Legislative Analysis

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INCOME TAX CHANGES

Senate Bill 748 (S-2) as passed by the Senate
Sponsor: Sen. Jack Brandenburg

Senate Bill 749 (S-1) as passed by the Senate
Sponsor: Sen. Margaret O'Brien

Senate Bill 750 (S-2) as passed by the Senate
Sponsor: Sen. Marty Knollenberg

House Committee: Tax Policy
Senate Committee: Finance
Complete to 1-30-18

BRIEF SUMMARY:

Senate Bill 748 would amend the Income Tax Act to:

- Change definitions and references to reflect the recently enacted federal Tax Cut and Jobs Act of 2017, and remove reference to personal and dependency exemptions allowed on a taxpayer's federal income tax return.
- Allow a taxpayer to claim personal and dependency exemptions on the state income tax, and set the amount of the exemption in statute at $4,500 for the 2018 tax year, $4,600 for the 2019 tax year, and $4,700 for the 2020 tax year, with a modified inflation adjustment returning thereafter.

[An exemption reduces the amount of income subject to tax.]

Senate Bill 749 would amend the Income Tax Act to allow a taxpayer to claim a credit against the income tax in an amount equal to 100% of the credit the taxpayer claims under section 21 of the Internal Revenue Code (commonly called the Child and Dependent Care Credit).

[A credit directly reduces tax liability.]

Senate Bill 750 would amend the City Income Tax Act to remove references to the federal Internal Revenue Code and replace them with references to the Income Tax Act, with regard to deductions for the personal and dependency exemptions on city income taxes.

The bills are tie-barred, meaning that none could take effect unless all three were enacted into law.

DETAILED SUMMARY:

Senate Bill 748
Currently under the Income Tax Act, a taxpayer can claim a personal exemption and multiply the amount by the number of personal or dependency exemptions "allowable on the taxpayer's

federal income tax return pursuant to the internal revenue code." The bill would remove the reference to the federal income tax return and provide for the determination of exemptions as follows:

- Each taxpayer may claim 1 personal exemption. If a joint return is not made by the taxpayer and his or her spouse, the taxpayer may claim a personal exemption for the spouse if the spouse does not have any gross income and is not the dependent of another taxpayer.
- A taxpayer may claim a dependency exemption for each individual who is a dependent of the taxpayer for the tax year.

With regard to the $1,500 deduction available to an individual to whom a deduction is allowable to another taxpayer, the bill would remove federal references and replace with the exemption system described above.

Currently under the act, the personal exemption amount is set at either an inflation-adjusted amount (rounded to the nearest $100) or an amount specifically set in statute, whichever is greater. The personal exemption amount for tax year 2017 is $4,000.

The bill would set the following amounts in statute for the personal exemption:

- On and after January 1, 2014 and before January 1, 2018: $4,000.
- For the 2018 tax year: $4,500.
- For the 2019 tax year: $4,600.
- For the 2020 tax year: $4,700

For the 2021 tax year and each tax year thereafter, the inflation-adjusted amount would be increased by an additional $700.

The bill would repeal section 30e of the Income Tax Act. This section defines "dependent" as 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.

The bill would add "dependent" to the definitions section of the act, and define it as "a dependent as defined in section 152 of the internal revenue code."

The bill would change the definition of "internal revenue code" and define it as the United States internal revenue code of 1986 in effect on January 1, 2018.

The bill would also repeal section 30f of the Income Tax Act, which provides for adjustments from taxable income for interest earned on the contributions to a taxpayer's education savings account and distributions that are qualified withdrawals from an education savings account, to the extent *not deducted* in determining adjusted gross income. Instead, the bill would allow a taxpayer to deduct, to the extent *included* in adjusted gross income, interest earned and qualified withdrawals.

The bill would make an identical change regarding interest and distributions for an ABLE savings account, allowing interest earned and qualified withdrawals to be deducted to the extent *included* in adjusted gross income.

Finally, the bill contains an enacting section that states legislative intent to annually appropriate sufficient funds from the state general fund to the state School Aid Fund (SAF) to fully compensate for any loss of revenue to the SAF resulting from the enactment of the bill.

