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BILL ANALYSIS

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Senate Bill 378 (Substitute S-1 as reported by Committee of the Whole)
Sponsor: Senator Jim Runestad
Committee: Finance

CONTENT

The bill would amend the Income Tax Act to allow a taxpayer to claim a $500 credit against his or her individual income tax for each of the taxpayer's qualified dependents for tax years that begin on and after January 1, 2022, through December 31, 2025. If the credit exceeded the taxpayer's tax liability for that tax year, the portion of the credit that exceeded the liability would not be refunded.

MCL 206.254 Legislative Analyst: Christian Schmidt

FISCAL IMPACT

The bill would reduce State individual income tax revenue to the General Fund and School Aid Fund by approximately $725.0 million per year for fiscal year (FY) 2022-23 through FY 2025-26.

Before tax year 2012, Michigan offered a deduction for dependent children under the age of 19, at $600 per child. In tax year 2011, the last year of the deduction, deductions were claimed for 2.3 million children age 18 and under. Because, in some cases, taxpayers were unable to claim the full deduction (the value of the standard deductions/personal exemptions plus any additional child deductions exceeded income), the provision was estimated to reduce revenue to the State by $51.6 million in FY 2010-11. The tax rate for tax year 2011 was 4.35%, implying the provision would have reduced revenue by $50.4 million under the current 4.25% tax rate.

Tax credits reduce revenue substantially more than an income deduction of the same amount. A $500 per child deduction lowers the tax liability by the income times the tax rate, and under the current 4.25% tax rate, such a deduction generally would be $21 per child (compared to a $500 per child reduction under a $500 per child credit). Essentially, the credit would be equivalent, at a 4.25% rate, to deducting approximately $11,765 of income per child.

The credit would be nonrefundable, meaning that if the amount of the credit exceeded tax liability before credits, the excess would not be refunded (nor cost the State revenue). However, given that the average tax liability before credits is about $2,100 per return, the nonrefundability provisions would have a substantial chance of eliminating the individual income tax liability for a substantial number of taxpayers because child dependents represent about 26% of the dependents claimed by all taxpayers.

Without accounting for nonrefundability, the bill likely would cost the State approximately $1.15 billion. Using 2011 tax year data (the most recent year for which returns provided information regarding the dependents potentially eligible for the credit), the nonrefundability issue appears to be relatively significant and would have reduced the revenue loss to $711.4 million.

Average and total income have increased in Michigan since 2011, so the impact of the nonrefundability provisions likely would be less than it would have been in 2011. Adjusted gross income on Michigan returns increased 47.1% between tax year 2011 and 2019 (the latest tax year for which data are available). However, the impact of the bill would depend on the distribution of income and returns that could claim the credit. Based on a preliminary analysis, nonrefundability would appear to reduce the revenue loss to $725.0 million per year based on 2019 income data.

Virtually all of the impact would affect General Fund revenue and would affect revenue in FY 2022-23 through FY 2025-26. There could be some reduction in FY 2021-22 if taxpayers adjusted withholding to reflect anticipated credits. Generally, most of the impact likely would affect annual payments, either by lowering annual payments or by increasing refunds attributable to refundable credits. Assuming an 80/20 split across refunds versus reduced payments (about 20% of returns have a payment due), the split at a $725.0 million reduction would be to reduce School Aid Fund revenue by $34.5 million and General Fund revenue by $690.5 million per year.

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