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END TUITION TAX CREDIT; APPROPS FOR HIGHER ED

Senate Bill 371 (Substitute H-11)
First Analysis (10-23-01)

Sponsor: Sen. John J. H. Schwarz, M.D.
House Committee: Appropriations
Senate Committee: Appropriations

THE APPARENT PROBLEM:

Under the Income Tax Act, a taxpayer can claim a non-refundable credit for eight percent of undergraduate tuition and uniformly required fees paid to a Michigan institution of higher learning, up to a maximum credit of $375 per student per year for up to four years. This tuition tax credit is available to a resident of the state with an adjusted gross income of $200,000 or less for fees and tuition paid on behalf of any student (including the claimant). However, the credit is only available if the student is attending an institution that promises not to raise fees and tuition rates during the next academic year by more than the rate of inflation (specifically, the annual average percentage increase in the U.S. consumer price index for all urban consumers). The original aim of the inflation clause was to put pressure on colleges and universities to restrain tuition increases. Generally speaking, it has not had this result in recent years. Partly, this is because inflation rates have been so low. The inflation cap has, however, severely reduced the number of families eligible for the tax credit. For the 2000 tax year, for example, 22 schools were listed as qualifying institutions in the instruction booklet accompanying the state tax form, including 17 community colleges, 4 private colleges, and only 1 four-year public university.

Leaders of the state's public colleges and universities have argued for some time that the best way to restrain tuition increases is through adequate funding, and have called for an end to the inflation-based tax credit. Governor Engler's proposed budget for fiscal year 2002 recommended an additional increase in appropriations for higher education contingent on the repeal of the tuition tax credit. The recent national economic downturn and the accompanying reduction in anticipated state revenues has led colleges and universities to raise tuition for the current academic year by significant amounts, with double digit increases in some cases. The search for additional revenue for public institutions of higher education has intensified efforts to eliminate the tuition tax credit, with the proceeds to be distributed to institutions of higher education.

THE CONTENT OF THE BILL:

The bill would amend the Income Tax Act so that the undergraduate tuition tax credit would not be available for tax years beginning on or after January 1, 2001. Further, the bill would appropriate additional funds to institutions of higher education, including public universities, community colleges, and, through grants for general degree graduates, private institutions. (The appropriation would total $32.7 million, according to the House Fiscal Agency, with $26.2 million to state universities, $1.3 million to independent colleges and universities, and $5.2 million to community colleges.) Moreover, the bill would specify that it is the intent of the legislature that each public university distribute the 2001-2002 funds to all resident undergraduate students who paid tuition and fees for the fall 2001 academic semester or term. (The "intent" language would not apply to community colleges and private colleges and universities.)

The appropriations in the bill would be made for the 2001-2002 state fiscal year and would be "allocated as base funding increases to be carried over to subsequent fiscal years to provide institutions of higher education and community colleges a greater capacity to moderate tuition charges". The intended distribution to resident undergraduate students at public universities would be on a FYES (fiscal year equated student) basis to students enrolled for the fall 2001 academic semester or term. Part-time students would receive a pro rata share based on FYES. (One FYES equals 30 semester credit hours for students enrolled in public universities.)

Under the bill, a public university would have to certify in writing that it will distribute the appropriated funds to resident undergraduate students on or before December 15, 2001, before the appropriation would be released. If the certification was not received by November 15, a university's funds would be reallocated to the other schools that comply. The state treasurer would release the appropriations to individual public universities no later than ten days after the state budget office received the required certification. The appropriation for the grant for general degree graduates would be released within 45 days after the effective date of the bill.

MCL 206.274

HOUSE COMMITTEE ACTION:

The House Appropriations Committee reported a substitute that differs from the Senate-passed version in several ways. The Senate version intended that both community colleges and public universities distribute funds directly to all undergraduates "on a per capita basis". The House substitute intends that only public universities distribute the money directly (based on per FYES or fiscal year equated students) and limits the distribution to resident undergraduates. The House version allocates money in part based on the proportion of the state's total resident undergraduates that a university has rather than its total number of students, in-state and out-of-state. The allocation of money among public universities (and the per pupil distribution) is different in the two versions. The community college and private college and university allocations are the same in the two versions. In the House version, the allocations per student would range from $133 per resident undergraduate to $225 per resident undergraduate, according the House Fiscal Agency. In the Senate-passed version, according to HFA information, the range would be from $59 per student to $242 per student.

BACKGROUND INFORMATION:

The Department of Treasury's Office of Revenue and Tax Analysis issued a study in February 2001 entitled "Michigan's Experience with the College Tuition Tax Credit". The study can be found on the department's web site at www.treas.state.mi.us/college/TuitionCredit.pdf. The study provides, among other things, a history of the number of qualifying institutions, the total dollar amount of credits per kind of institution, and the average credit amount per kind of institution. It also provides information about credit recipients by adjusted gross income and filing status. Further, the report provides detailed information for years 1995 through 1999 about the number of claimants, the dollar amount of credits claimed, and the average credit for all of the qualifying institutions. The report indicates that in 1998 there were 36 qualifying institutions, $22.4 million of dollars claimed in credits by 145,000 taxpayers, with an average credit of $155. In 1999, however, there were only 14 qualifying institutions, $4.3 million claimed in credits by 56,600 taxpayers, with an average credit of $85 (reflecting that no public universities qualified). The inflation rate affecting the 1999 tax year was 1.6 percent.

