Senate Fiscal Agency
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BILL ANALYSIS

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House Bill 4568 (Substitute S-1)
Senate Bill 784 (Substitute S-2)
Sponsor: Representative Matt Hall (H.B. 4568)
Senator Jon Bumstead (S.B. 784)
House Committee: Tax Policy (H.B. 4568)
Senate Committee: Finance (S.B. 784; H.B. 4568-*discharged*)

Date Completed: 5-19-22

CONTENT

House Bill 4568 (S-1) would amend the Income Tax Act to do the following:

-- Increase the personal exemption, beginning on and after the 2023 tax year, by $1,800 (the personal exemption for the 2021 tax year is $4,900).
-- Specify that, beginning January 1, 2023, after a person reached 67 years of age, he or she would be eligible for an unrestricted deduction of $21,800 for a single return or $43,600 for a joint return, and, beginning with the 2024 tax year, require this deduction to be adjusted for inflation.
-- Reduce, beginning with the 2023 tax year, the individual income tax rate from 4.25% to 4.0%.
-- Increase, from 6.0% to 20.0%, the Earned Income Tax Credit (EITC), beginning with the 2022 tax year.
-- Allow a taxpayer to claim, for tax years beginning on and after January 1, 2022, a $500 nonrefundable tax credit for each qualified dependent (i.e., a dependent who is less than 19 years old on the last day of the tax year for which the credit is claimed) for which an exemption was claimed for that tax year.
-- Allow, beginning with the 2023 tax year, a disabled veteran who met the bill's criteria, his or her widow or widower, or a widow or widower of a veteran killed in action to claim a credit against his or her income tax in an amount equal to 100% of the property tax levied on his or homestead deductible for Federal income tax purposes.
-- Require a claimant to claim the credit on his or her annual income tax return or by filing with the local tax collecting unit an affidavit that authorized it to claim the credit on his or her behalf.
-- Require a local tax collecting unit that received an affidavit stating a claimant's intent to claim the proposed credit to provide the Department of Treasury with a copy of the affidavit and information needed to determine the amount of property taxes levied and deferred on the homestead.
-- Specify that if the amount of the credit exceeded the claimant's tax liability, any amount not used as offset would have to be approved for payment to the claimant.
-- Specify that the credit proposed under the bill would be exempt from execution, levy, attachment, garnishment, or other legal process to collect a debt.

Senate Bill 784 (S-2) would amend the General Property Tax Act to do the following:

-- Eliminate language that exempts the homestead of a disabled veteran who met the bill's criteria or his or her unremarried surviving spouse from property taxes levied under the Act.
-- Specify that a disabled veteran, the widow or widower of a disabled veteran, or the widow or widower of a veteran killed in action who wanted to defer collection of his or her property tax and authorize a local tax collecting unit to claim the homestead income tax credit proposed under House Bill 4568 (S-1) would have to file an affidavit with the local tax collecting unit.
-- Require a local tax collecting unit that received an affidavit to defer collecting property taxes levied on the homestead until the State paid the property taxes or rejected the claim for the credit, and to provide the Department with a copy of the affidavit and inform the Department of the amount of tax deferred.
-- Specify that property taxes deferred under the bill would not be subject to penalties or interest for the deferment period.
-- Specify that after the State's payment of property tax or rejection of the claim, the local tax collecting unit would have to notify the claimant of the payment or rejection, the amount of unpaid tax, and the date by which the balance would have to be paid.

The bills are tie-barred. Senate Bill 784 (S-2) would take effect December 31, 2022.

MCL 206.30 et al. (H.B. 4538) Legislative Analyst: Jeff Mann
211.7b (S.B. 784)

FISCAL IMPACT

Estimated Impact of HB 4568 (S-1) and SB 784 (S-2) (millions of dollars)				
Provision	**FY 2021-22**	**FY 2022-23**	**FY 2023-24**	**FY 2024-25**
Rate Reduction	$0.0	($560.3)	($841.1)	($871.0)
Increase Personal Exemption	0.0	(376.6)	(502.1)	(502.1)
Qualified Dependent Credit	(581.3)	(775.0)	(775.0)	(775.0)
Increase EITC	0.0	(262.0)	(262.0)	(262.0)
Increase Senior Deductions	0.0	(35.7)	(54.8)	(64.3)
Disabled Veteran Credit	0.0	0.0	(191.6)	(212.2)
Total	**($581.3)**	**($2,009.7)**	**($2,626.5)**	**($2,686.7)**
General Fund	*($494.1)*	*($1,792.2)*	*($2,384.0)*	*($2,442.2)*
School Aid Fund..............	*($87.2)*	*($217.5)*	*($242.6)*	*($244.5)*
Note: See text for discussion of fund source splits for individual provisions.				

