience a pop-up tax of \$540, assuming a property tax rate of 36 mills. The new homeowner would qualify for a \$540 credit under this new property tax credit and an increase in the existing homestead property tax credit equal to \$324. Therefore, under this bill, the taxpayer would qualify for a total increase in credits of \$864, which would exceed the overall \$540 increase in property taxes.

Random Nature of Credit. The amount any particular taxpayer would qualify for under this new credit would be very random because it would depend on the difference between the property's SEV and taxable value at the time of the change in ownership – the greater the difference, the greater the credit the new owner would qualify for. The credit would not be related to the new owner's income level or overall level of property taxes, but would depend only on the amount that the property's property taxes increase for the new owner compared with what they were for the previous owner. As a result, the size of the credit could vary greatly among taxpayers with identical income levels who purchase similarly valued property. For example, if Individual A and Individual B each purchase a house for \$150,000, the taxable value for each of these newly purchased houses would revert to the SEV level, which in this example would equal \$75,000. At a tax rate of 36 mills, both of these new homeowners would incur a property tax liability of \$2,700. However, if the house purchased by Individual A were owned by its previous owner for 10 years and had a taxable value equal to 40% of the market value or \$60,000 just prior to the change in ownership, while the house purchased by Individual B was owned by its previous owner for only two years and had a taxable value equal to 48% of the market value or \$72,000, then Individual A would qualify for a credit under this bill equal to \$540, but Individual B would qualify for a credit equal to only \$108, even though their property values and property taxes are currently identical.

The loss in income tax revenue under this bill would reduce General Fund/General Purpose revenue. The bill would have no direct impact on local government.

Fiscal Analyst: Jay 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.