Legislative Analysis

INCOME TAX AMENDMENTS

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House Bill 4961 (H-1) as passed by the House
Sponsor: Rep. Ann Bollin
Committee: Finance
Revised 9-26-25

SUMMARY:

House Bill 4961 would amend the Income Tax Act to provide that, for tax years beginning after December 31, 2024, a taxpayer's adjusted gross income (or federal taxable income, as applicable) must be calculated as though sections 168(n) and 174A of the federal Internal Revenue Code[1] were not in effect, and as though sections 163(j), 168(k), 174, and 179 of the Internal Revenue Code, as in effect on December 31, 2024, applied.[2] In addition, for tax years beginning after December 31, 2021, a taxpayer's adjusted gross income (or federal taxable income, as applicable) would have to be calculated as if the transition rules under section 70302 of the One Big Beautiful Bill Act (OBBBA), Public Law 119-21, do not apply, including any provisions related to the application of section 174A of the Internal Revenue Code.[3]

These provisions would apply to determining the adjusted gross income (or federal taxable income, as applicable) of individuals, resident estates or trusts, and taxpayers (including flow-through entities) subject to the corporate income tax.

<u>Individual income tax</u>
In addition, for tax years beginning after December 31, 2025, and before January 1, 2029, in determining taxable income, an individual taxpayer could deduct from their adjusted gross income (to the extent it wasn't already deducted in determining adjusted gross income) an amount equal to the sum of the following deductions allowed to be claimed on the taxpayer's federal income tax return for the same tax year:

- Qualified tips under section 224 of the Internal Revenue Code.[4] A nonresident could deduct only tips for services performed in Michigan.
- Qualified overtime compensation under section 225 of the Internal Revenue Code.[5] A nonresident could deduct only overtime pay for services performed in Michigan.

<u>Tier 3 retirement income</u>
The act now contains a three-tier system under which a taxpayer's birth year determines how retirement income is taxed (for a joint return, the treatment of retirement income is based on the birth year of the older spouse). Currently, taxpayers in Tier 3 (those born after 1952) are

[1] Currently, *Internal Revenue Code*, when used in Parts 1 and 2 of the act, means the United States Internal Revenue Code of 1986 in effect on January 1, 2018, or, at the option of the taxpayer, in effect for the tax year. The bill would change the date in applicable definitions to January 1, 2025.
[2] If necessary, the state treasurer would have to modify the application of any references in the Internal Revenue Code to the sections described above to effect the purpose of these provisions, including references in the OBBBA.
[3] See https://www.house.mi.gov/hfa/PDF/Alpha/Fiscal_Brief_OBBBA_of_2025_Jul2025.pdf for a description of significant federal tax changes and other federal programming changes made by the OBBBA.
[4] https://www.law.cornell.edu/uscode/text/26/224
[5] https://www.law.cornell.edu/uscode/text/26/225

not able to exempt any retirement income (except Social Security income) until reaching age 67. After turning 67, these taxpayers can choose between taking a deduction of $20,000 for single filers ($40,000 for joint returns) against *all* types of income or continuing to exempt Social Security income and claiming other personal exemptions they are eligible for. Under the bill, for tax years that begin on and after January 1, 2026, and before January 1, 2029, a Tier 3 taxpayer opting to take the $20,000/$40,000 deduction against *all* income could also deduct Social Security income (but could not then also take the standard personal exemptions).[6]

<u>Corporate income tax revenue distribution</u>

The act now provides that, for the 2024-25 state fiscal year, the revenue collected under Part 2 (corporate income tax, or CIT) must be distributed as follows, in the following order:

- Up to $1.2 billion to the general fund.
- Up to $50.0 million, if available, to the Michigan Housing and Community Development Fund.[7]
- Up to $50.0 million, if available, to the Revitalization and Placemaking Fund.[8]
- Up to $500.0 million, if available, to the Strategic Outreach and Attraction Reserve (SOAR) Fund.[9]
- The balance to the general fund.

For 2025-26 and subsequent state fiscal years, $50.0 million of CIT revenue must be deposited into the Michigan Housing and Community Development Fund, and the balance into the state's general fund.

Under the bill, for the 2024-25 fiscal year, CIT revenue would have to be distributed as follows, in the following order:

- Up to $1.2 billion to the general fund.
- Up to $50.0 million, if available, to the Michigan Housing and Community Development Fund.
- Up to $50.0 million, if available, to the Revitalization and Placemaking Fund.
- Up to $250.0 million, if available, to the Healthy Michigan Fund.[10]
- The balance to the general fund.

For the 2025-26 and subsequent state fiscal years, CIT revenue would have to be distributed as follows, in the following order, under the bill:

- Up to $1,200.0 million to the general fund.
- Up to $50.0 million, if available, to the Michigan Housing and Community Development Fund.

[6] Under both current law and the bill, a Tier 3 taxpayer could also opt to take a percentage (being phased in with annual increases) of the maximum deduction available to Tier 1 taxpayers (born before 1946) for private retirement income for retirement/pension benefits (for tax year 2024 this maximum is $64,040 for a single filer and $128,080 for a joint return).

[7] https://www.michigan.gov/mshda/developers/housing-and-community-development-fund-hcdf

[8] https://www.michiganbusiness.org/rap/

[9] https://www.michiganbusiness.org/real-estate/sites-and-buildings/ssrp-and-cip/

[10] https://www.michigan.gov/healthymiplan

- An amount to the Neighborhood Road Fund[11] that varies by fiscal year as described below.
- The balance to the general fund.