The bills would reduce revenue to the General Fund and School Aid Fund (SAF) by approximately $581.3 million in fiscal year (FY) 2021-22, $2.0 billion in FY 2022-23, $2.6 billion in FY 2023-24, and $2.7 billion in FY 2024-25. The revenue loss would increase in later years as the economy continues to grow and inflation raises allowable exemption rates relative to current law. The bills would affect revenue in six ways:

1) House Bill 4568 (S-1) would lower the tax rate levied under the individual income tax (and flow-through entity tax, which mirrors the individual income tax).
2) House Bill 4568 (S-1) would increase the personal exemption.
3) House Bill 4568 (S-1) would create a new nonrefundable credit for qualified dependents.
4) House Bill 4568 (S-1) would increase the EITC from 6% of the Federal EITC to 20%.
5) House Bill 4568 (S-1) would increase the amount of income certain seniors could deduct from their income.

6) House Bill 4568 (S-1) and Senate Bill 784 (S-2) would combine to eliminate the property tax exemption for certain disabled veterans and replace it with an income tax credit; the bills also would increase the number of disabled veterans eligible to receive the credit.

The changes to the tax rate under the individual income tax would be effective January 1, 2023. As a result, FY 2022-23 would not experience a full year impact of the changes because a portion of the fiscal year would have received tax year 2022 withholding and annual payments received in FY 2022-23 will be based on tax year 2022 income. The individual income tax rate change under the bill would reduce General Fund revenue by $560.3 million in FY 2022-23, $841.1 million in FY 2023-24 and $871.0 million in FY 2024-25. Any revenue reduction associated with changing the individual income tax rate would reduce General Fund revenue. The SAF is held harmless for revenue reductions associated with changes in the individual income tax rate.

The provisions increasing the personal exemption also would become effective January 1, 2023, and would not have a full-year impact on FY 2022-23 revenue. The revenue impact of changes in the personal exemption are related to the tax rate. Adjusting for the lower tax rate proposed by the bills, the increase in the personal exemption would reduce revenue by approximately $376.6 million in FY 2022-23, and $502.1 million per year in future years. In FY 2022-23, the provisions would reduce SAF revenue by approximately $94.1 million and General Fund revenue by approximately $282.5 million. In FY 2023-24 and later fiscal years, the provisions would reduce SAF revenue by approximately $125.5 million per year, and General Fund revenue by approximately $376.6 million per year.

The impact of the nonrefundable credit for dependents under the age of 19 would reduce individual income tax revenue by approximately $775.0 million per year. While the credit would be effective for tax year 2022, it would not be claimed until taxpayers filed their tax year 2022 returns (due April 15, 2023, which falls in FY 2022-23). The credit would reduce FY 2021-22 revenue because (given the effective date of the credit) a portion of the impact would accrue back to FY 2021-22 (lowering FY 2021-22 General Fund revenue by $581.3 million). Tax credits reduce General Fund revenue, unless they reduce gross collections (withholding, estimated payments, and annual payments) and any reduction in gross collections would lower both General Fund and SAF revenue. With the new tax rate proposed by the bill, approximately 25.0% of any reduction in gross collections (for example lower annual payments due to the credit or reduced withholding collections because taxpayers reduced their withholdings in anticipation of receiving the credit) as a result of the bill, would reduce SAF revenue. If 15% of the revenue reduction under the proposed credit lowered gross collections, the credit would reduce General Fund revenue by approximately $494.1 million in FY 2021-22 and approximately $658.8 million per year in later fiscal years, and would lower SAF revenue by approximately $87.2 million in FY 2021-22 and approximately $116.3 million per year in later fiscal years.

