Senate Fiscal Agency
P.O. Box 30036
Lansing, Michigan 48909-7536

BILL ANALYSIS

Telephone: (517) 373-5383
Fax: (517) 373-1986

Senate Bill 768 (Substitute H-3 as passed by the House)
Sponsor: Senator Aric Nesbitt
Senate Committee: Finance
House Committee: Tax Policy (discharged)

CONTENT

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

-- Modify the current framework for the deduction of retirement income and specify that, for a person born after 1945, and, beginning on and after January 1, 2022, when the person reached the age of 62 (instead of 67), he or she would be eligible for an unrestricted deduction of $20,000 for a single return and $40,000 for a joint return.
-- Specify that, in determining taxable income, a person who elected to take the unrestricted retirement income deduction and after that still had certain retirement or pension benefits (e.g., a State or other public pension or a retirement annuity policy) could take an additional deduction of $20,000 for a single return or $40,000 for a joint return against those retirement or pension benefits.
-- Eliminate the prohibition for those born after 1952, once they reach the age of 67, from claiming the personal exemption if they choose to take the unrestricted deduction.
-- Reduce, beginning January 1, 2022, the individual income tax rate from 4.25% to 3.9%.
-- Allow a taxpayer to claim, for tax years beginning on and after January 1, 2022, a nonrefundable tax credit against the individual income tax of $500 for each qualified dependent of the taxpayer.

MCL 206.30 et al. Legislative Analyst: Jeff Mann

FISCAL IMPACT

Assuming the bill were effective April 1, 2022, the bill would reduce revenue to the General Fund and School Aid Fund (SAF) by approximately $1.38 billion in fiscal year (FY) 2021-22, $2.87 billion in FY 2022-23, and $2.52 billion in FY 2023-24. The revenue loss would increase in later years as the economy continues to grow and population demographics increase the number of individuals covered by the bill's provisions. The bill would affect revenue in three ways: 1) it would lower the tax rate levied under the individual income tax (and flow-through entity tax, which mirrors the individual income tax), 2) it would create a new nonrefundable credit for qualified dependents, and 3) it would increase the amount of income certain individuals age 62 or older could deduct from their income. In addition, the bill could affect the distributions to the State under the Coronavirus State and Local Fiscal Recovery Fund (SLFRF) program.

The changes to the tax rate under the individual income tax would be retroactive. As a result, how the impact on tax year 2022 would be distributed across FY 2021-22 and FY 2022-23 would depend on when the bill became effective, how the Department of Treasury altered withholding schedules, and the degree to which payments that already have been made in FY 2021-22 for tax year 2022 resulted in lower annual payments or increased refunds in FY 2022-23 (when taxpayers file their annual returns for tax year 2022). Assuming that any changes in withholding did not capture the retroactive nature of the rate changes, the

individual income tax rate change under the bill would reduce General Fund revenue by $498.3 million in FY 2021-22, $1.34 billion in FY 2022-23 and $1.12 billion in FY 2023-24. To the extent timing issues pushed more of the tax year 2022 impact into FY 2022-23, the revenue loss in FY 2021-22 would be lower and the revenue loss in FY 2022-23 would be greater. 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. Individual income tax revenue is split between the General Fund and the SAF, with the SAF receiving approximately 23.8% of any gross collections. The rate changes would increase the share of individual income tax revenue directed to the SAF to approximately 25.95%.

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 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. 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 tax rate proposed by the bill, approximately 25.9% 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 $658.8 million per year thereafter, and reduce SAF revenue by approximately $87.2 million in FY 2021-22 and $116.3 million per year in later fiscal years.