The amount allocated above to the Michigan Transportation Fund would be as follows:

- For the 2025-26 state fiscal year, up to $688.0 million, if available.
- For the 2026-27 state fiscal year, up to $776.0 million, if available.
- For the 2027-28 state fiscal year, up to $864 million, if available.
- For the 2028-29 state fiscal year, up to $952.0 million, if available.
- Beginning with the 2029-30 state fiscal year, up to $1,040.0 million, if available.

Other provisions

The bill would repeal section 51d of the Income Tax Act, effective September 30, 2025. That section now provides for a distribution of revenue from the individual income tax to the Michigan Transportation Fund of $600.0 million every October 1.

The bill can take effect only if House Bills 4183, 4951, and 4968 are also enacted into law. Those bills address, respectively, the motor fuel tax, a proposed excise tax on the wholesale price of marijuana, and the insurance provider assessment.

MCL 206.12 et seq.

FISCAL IMPACT:

The bill would make various changes to the Income Tax Act for individuals, resident estates or trusts, and taxpayers subject to the corporate income tax. The bill would also change current earmarks from the individual income tax and the CIT for transportation purposes. The changes are summarized below.

Decoupling from the One Big Beautiful Bill Act (OBBBA)

The bill would decouple from the following five federal tax changes made in the OBBBA:

- Immediate Deduction of Research and Experimental Expenses (IRC 174A)
- Special Depreciation of Certain Production Property (IRC 168(n))
- Bonus Depreciation allowing for deduction of 100% of the cost of equipment in first year (IRC 168(k))
- Business Interest Deduction Increase (IRC 163(j))
- Increased Limit on Depreciable Business Assets Deduction (IRC 179)

Taken together, these provisions were expected to reduce revenues (almost exclusively GF/GP) by approximately $540.0 million in FY 2025-26, $443.0 million in FY 2026-27, $434.0 million in FY 2027-28, $349.0 million in FY 2028-29, and $275.0 million in FY 2029-30 according to the Department of Treasury.

The bill would preempt any state revenue loss from these federal tax changes under the OBBBA by reverting to the pre-OBBBA tax base through decoupling.

[11] The Neighborhood Road Fund, as proposed by House Bill 4230, would be allocated to support the preservation and maintenance of certain bridges and local roads.

Individual income tax

The bill would authorize an individual taxpayer to deduct qualified tips and qualified overtime compensation from adjusted gross income when calculating their state income tax liability for tax years 2026 through 2028. The deductions for qualified tips and qualified overtime compensation were included in the OBBBA to reduce or eliminate the federal tax liability on these forms of income subject to certain limitations.[12] However, because the deductions were considered "below the line," under current law they would not affect an individual taxpayer's Michigan tax base. The bill would permit the deductions against adjusted gross income for state tax liability purposes.

Table 1 provides revenue loss estimates for the deduction for qualified overtime compensation according to the Department of Treasury:

Table 1: Estimated Revenue Loss - Deduction for Qualified Overtime Compensation (millions)

	FY 2025-26	FY 2026-27	FY 2027-28
GF/GP	($97.9)	($110.9)	($97.6)
SAF	(14.6)	(16.6)	(14.6)
TOTAL	**($112.5)**	**($127.4)**	**($112.2)**

Table 2 provides revenue loss estimates for the deduction for qualified tips according to the Department of Treasury:

Table 2: Estimated Revenue Loss - Deduction for Qualified Tips (millions)

	FY 2025-26	FY 2026-27	FY 2027-28
GF/GP	($39.2)	($44.2)	($44.1)
SAF	(5.9)	(6.6)	(6.6)
TOTAL	**($45.1)**	**($50.8)**	**($50.7)**

Retirement tax treatment of taxable Social Security for Tier 3

The bill would allow Tier 3 individuals (taxpayers born after 1952) to exempt taxable Social Security benefits if they choose to take the $20,000 (single)/$40,000 (joint) standard deduction on *all* income after reaching the age of 67. Under current law, Tier 3 individuals who elect the standard deduction against *all* income will have that deduction reduced by the taxable Social Security benefits included in adjusted gross income and the personal exemption amount. By allowing Tier 3 individuals to exempt taxable Social Security benefits, it is expected that the bill would reduce revenues by between $20.0 million and $30.0 million annually. To the extent that the reduction is realized through gross income tax collections (withholding, estimated payments, and annual payments), the School Aid Fund would absorb about 23.8% of the impact, with the rest coming from the general fund If the reduction is a result of higher refunds, the impact would be borne by the general fund.

[12] For more details, see https://www.irs.gov/newsroom/one-big-beautiful-bill-act-tax-deductions-for-working-americans-and-seniors

Earmarks for transportation

The bill would change how FY 2024-25 CIT revenues are distributed by eliminating the $500.0 million deposit into the Strategic Outreach and Attraction Reserve (SOAR) Fund and instead include a new deposit of $250.0 million o the Healthy Michigan Fund. This would also result in an increase of FY 2024-25 general fund revenues from the CIT of $250.0 million.

Beginning in FY 2025-26, the bill would remove the distribution of revenue from the individual income tax to the Michigan Transportation Fund (MTF) of $600.0 million. In its place, the bill would include an earmark of CIT revenue for the Neighborhood Road Fund that would begin at $688.0 million in FY 2025-26 and grow by $88.0 million annually until it reaches a total of $1.04 billion in FY 2029-30, if CIT revenues were great enough to permit the maximum distribution. There would be a corresponding reduction in GF/GP revenues equal to $88.0 million in FY 2025-26, $176.0 million in FY 2026-27, $264.0 million in FY 2027-28, $352.0 million in FY 2028-29, and $440.0 million in each subsequent year.

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