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BILL



ANALYSIS

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House Bill 5420 (Substitute H-4 as reported without amendment)
House Bill 5421 (as reported without amendment)
House Bill 5422 (Substitute H-1 as reported without amendment)
Sponsor: Representative Roger Hauck (H.B. 5420)
Representative Jeffrey R. Noble (H.B. 5421)
Representative Jim Tedder (H.B. 5422)

House Committee: Tax Policy
Senate Committee: Finance

CONTENT

House Bill 5420 (H-4) would amend Part 1 of the Income Tax Act to do the following:

- Specify the number of personal and dependency exemptions a taxpayer would be allowed, and delete language under which the number of exemptions depends on the number allowed on a taxpayer's Federal return.
- Increase the personal exemption from the current \$4,000 to \$4,300 for the 2018 tax year, \$4,600 for the 2019 tax year, and \$4,800 for the 2020 tax year and each subsequent tax year.
- Require an amount equal to all revenue the State School Aid Fund lost as a result of the bill's changes regarding personal and dependency exemptions to be deposited in the Fund.
- Specify that an individual with respect to whom a deduction was allowable to another taxpayer during the tax year would not be considered to have an allowable exemption for purposes of the Act's personal exemption calculation, and would be exempt from the income tax and not required to file a return, if the person had an adjusted gross income of \$1,500 or less.
- Revise the deduction for contributions to and distributions from an ABLE savings account, and interest earned on contributions to education savings accounts.

House Bill 5421 would amend the City Income Tax Act to do the following:

- Allow a taxpayer deductions for the full personal and dependency exemptions authorized by Part 1 of the Income Tax Act, instead of under the Internal Revenue Code, or a deduction of a minimum of \$600 for each personal and dependency exemption under the rules for determining exemptions and dependents under Part 1, instead of under the Internal Revenue Code.
- Allow a city to provide an exemption of a certain amount for a person with respect to whom a deduction under Part 1 of the Income Tax Act, instead of the Internal Revenue Code, would be allowable to another taxpayer and was therefore not considered to have a personal exemption.

House Bill 5422 (H-1) would amend the Income Tax Act to allow an individual who was 62 years of age or older at the close of the tax year to claim a \$100 credit for a single or joint return, or a \$200 credit for a joint return if each spouse filing the return were 62 or older, for the 2018 tax year and each subsequent tax year.

FISCAL IMPACT

House Bill 5420 (H-4) would reduce General Fund revenue from currently forecasted amounts by an unknown but significant amount in fiscal year (FY) 2017-18 and FY 2018-19, depending on when the bill's changes became effective, by approximately \$168.6 million in FY 2019-20, and by a lesser amount that would decline each subsequent fiscal year--reaching zero by approximately FY 2026-27.

The reduction in revenue during FY 2017-18 and FY 2018-19 would depend on when the bill was effective. If the changes for tax year 2018 were made retroactive, and effective beginning January 1, 2018, and income tax payments and withholding tables were adjusted to reflect that retroactivity, the bill would reduce FY 2017-18 General Fund revenue by approximately \$66.8 million and FY 2018-19 revenue by \$132.7 million. However, if the bill's changes were not effective until April 1, 2018, revenue in FY 2017-18 would be reduced by approximately \$44.5 million; however, the revenue reduction in FY 2018-19 would increase to approximately \$155.0 million.

The impact of the bill would decline after FY 2019-20 because the difference between the value of the personal exemption under the bill and under current law would decline. Depending on the inflation rate over time, the difference would be expected to be eliminated by approximately FY 2026-27.

Under current law, approximately 23.8% of gross income tax revenue is earmarked to the School Aid Fund; and an increase in the personal exemption would lower School Aid Fund revenue. However, the bill would increase the earmark of revenue to the School Aid Fund to offset the loss. As a result, if the bill lowered FY 2018-19 revenue by \$155.0 million, the earmark of revenue to the School Aid Fund would increase by \$36.9 million, so the entire \$155.0 million in lower collections would reduce General Fund revenue.

In addition to the bill's impact relative to current revenue forecasts, the bill would reduce General Fund revenue relative to current law by approximately \$1.1 billion in FY 2017-18, and approximately \$1.4 billion in FY 2018-19. The revenue loss relative to current law would increase in subsequent fiscal years. These additional losses would reflect that the Federal tax reform legislation adopted in December 2017 would effectively eliminate the personal exemption under the Michigan individual income tax, thereby increasing revenue by approximately \$1.1 billion in FY 2017-18 and \$1.4 billion in FY 2018-19 (and additional amounts in future fiscal years). The bill's changes regarding the definition of "dependent" are meant to effectively decouple Michigan's current individual income tax provisions for dependents from the Federal tax reform changes. However, current revenue estimates do not account for the impact of Federal tax reform on Michigan's statutory tax provisions. Consequently, while the bill's changes to the definition would lower revenue relative to current law, the changes would not lower revenue relative to current revenue estimates.

While the changes in the definition of "dependent" would not lower revenue below current revenue estimates, the bill also would increase the personal exemption amount above the levels that would exist if the bill only decoupled Michigan tax provisions from the Federal tax reform legislation. As a result, the bill also would reduce revenue relative to currently forecasted levels.

House Bill 5421 would have no impact on State revenue or expenditure. However, the bill would prevent an increase in local unit revenue resulting from the passage of Federal tax reform legislation in December 2017. Without the enactment of this proposal, the Federal tax reform legislation adopted in December 2017 will effectively eliminate the personal exemption under city income taxes. Based on data from 2014, approximately 1.5 million exemptions were claimed with cities under their income tax ordinances (approximately 600,000 resident returns and approximately 900,000 nonresident and part-year resident returns). Statute requires city income tax ordinances to provide a personal exemption of at least \$600 per allowable exemption. Several cities, including Battle Creek, Grayling, Hudson, Ionia, Portland, Saginaw, and Springfield, provide exemptions that exceed \$600. Based on 2014 data, the increase in local unit revenue attributable to the Federal changes will be approximately \$9.9 million under existing law. Thus, the bill would prevent local unit revenue from increasing by \$9.9 million per year.

House Bill 5422 (H-1) would reduce General Fund revenue by approximately \$200.4 million in fiscal year 2018-19. Due to changes in age demographics, the revenue loss would increase in future years, with the loss totaling \$205.4 million in FY 2019-20 and \$210.3 million in FY 2020-21.

Date Completed: 2-1-18

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