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BILL ANALYSIS

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Senate Bill 748 (Substitute S-1 as reported)
Sponsor: Senator Jack Brandenburg
Committee: Finance

CONTENT

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

-- Specify the number of personal and dependency exemptions a taxpayer would be allowed, and delete language under which the number of exemptions depends on the number allowed on a taxpayer's Federal return.
-- Increase the personal exemption from the current $4,000 to $4,500 for the 2018 tax year, $4,600 for the 2019 tax year, and $4,700 for the 2020 tax year.
-- Beginning with the 2021 tax year, require the inflation-based adjusted amount of the exemption to be increased by an additional $700.
-- Specify that an individual with respect to whom a deduction was allowable to another taxpayer during the tax year would not be considered to have an allowable exemption for purposes of the Act's personal exemption calculation, and would be exempt from the income tax and not required to file a return, if the person had an adjusted gross income of $1,500 or less.
-- Revise the deduction for contributions to and distributions from an ABLE savings account, and interest earned on contributions to education savings accounts.

The bill also would repeal Section 30e of the Act, which defines "dependent" as an individual for whom the taxpayer may claim a dependent exemption on the taxpayer's Federal income tax return under the Internal Revenue Code (IRC). The bill would define "dependent" as a dependent as defined in Section 152 of the IRC.

Under the bill, the number of personal and dependency exemptions allowed would be determined as follows:

-- Each taxpayer could claim one personal exemption; however, if the taxpayer and his or her spouse did not make a joint return, the taxpayer could claim a personal exemption for the spouse if the spouse, for the calendar year in which the taxpayer's taxable year began, did not have any gross income and were not the dependent of another taxpayer.
-- A taxpayer could claim a dependency exemption for each individual who was a dependent of the taxpayer for the tax year.

MCL 206.30 et al.

Legislative Analyst: Drew Krogulecki

FISCAL IMPACT

The bill would reduce General Fund and School Aid Fund revenue from currently forecasted amounts by an unknown but significant amount in fiscal year (FY) 2017-18 and FY 2018-19, depending on when the bill's changes became effective, and by approximately $150.0 million in FY 2019-20, approximately $189.4 million in FY 2020-21, and approximately $206.0 million in each subsequent fiscal year.

The reduction in revenue during FY 2017-18 and FY 2018-19 would depend on when the bill was effective. If the changes for tax year 2018 were made retroactive, and effective beginning January 1, 2018, and income tax payments and withholding tables were adjusted to reflect that retroactivity, the bill would reduce FY 2017-18 General Fund and School Aid Fund revenue by approximately $110.9 million and FY 2018-19 revenue by $147.4 million. However, if the bill's changes were not effective until April 1, 2018, revenue in FY 2017-18 would be reduced by approximately $73.9 million; however, the revenue reduction in FY 2018-19 would increase to approximately $184.4 million.

The impact of the bill would increase beginning in FY 2020-21 because the difference between the value of the personal exemption under the bill and under current law would increase. Depending on the inflation rate, the difference would be expected to be increase from $500 in tax years 2018 through 2020 to $700 in tax year 2021 and subsequent years.

Under the law, approximately 23.8% of gross income tax revenue is earmarked to the School Aid Fund; therefore, that share of the total revenue reduction would lower School Aid Fund revenue. Consequently, if the bill lowered FY 2018-19 revenue by $147.4 million, School Aid Fund revenue would be reduced by $35.1 million, and the remaining $112.3 million in uncollected revenue would reduce the General Fund.

In addition to the bill's impact relative to current revenue forecasts, the bill would reduce General Fund and School Aid Fund revenue relative to current law by approximately $1.1 billion in FY 2017-18, and approximately $1.4 billion in FY 2018-19. The revenue loss relative to current law would increase in subsequent fiscal years. These additional losses would reflect that the Federal tax reform legislation adopted in December 2017 would effectively eliminate the personal exemption under the Michigan individual income tax, thereby increasing revenue by approximately $1.1 billion in FY 2017-18 and $1.4 billion in FY 2018-19 (and additional amounts in future fiscal years). The bill's changes regarding the definition of "dependent" are meant to effectively decouple Michigan's current individual income tax provisions for dependents from the Federal tax reform changes. However, current revenue estimates do not account for the impact of Federal tax reform on Michigan's statutory tax provisions. Consequently, while the bill's changes to the definition would lower revenue relative to current law, the changes would not lower revenue relative to current revenue estimates.

While the changes in the definition of "dependent" would not lower revenue below current revenue estimates, the bill also would increase the personal exemption amount above the levels that would exist if the bill only decoupled Michigan tax provisions from the Federal tax reform legislation. As a result, the bill also would reduce revenue relative to currently forecasted levels.

Date Completed: 1-17-18 Fiscal Analyst: David Zin