FISCAL IMPLICATIONS:

According to the House Fiscal Agency, the bill would appropriate $32.7 million to postsecondary institutions, with $26.2 million for state universities, $1.3 million for independent colleges and universities (through the General Degree Grant Reimbursement Program), and $5.2 million for community colleges. The HFA says the distribution for state universities is based primarily on the university's proportionate share of the total number of resident undergraduate fiscal year equated students in fiscal year 2000-2001 and secondarily on the university's annual state appropriation for fiscal year 2000-2001. For community colleges, the allocations are based on a combination of across-the-board and formula-funding components, using the fiscal year 2000-2001 budget as a base. For independent colleges and universities, the allocation is made through the General Degree Grant Reimbursement Program, which provides a per-graduate amount based on the number of degrees conferred on Michigan residents in the prior academic year. The substitute bill, says the HFA, also repeals the contingent appropriations sections contained in the already-enacted community college and higher education budgets for fiscal year 2001-2002. (HFA fiscal note dated 10-18-01) A chart distributed by the House Fiscal Agency to the House Appropriations Committee indicates the amount per resident undergraduate university student in the House Substitute would be in the $133 to $153 range for Grand Valley State University, Saginaw Valley State, Lake Superior State, Oakland University, University of Michigan at Flint, Central Michigan, University of Michigan at Dearborn, Eastern Michigan, Western Michigan, Ferris State, and Northern Michigan. The amount per resident undergraduate would range from $164 to $225 for Michigan State, Michigan Technological University, Wayne State, and the University of Michigan at Ann Arbor. The average is $158 per resident undergraduate.

ARGUMENTS:

For:

This proposal would eliminate the tuition tax credit in future years and allocate an additional $32.7 million among institutions of higher education in base funding increases to be carried over into the future. This will help restrain future tuition increases. Indeed, the state's public universities are to return this year's additional appropriation directly to resident undergraduates. This will directly benefit over 166,000 university students in the state as opposed to the relative few that would benefit this year from the tuition tax credit. The allocations to community colleges and private colleges and universities will indirectly benefit students, as well. The bill will help the families of students in a year when tuition increases are significant (as well as in future years with the additional dollars for institutional budgets).

Generally speaking, the tuition tax credit is not working as a means of holding down college tuition. Few four-year institutions have made the list of eligible colleges in recent years: only one in 2000 and none in 1999. (It should be noted that inflation rates have been very low recently; in fact, inflation averaged just over two percent for the three years 1997 through 1999, according to the Department of Treasury.) Most credit recipients are community college students and their credits are relatively small. Further, many tax filers who are eligible don't apply for the credit. Higher education leaders have consistently advocated the repeal of this credit, arguing that adequate state funding is the best means of holding the line on tuition. They say that tuition was held in line when appropriations were at levels to make that possible. Currently, universities face double digit increases in utility costs and health care, while receiving lower appropriation increases than in the past. At a time of very tight budgets and gloomy revenue forecasts, it makes sense to take the money dedicated to the tuition tax credit and put it directly into the higher education budget.

Against:

Critics say there are a number of reasons to resist this proposal. For one thing, it is the repeal of a tax break in the face of budget difficulties, which some people believe is on its face the wrong approach to state tax and spending policies. While the credit may have limited application, every year there are families who benefit from it. There are many credits and deductions throughout the state's tax laws with limited application whose repeal would produce additional revenue for use in the higher education (and other) budgets. Indeed, why should revenue saved by repealing the tuition tax credit go to the higher education budget anyway, particularly in a time in which all budgets are under stress and face new scrutiny? And, if the problem with the tuition credit is that few people are eligible, that could easily be solved by adjusting or removing the inflation clause and making the credit available to nearly all families with students enrolled in higher education. This bill would redistribute dollars away from current tax credit recipients (mostly community college students at present) attending institutions that are holding down tuition and send them to all resident undergraduate students based, in part, on the current appropriations level of the institution attended. Is this fair?

POSITIONS:

The Department of Management and Budget supports ending the tuition tax credit and appropriating the additional money for higher education. (10-22-01)

The President Council, State Universities of Michigan supports repeal of the tuition tax credit and an increase in the base funding for universities. (10-22-01)

The Michigan Community College Association supports the bill. (10-22-01)

The Association of Independent Colleges and Universities of Michigan supports the bill. (10-22-01)

Analyst: C. Couch

■This analysis was prepared by nonpartisan House staff for use by House members in their deliberations, and does not constitute an official statement of legislative intent.