The provisions increasing the EITC would reduce General Fund revenue beginning in FY 2022-23 because credits are paid in the fiscal year ending in the year following the tax year they are earned. As a result, the bill would have no effect on FY 2021-22 revenue but would reduce by approximately $262.0 million per year beginning in FY 2022-23. The provisions would not affect SAF revenue because individual income tax revenue to the School Aid Fund is based on gross collections, which exclude the revenue impact of tax credits.

The bills also would increase the amount of income certain seniors deducted by $1,800 per return for single filers, and $3,600 per return for joint returns. The provisions would affect individuals born after 1945 and at least 67 years old. With the lower income tax rate proposed by the bill, the maximum impact for any individual taxpayer would be a liability reduction of $72 per year for a single return and $144 for a joint return. Some taxpayers would not have sufficient income to fully claim the increased deduction amounts and would experience lesser reductions in liability. The proposed increased deduction amount for certain seniors is estimated to reduce revenue by $35.5 million in FY 2022-23, $54.8 million in FY 2023-24, $64.3 million in FY 2024-25, and then grow by approximately $10.0 million per year in future years.

The proposed increased deduction for certain seniors is expected to reduce General Fund revenue by $28.6 million in FY 2022-23, $43.8 million in FY 2023-24, and $51.5 million in FY 2024-25; SAF revenue would be reduced by approximately $7.1 million in FY 2022-23, $11.0 million in FY 2023-24, and $12.9 million in FY 2024-25. As indicated earlier, the revenue loss would increase in future fiscal years as more taxpayers become eligible for the increased deduction.

The bills also would provide inflationary adjustments to the deduction amounts seniors may claim beginning for tax year 2024. The revenue reduction from this change is not included in these estimates, but the bill would reduce both General Fund and SAF revenue in FY 2023-24 and later fiscal years by an unknown amount that would depend on inflation, taxpayer income, and the change in the number of seniors claiming the deductions. Under the proposed tax rate, every $100 increase in the exemption amount would reduce revenue by approximately $4.4 million in tax year 2024 and the amount would increase in future years as the number of seniors eligible to claim the deductions, and inflation, increased.

The provisions affecting disabled veterans would reduce General Fund revenue by approximately $201.7 million in FY 2023-24 and $222.3 million in FY 2024-25. The provisions also would increase SAF revenue by approximately $10.1 million, beginning in FY 2023-24. The revenue reduction to the General Fund would increase in subsequent fiscal years as both taxable values rise and the number of exemptions increase, while the increase to the SAF would increase over time only as taxable values increase. Similarly, the impact would increase or decrease, respectively, with any increase or decrease in millage rates on affected properties.

Provisions that would affect disabled veterans currently eligible for the property tax exemption would reduce revenue by approximately $92.2 million in FY 2023-24 and $106.9 million in FY 2024-25. The provisions that would expand eligibility to veterans with disability ratings between 50% and 100% would reduce revenue by approximately $109.5 million in FY 2023-24 and $115.5 million in FY 2024-25.

Since the current property tax exemption first was enacted, the number of exemptions has grown rapidly, at about 14.0% per year. The number of Michigan veterans paid at a disability rating of 100% increased at an average rate of 9.0% per year between 2015 and 2018. Similarly, the number of disabled veterans with a disability rating of 50% or more, but less than 100%, has risen at approximately 5.5% per year.

The bill also would have a negative fiscal impact on the Department of Treasury. The Department likely would experience additional one-time and ongoing costs to process affidavits, remit credits directly to local tax collecting units, and provide informational materials to local tax collecting units. The Department would incur one-time costs to develop forms and the application process and to create information technology systems. The ongoing costs would include staff and information technology costs to annual process affidavits. Both the one-time and ongoing costs likely would be greater than current appropriations.

Combined, all the bills' provisions would reduce General Fund revenue by approximately $494.1 million in FY 2021-22, $1.8 billion in FY 2022-23, and $2.4 billion in FY 2023-24.

Across all changes, the bills would reduce School Aid Fund revenue by approximately $87.2 million in FY 2021-22, $217.5 million in FY 2022-23, and $242.6 million in FY 2023-24.

Fiscal Analyst: David Zin