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BILL ANALYSIS

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Senate Bill 414 (as enrolled)
Sponsor: Senator Wayne Schmidt
Senate Committee: Government Operations
House Committee: Roads and Economic Development

Date Completed: 11-4-15

CONTENT

The bill would amend Part 1 of the Income Tax Act to do the following:

-- Reduce the individual income tax rate for a tax year beginning on and after January 1, 2023, if the percentage increase in General Fund/General Purpose (GF/GP) revenue from the prior fiscal year exceeded a positive inflation rate for the same period.
-- Prescribe a formula to calculate the amount of the rate reduction.

The bill would require the State Treasurer and the Directors of the Senate and House Fiscal Agencies to determine, by the date of each January revenue estimating conference, beginning in 2023, whether the total revenue distributed to GF/GP revenue had increased as required under the bill (which would determine whether a rate reduction would be triggered).

The bill is tie-barred to House Bill 4370. (House Bill 4370 would amend the Income Tax Act to direct certain amounts of income tax revenue to the Michigan Transportation Fund beginning in fiscal year 2018-19, and to modify the homestead property tax credit beginning in 2018.) The Senate bill also is tie-barred to House Bills 4614, 4616, 4736, 4737, and 4738, which would amend the Streamlined Sales and Use Tax Revenue Equalization Act, the Motor Carrier Fuel Tax Act, the Michigan Vehicle Code, Public Act 51 of 1951, and the Motor Fuel Tax Act, respectively.

MCL 206.51 Legislative Analyst: Suzanne Lowe

FISCAL IMPACT

The bill would reduce General Fund revenue by an unknown and significant amount that would depend on economic factors such as the inflation rate and underlying economic growth, Federal and State tax policy, State spending policy, and taxpayer behavior. The first fiscal year that revenue could be reduced under the bill would be FY 2022-23.

Based on current forecasts of revenue through FY 2016-17, if the bill's provisions were effective for FY 2016-17 and used FY 2014-15 as the base year, every 1.0% that General Fund revenue grows more rapidly than 1.425 times the inflation rate would require a rate reduction that would reduce revenue by approximately $100.0 million per year. On a full fiscal year basis, a reduction in the individual income tax rate of 0.1% (for example, from 4.25% to 4.15%) would reduce revenue by approximately $230.0 million. As a result, every $100.0 million by which General Fund revenue growth exceeds 1.425 times the rate of inflation would trigger a rate reduction of approximately 0.04% (for example, from 4.25% to 4.21%).

The potential for the rate reduction to be triggered can be viewed from a historical perspective, considering what would have occurred if the bill had been in effect in prior years.

General Fund revenue has grown or is forecasted to grow more rapidly than 1.425 times the rate of inflation, as defined by the bill, in 20 of the 50 years between FY 1967-68, the first year in which Michigan levied the individual income tax, and FY 2016-17, as forecast, and in seven of the 25 years since FY 1992-93. However, had the provisions of the bill been in effect beginning in some prior fiscal year, rate reductions would not have been triggered in all of these years because a rate reduction in an earlier year would potentially result in revenue not growing at a faster rate than inflation in later years. Similarly, in some years, such as FY 1999-2000, the scheduled rate reduction from 4.40% to 4.25% was greater than the rate reduction that would have been required by the provisions in the bill.

A more detailed discussion of the mechanics of the rate adjustment mechanism in the bill can be seen in the analysis of the S-1 version of the bill passed by the Senate on July 1, 2015; although that analysis was based on growth in excess of the inflation rate rather than 1.425 times the inflation rate, and was evaluated on a year-to-year basis rather than with respect to a base year of revenue.

In most fiscal years over the last 25 years, General Fund revenue grew more rapidly than inflation as a result of distinct circumstances. For example, in the last 1990s, General Fund revenue grew more rapidly than inflation primarily as a result of increased capital gain realizations associated with the "tech bubble" in the stock market. Similarly, in FY 2012-13, General Fund revenue grew more rapidly than inflation because of increased capital gains and dividends taken in response to the Federal "fiscal cliff" crisis coupled with delayed filings for credits available under the Michigan Business Tax (MBT). The forecasted growth of General Fund revenue over the rate of inflation in FY 2014-15 primarily reflects the fact that FY 2013-14 revenue was pushed lower than what economic growth would have suggested because of a substantial increase in the number and amount of MBT credits claimed in FY 2013-14. The provisions of the bill would trigger rate reductions whether the growth in General Fund revenue over the 1.425-times-the-rate-of-inflation reflected rapid economic growth or factors unrelated to the underlying economy.

When viewed historically, the likelihood of rate reductions under the bill also would have been affected by both tax and spending policies. As mentioned above, the scheduled rate reduction for FY 1999-2000 was greater than the reduction that would have been calculated by the provisions of the bill. Similarly, in years when the State has deposited revenue into the Budget Stabilization Fund (BSF), it reduced or eliminated rate reductions that would have otherwise been triggered had the bill been effective. Furthermore, during recessions, circumstances such as withdrawals from the BSF or increased Federal aid that has effectively increased General Fund revenue have prevented the base from which General Fund revenue growth would be computed under the bill from declining as rapidly as ongoing revenue, resulting in slower growth in revenue during the initial years of the recovery and decreasing or eliminating any rate reductions that would have been triggered if General Fund revenue grew as rapidly as ongoing revenue. A similar impact would occur due to House Bill 4370, to which the Senate bill is tie-barred. The enrolled version of that bill would earmark revenue to the Michigan Transportation Fund beginning in FY 2018-19. The earmark increase in magnitude through FY 2020-21, thus reducing the chances that General Fund revenue would grow rapidly enough to trigger tax rate reductions under the Senate bill if the bill's provisions were in effect during those years.

Regardless of the circumstances resulting in a rate reduction under the bill, based on revenue levels forecasted through FY 2016-17, every 1.0% that General Fund revenue grows more rapidly than 1.425 times the rate of inflation would require a rate reduction that would reduce revenue by approximately $100.0 million per year, as described above. The bill's provisions regarding potential reductions in the tax rate would not affect rates until at least FY 2022-23.

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