Senate Fiscal Agency
P. O. Box 30036
Lansing, Michigan 48909-7536

BILL ANALYSIS

Telephone: (517) 373-5383
Fax: (517) 373-1986

Senate Bill 414 (Substitute S-1 as reported)
Sponsor: Senator Wayne Schmidt
Committee: Government Operations

CONTENT

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

-- Reduce the individual income tax rate for a tax year beginning on and after January 1, 2018, 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.
-- Require the following amounts of income tax revenue to be deposited in the Michigan Transportation Fund (MTF): $350.0 million in fiscal year (FY) 2016-17 and $700.0 million in each subsequent fiscal year through FY 2032-33.
-- Require the revenue to be distributed as provided in Public Act 51 of 1951 (the MTF law).

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 2018, 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 states: "It is the intent of the legislature to offset the fiscal impact on the state general fund resulting from the [proposed] earmark to the Michigan transportation fund…by reducing or cutting general fund expenditures in fiscal year 2016-2017 and each fiscal year thereafter."

The bill is tie-barred to House Bills 4612 through 4616. (House Bill 4613 (S-1) would amend Public Act 51 of 1951 and, among other things, would require the income tax revenue directed to the MTF under Senate Bill 414 (S-1) to be distributed as follows: 39.1% to the Michigan Department of Transportation, 39.1% to county road commissions, and 21.8% to cities and villages.)

MCL 206.51 Legislative Analyst: Suzanne Lowe

FISCAL IMPACT

The bill would reduce General Fund revenue by $350.0 million in FY 2016-17, by $700.0 million in FY 2017-18, and in later fiscal years 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 bill also would increase revenue to the Michigan Transportation Fund by $350.0 million in FY 2016-17 and by $700.0 million per year from FY 2017-18 through FY 2032-33.

Based on current forecasts of revenue through FY 2016-17, every 1.0% that General Fund revenue grows more rapidly than inflation 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 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 inflation, as defined by the bill, in 26 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 12 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. For example, General Fund revenue grew more rapidly than inflation in every year between FY 2010-11 and FY 2012-13; however, if the bill had been in effect since at least FY 2009-10, the rate reduction triggered for FY 2011-12 would have caused General Fund revenue to grow more slowly than inflation in FY 2012-13. 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.

Had the provisions of the bill been in effect historically, and tax policy is assumed to have remained the same (such as the scheduled rate reductions between FY 1999-2000 and FY 2004-05 or the rate increase in FY 2008-09), the effect of the bill would have depended on the year in which it first took effect. For example, if the bill had been effective for any fiscal year before FY 2011-12, it would have resulted in a loss of General Fund revenue in FY 2011-12 of $206.8 million, $106.5 million in FY 2012-13, $75.5 million in FY 2013-14, and $81.8 million in FY 2014-15; while if the provisions had first become effective in FY 2011-12, there would have been no impact until a forecasted $210.3 million reduction in FY 2015-16.

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 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. Similarly, the proposed $350.0 million earmark to the Michigan Transportation Fund in FY 2016-17 would result in General Fund revenue growing less than inflation, instead of exceeding the growth in the price level absent the bill.

Regardless of the circumstances resulting in a rate reduction under the bill, based on current forecasts of revenue through FY 2016-17, every 1.0% that General Fund revenue grows more rapidly than 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 be effective until FY 2017-18. However, the bill also would reduce General Fund revenue in FY 2016-17 by $350.0 million, and by $700.0 million in each year between FY 2017-18 and FY 2032-33, by earmarking revenue to the Michigan Transportation Fund. Combined with the MTF earmark, any rate reductions in FY 2017-18 or later would lower General Fund revenue by more than $700.0 million under the bill.

Date Completed: 7-1-15 Fiscal Analyst: David Zin