# Legislative Analysis

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**INCOME TAX CHANGES**

**House Bill 5420 (proposed substitute H-1)**
**Sponsor: Rep. Roger Hauck**

**House Bill 5421 as introduced**
**Sponsor: Rep. Jeffrey R. Noble**

**House Bill 5422 as introduced**
**Sponsor: Rep. Jim Tedder**

**Committee: Tax Policy**
**Complete to 1-16-18**

**BRIEF SUMMARY:**

HB 5420 would amend the Income Tax Act to:

- Change definitions and references to reflect the recently enacted federal Tax Cut and Jobs Act of 2017, and remove references to personal and dependency exemptions allowed on a taxpayer's federal income tax return.
- Allow a taxpayer to claim personal and dependency exemptions on the state income tax, and set the amount of the exemption in statute at $4,300 for the 2018 tax year, $4,600 for the 2019 tax year, and $4,800 for the 2020 tax year and each tax year thereafter.

[An exemption reduces the amount of income subject to tax.]

HB 5421 would amend the City Income Tax Act to strike references to the federal Internal Revenue Code and replace them with references to the Income Tax Act, with regard to deductions for the personal and dependency exemptions on city income taxes.

HB 5422 would amend the Income Tax Act to allow a "qualified taxpayer" (an individual who is at least 62 years old at the close of the tax year) to claim a $100 or $200 credit (single filer/joint filer) against the income tax.

[A credit directly reduces tax liability.]

The bills are tie-barred, meaning that none could take effect unless all three were enacted into law.

**DETAILED SUMMARY:**

HB 5420
Currently under the Income Tax Act, a taxpayer can claim a personal exemption and multiply the amount by the number of personal or dependency exemptions "allowable on

the taxpayer's federal income tax return pursuant to the internal revenue code." The bill would remove the reference to the federal income tax return and provide for the determination of exemptions as follows:

- Each taxpayer may claim 1 personal exemption. If a joint return is not made by the taxpayer and his or her spouse, the taxpayer may claim a personal exemption for the spouse if the spouse does not have any gross income and is not the dependent of another taxpayer.
- A taxpayer may claim a dependency exemption for each individual who is a dependent of the taxpayer for the tax year.

Currently under the act, the personal exemption amount is set at either an inflation-adjusted amount (rounded to the nearest $100) or an amount specifically set in statute, whichever is greater. The personal exemption amount for tax year 2017 is $4,000.

The bill would set the following amounts in statute for the personal exemption:

- On and after January 1, 2014 and before January 1, 2018: $4,000.
- For the 2018 tax year: $4,300.
- For the 2019 tax year: $4,600.
- For the 2020 tax year and each tax year after 2020: $4,800.

The bill would repeal section 30e of the Income Tax Act. This section defines "dependent" as an individual for whom the taxpayer may claim a dependency exemption on the taxpayer's federal income tax return pursuant to the Internal Revenue Code.

The bill would add "dependent" to the definitions section of the act, and define it as "a dependent as defined in section 152 of the internal revenue code."

The bill would change the definition of "internal revenue code" and define it as the United States internal revenue code of 1986 in effect on January 1, 2018.

MCL 206.8 et seq.

<u>HB 5421</u>
Currently under the City Income Tax Act, when computing taxable income, a taxpayer is allowed deductions for the personal dependency exemptions authorized by "the federal internal revenue code." The bill would remove this language, and instead refer to personal and dependency exemptions authorized by "Part 1 of the Income Tax Act of 1967" (i.e., the changes proposed in <u>HB 5420</u>).

MCL 141.631 and 141.644

<u>HB 5422</u>
The bill would add a new section to the Income Tax Act. For the 2018 tax year and each tax year thereafter, a "qualified taxpayer" could claim a $100 credit against the income tax, or a $200 credit for a joint return if both taxpayers were "qualified taxpayers." If the credit

allowed exceeded the tax liability of the taxpayer, the amount that exceeded the tax liability would be refunded.

The bill would define "qualified taxpayer" to mean an individual who is 62 years of age or older at the close of the tax year.

Proposed MCL 206.254

**FISCAL IMPACT:**

HB 5420

Under current law, the personal exemption is projected to increase due to inflationary adjustments from $4,000 in TY 2018 to $4,100 for TY 2019, $4,200 for TY 2020, and $4,300 for TY 2021. In contrast House Bill 5420 would increase the personal exemption to $4,300 in TY 2018, $4,600 in TY 2019, and $4,800 in TY 2020 and subsequent years until the inflation-adjusted amount under current law exceeds $4,800 at some point in the future. The table below presents the estimated personal exemption under current law, the proposed personal exemption under House Bill 5420, and the estimated annual and cumulative revenue impacts.

| Tax Year | Current Law Personal Exemption | Proposed Personal Exemption | Fiscal Year | Annual Impact (millions) |
|---|---|---|---|---|
| 2018 | $4,000 | $4,300 | FY 2017-18 | -$45.0 |
| 2019 | $4,100 | $4,600 | FY 2018-19 | -$157.5 |
| 2020 | $4,200 | $4,800 | FY 2019-20 | -$172.5 |
| 2021 | $4,300 | $4,800 | FY 2020-21 | -$157.5 |

Because increasing the personal exemption reduces individual income tax withholding, about 23.8% of the revenue loss will come from the School Aid Fund, with the remainder reducing general fund revenue.

HB 5421

As written, House Bill 5421 would simply make technical amendments to the City Income Tax Act to change the definition of personal and dependency exemptions. Under current law, personal and dependent exemptions are defined by referencing the federal internal revenue code. However, to prevent any unintended consequences the federal Tax Cut and Jobs Act of 2017 might have toward eliminating the personal exemption in the City Income Tax Act, the definition is changed to reference the state Income Tax Act of 1967. Because the bill would be maintaining the existing personal and dependent exemptions, it would have no fiscal impact.

HB 5422

Relative to current law, the bill would reduce net income tax revenue by approximately $200.0 million on an annual basis. According to 2016 population estimates, there were just under 2.0 million individuals aged 62 and over in Michigan, so if each senior filed for a credit, the net cost would approach $200.0 million. Because the credit would increase refunds (or reduce payments), the bulk of the revenue loss would be borne by the general fund.

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