The bill also would increase the amount of income certain individuals age 62 or older could deduct. Individuals affected by the bill would include those born after 1945 and who are at least 62 years old, although some individuals born after 1945 who do not have retirement income affected by the bill would not experience any change in liability. Some taxpayers would not have sufficient income to fully claim the increased deduction amounts. If effective April 1, 2022, the proposed increased deduction amount for certain individuals age 62 or older would reduce revenue by $295.5 million in FY 2021-22, $754.4 million in FY 2022-23, and $622.3 million in FY 2023-24. These reductions would continue to rise in magnitude as population demographics increased the number of taxpayers eligible for the deductions provided under the bill.

Like the rate changes, the proposed deduction amount for certain seniors would be retroactive for the full tax year in 2022. The relative impact of the increased senior deductions on the General Fund and the SAF would depend on how the increased exemption affected individual income tax withholding, as well as estimated and annual payments, and refunds. Increased refunds would lower only General Fund revenue, while reduced withholding, estimated, or annual payments would be split between the SAF and the General Fund revenue. Assuming an April 1, 2022, effective date, the increased deduction for certain seniors is expected to reduce General Fund revenue by $266.0 million in FY 2021-22, $603.5 million in FY 2022-23, and $497.8 million in FY 2023-24. The reduction to the SAF would be approximately $29.6 million in FY 2021-22, $150.9 million in FY 2022-23, and $124.5 million in FY 2023-24.

Combined, if the bill's provisions became effective April 1, 2022, the bill would reduce General Fund revenue by approximately $1.26 billion in FY 2021-22, $2.61 billion in FY 2022-23, and $2.27 billion in FY 2023-24. Across all changes, the bill would reduce SAF revenue by approximately $116.7 million in FY 2021-22, $267.1 million in FY 2022-23, and $240.7 million in FY 2023-24.

The bill could affect the distributions to the State under the SLFRF program. The American Rescue Plan Act prohibited SLFRF from being used to directly or indirectly offset a change in law, regulation or interpretation that reduces net tax revenue. Any reductions in net tax revenue must be "paid for" either through organic growth, increases in alternative revenue, or spending reductions in areas not replaced by Fiscal Recovery Funds. Organic growth is determined by comparing total tax revenue in a given fiscal year to a "baseline", which is total tax revenue for FY 2018-19, increased for inflation. If the total revenue after the tax changes is equal to or greater than the baseline, it will be assumed that organic growth "paid for" the tax reduction. The Michigan Department of Treasury is working to determine the amount of total tax revenue subject to this calculation, but the SFA is using the amount of State revenue subject to the revenue limit as an estimate of total tax revenue. According to the above estimates of revenue reduction, and current Consensus Revenue Estimating Conference forecasts of total State revenue, it is estimated that the bill would reduce revenue below the baseline by approximately $200.0 million in FY 2021-22, $2.1 billion in FY 2022-23, $1.8 billion in FY 2023-24, for a total of approximately $4.1 billion in revenue reductions that would need to be offset.

Any reduction beyond the amount that can be considered organic growth would need to be offset either by other tax increases or by spending cuts in budget areas that did not receive SLFRF. If the revenue reductions were not fully offset by one of the above methods, any amount of revenue reduction that was not offset would be subject to recoupment by the United States Treasury. Based on enacted appropriations, the State has approximately $4.8 billion in unappropriated SLFRF funds.

Estimated Impact of Senate Bill 768 (H-3)
(in millions, assuming 4/1/22 effective date)

	FY 2021-22	FY 2022-23	FY 2023-24
Reduce tax rate to 3.9%	($498.3)	($1,343.0)	($1,118.1)
Child tax credit	($581.3)	($775.0)	($775.0)
Increase deductions for certain individuals age 62 or older	($295.5)	($754.4)	($622.3)
Total	**($1,375.1)**	**($2,872.4)**	**($2,515.4)**
General Fund	($1,258.3)	($2,605.2)	($2,274.7)
School Aid Fund	($116.7)	($267.1)	($240.7)

Date Completed: 3-3-22

Fiscal Analyst: Ryan Bergan
David Zin

SAS\Floor\sb768b
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.