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

BILL ANALYSIS

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

Senate Bill 378 (as introduced 4-21-21)
Sponsor: Senator Jim Runestad
Committee: Finance

Date Completed: 4-28-21

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 dependent for tax years that begin on and after January 1, 2021, through December 31, 2024.

The bill specifies that, for tax years beginning on and after January 1, 2021, through December 31, 2024, a taxpayer could claim a credit against the individual income tax equal to $500 for each qualified dependent of the taxpayer for which an exemption was claimed under Section 30(2)(b) for that same tax year. If the credit exceeded the tax liability of the taxpayer for the tax year, that portion of the credit that exceeded the tax liability would not be refunded. (Section 30(2)(b) of the Act allows a taxpayer to claim a dependency exemption against his or her taxable income for each individual who is a dependent of the taxpayer for the tax year.)

"Qualified dependent" would mean a dependent who is younger than 19 years of age on the last day of the tax year for which the credit is claimed.

Proposed 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) 2021-22 through FY 2024-25. When combined with the likely prospect that the bill would eliminate forecasted reductions in the individual income tax rate under Michigan Compiled Laws 206.51, the net revenue reduction compared to current-law estimates would decline from $725.0 million in FY 2021-22 to $201.0 million in FY 2024-25.

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 is 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 2021-22 through FY 2024-25. There could be some reduction in FY 2020-21 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.

The bill likely would eliminate the currently forecasted rate reduction in the individual income tax rate estimated to occur in FY 2022-23. Based on the January 2021 Consensus Revenue Estimates, the triggered rate reduction is anticipated to lower revenue by $193.0 million in FY 2022-23, $439.0 million in FY 2023-24, and $524.0 million in FY 2024-25. As a result, the net fiscal impact of the bill would be less in FY 2023-23 through FY 2024-25. The combined impact of the bill and the eliminated rate reductions under the income tax rate trigger would be to lower revenue by approximately $725.0 million in FY 2021-22, $532.0 million in FY 2022-23, $286.0 million in FY 2023-24, and $201.0 million in FY 2024-25.

Fiscal Analyst: David Zin

SAS\S2122\s378sa