MCL 206.8 et seq.

Senate Bill 749
The bill would add a new section to the Income Tax Act. For tax years beginning on and after January 1, 2018, a taxpayer could claim a credit against the income tax in an amount equal to 100% of the credit the taxpayer is allowed to claim as a credit under section 21 of the Internal Revenue Code in the same tax year.

If the credit allowed exceeded the tax liability of the taxpayer, the portion of the credit that exceeded the liability would not be returned.

[The federal Child and Dependent Care Credit under section 21 is available to taxpayers who pay for expenses for the care of a qualify individual to enable the taxpayer to work or look for work. The credit amount is a percentage of the expenses paid for care, and the percentage depends on adjusted gross income.][1]

Proposed MCL 206.272a

Senate Bill 750
Currently under the City Income Tax Act, when computing taxable income, a taxpayer is allowed deductions for the personal and dependency exemptions authorized by "the federal internal revenue code." The bill would remove this language, and instead refer to personal and dependency exemptions authorized by "Part 1 of the Income Tax Act of 1967" (i.e., the changes proposed in SB 748). The bill would also refer to "Part 1 of the Income Tax Act of 1967" with regard to a potential exemption for a person with respect to whom a deduction is allowable to another taxpayer.

MCL 141.631

FISCAL IMPACT:

Senate Bill 748
Under current law, the personal exemption is projected to increase due to inflationary adjustments from $4,000 in TY 2018 to $4,100 for TY 2019, $4,200 for TY 2020, and $4,300 for TY 2021. In contrast, Senate Bill 748 would increase the personal exemption to $4,500 in TY 2018, $4,600 in TY 2019, and $4,700 in TY 2020. In subsequent years, the personal exemption would equal the inflation-adjusted amount under current law plus $700, which would equal $5,000 in TY 2021 given current inflation projections. The table below presents

[1] "Topic Number: 602 – Child and Dependent Care Credit" Internal Revenue Service https://www.irs.gov/taxtopics/tc602

the estimated personal exemption under current law, the proposed personal exemption under Senate Bill 748, and the estimated annual revenue impacts.

Tax Year	Current Law Personal Exemption	Proposed Personal Exemption	Fiscal Year	Annual Impact (millions)	SAF Impact (millions)	GF/GP Impact (millions)
2018	$4,000	$4,500	FY 2017-18	($75.0)	($17.9)	($57.2)
2019	$4,100	$4,600	FY 2018-19	($187.5)	($35.7)	($151.8)
2020	$4,200	$4,700	FY 2019-20	($150.0)	($35.7)	($114.3)
2021	$4,300	$5,000	FY 2020-21	($195.0)	($46.4)	($148.6)

In subsequent years, the $700 differential would reduce income tax revenue by about $210.0 million relative to current law, and would reduce revenue to the School Aid Fund by about $50.0 million per year. The remaining $160.0 million reduction would come from the general fund.

Senate Bill 749

Based on TY 2015 IRS data for the federal child care credit claimed by Michigan filers (which was claimed on 160,060 returns and totaled $81.2 million), the child care allowed under Senate Bill 749 would reduce income tax revenue by a similar amount. Because the credit would most likely reduce net income tax revenue (after refunds) as opposed to gross income tax revenue (before refunds), most of the revenue loss would be borne by the general fund.

Senate Bill 750

As written, Senate Bill 750 would simply make technical amendments to the City Income Tax Act to change the definition of personal and dependency exemptions. Under current law, personal and dependent exemptions are defined by referencing the federal internal revenue code. However, to prevent any unintended consequences the federal Tax Cut and Jobs Act of 2017 might have toward eliminating the personal exemption in the City Income Tax Act, the definition is changed to reference the state Income Tax Act of 1967. Because the bill would be maintaining the existing personal and dependent exemptions, it would have no fiscal impact.

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■ This analysis was prepared by nonpartisan House Fiscal Agency staff for use by House members in their deliberations, and does not constitute an official statement of legislative intent.