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BILL



ANALYSIS

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

Date Completed: 1-16-18

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.**
- **Revise the deduction for contributions to and distributions from an ABLE savings account, and interest earned on contributions to education savings accounts.**

Personal Exemption

Part 1 of the Act imposes a tax at the rate of 4.25% on the taxable income of individuals. "Taxable income" means adjusted gross income as defined in the Internal Revenue Code (IRC), subject to a number of additions and deductions. In addition to these adjustments, the Act provides for a personal exemption multiplied by the number of personal or dependency exemptions allowable on the taxpayer's Federal income tax return under the IRC, to be subtracted in the calculation that determines taxable income.

The bill would delete reference to the number of exemptions allowable on a Federal tax return. Instead, 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.

The bill 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 IRC. Under the bill, "dependent" would mean a dependent as defined in Section 152 of the IRC. (Under Section 152, "dependent" means a "qualifying child" or a "qualifying relative", as those terms are defined in that section.)

Currently, an individual with respect to whom a deduction under the IRC is allowable to another Federal taxpayer during the tax year is not considered to have an allowable Federal exemption for purposes of the Act's personal exemption, but may subtract \$1,500 in the calculation that determines taxable income. Under the bill, instead, an individual for whom a deduction under the Act's personal exemption is allowable to another taxpayer during the tax year would not be entitled to a personal exemption but could subtract \$1,500.

Exemption Amount

Currently, the amount of the personal exemption is \$4,000. The bill would increase amount as follows:

- For the 2018 tax year, \$4,500.
- For the 2019 tax year, \$4,600.
- For the 2020 tax year, \$4,700.

Under the Act, the amount of the personal exemption amount must be adjusted by an increase of \$100 when changes in the consumer price index trigger an increase, according to a formula in the Act. Under the bill, for the 2021 tax year and each subsequent tax year, the adjusted amount would have to be increased by an additional \$700.

Exempt Dependent

Under the Act, an individual with respect to whom a deduction under the IRC is allowable to another Federal taxpayer during the tax year is not considered to have an allowable Federal exemption for purposes of the Act's personal exemption calculation, and is exempt from the income tax and not required to file a return, if the person has an adjusted gross income of \$1,500 or less. Under the bill, this would apply to a person with respect to whom a deduction was allowable to another taxpayer.

Deductions

Currently, to the extent *not deducted* in determining adjusted gross income, a taxpayer may deduct distributions that are qualified withdrawals from an ABLE savings account to the designated beneficiary of the account. Under the bill, a taxpayer could deduct these distributions to the extent *included* in adjusted gross income.

The bill would make the same change with respect to deductions for contributions made by a taxpayer less qualified withdrawals made from education savings accounts, as well as interest earned on contributions to a taxpayer's education savings accounts.

MCL 206.30 et al.

Legislative Analyst: Suzanne Lowe

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, by approximately \$150.0 million in FY 2019-20, by 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 current 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 lower collections would reduce General Fund revenue.

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.

Fiscal Analyst: David Zin

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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.