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BILL ANALYSIS

House Bill 4961 (Substitute H-1 as passed by the House)
Sponsor: Representative Ann Bollin
House Committee: Finance (discharged)
Senate Committee: Committee of the Whole

Date Completed: 10-1-25

INTRODUCTION

Generally, the bill would modify Michigan's income tax policy in response to Public Law 119-21 (also known as the One Big Beautiful Bill Act, or OBBBA) and allocate income tax revenue to fund roads. Public Law 119-21 made significant changes to Federal business tax policy, broadly expanding deductions and exemptions for firms (see **BACKGROUND**). Some of these changes would reduce Michigan corporate income tax (CIT) and individual income tax (IIT) revenue. The bill would effectively "decouple" the State from these changes to avoid the revenue loss, requiring taxpayers to use pre-Public Law 119-21 policies; however, the bill incorporates certain changes made by Public Law 119-21, including the creation of parallel income tax deductions for qualified tips and qualified overtime compensation. The bill also would modify tax allocations for Fiscal Year (FY) 2025-26 through FY 2029-30 and make technical changes to the deduction of retirement and pension benefits for individuals born after 1952 who have turned 67.

The bill is tie-barred to House Bills 4183, 4951, and 4968. House Bill 4183 would increase the gas tax beginning October 1, 2025. House Bill 4951 would impose a 24% excise tax on the wholesale price of marihuana and allocate the revenue to the Neighborhood Road Fund for disbursement to municipalities for local road funding. House Bill 4968 would modify requirements concerning insurance provider assessments to comply with Federal law.

BRIEF FISCAL IMPACT

The bill would increase State General Fund and School Aid Fund (SAF) revenue in FY 2024-25 and later largely by preventing a loss of revenue due to Federal tax changes associated with Public Law 119-21. The impact on each fund would vary by year, with averted General Fund reductions generally in the $275.0 to $540.0 million range between FY 2025-26 and FY 2029-30 and averted SAF reductions averaging about $12.5 million per year. The bill would also implement provisions parallel to those in Public Law 119-21, reducing General Fund revenue by an average of $166.2 million between FY 2025-26 and FY 2027-28 and SAF reductions averaging approximately $21.6 million per year. The bill would reduce revenue to the Strategic Outreach and Attraction Reserve Fund (SOAR) by $500.0 million and increase revenue to the Healthy Michigan Fund by $250.0 million in FY 2024-25. The bill would increase revenue to the Neighborhood Road Fund by $688.0 million in FY 2025-26, increasing to $1.0 billion in FY 2029-30, while decreasing revenue to the Michigan Transportation Fund by $600.0 million per year beginning in FY 2025-26. The net impact of the bill's changes on combined General Fund and SAF revenue would increase revenue by $250.0 million in FY 2024-25, $294.5 million in FY 2025-26, $88.8 million in FY 2026-27, and $6.1 million in FY 2027-28; while decreasing State revenue by $3.0 million in FY 2028-29 and $175.0 million in FY 2029-30.

MCL 206.12 et al. Legislative Analyst: Abby Schneider Fiscal Analyst: David Zin

CONTENT

The bill would amend the Income Tax Act to do the following:

- **Establish income tax allocations for FY 2024-25 through FY 2029-30, which would generally increase road funding by an average of 12% each fiscal year.**
- **Specify under which sections of the Internal Revenue Code (IRC) a taxpayer's adjusted gross income (AGI) and Federal taxable income could be calculated, for tax years following tax year 2021.**
- **Establish State income tax deductions for qualified tips and qualified overtime compensation.**
- **Modify restrictions on retirement and pension benefit deductions for individuals born after 1952, generally to sunset these provisions on January 1, 2029.**

Revenue Allocation

Among other things, the Act establishes allocations for income tax revenue. The bill would sunset current allocations under the Income Tax Act on September 31, 2024; however, it would maintain the following earmarks under the CIT for FY 2024-25 *only*:

- $1.2 billion to the General Fund.
- After the previous deposit, up to $50.0 million to the Michigan Housing and Community Development Fund.
- After the previous deposits, up to $50.0 million to the Revitalization and Placemaking Fund.

Currently, the State is scheduled to deposit up to $500.0 million of CIT revenue in the SOAR Fund. Instead, the bill would require the State to deposit $250.0 million of CIT revenue in the Healthy Michigan Fund. After these deposits were made, the balance of any CIT revenue would have to be deposited in the General Fund.

The bill would establish CIT allocations for FY 2025-26 through FY 2029-30 as follows:

	Proposed FY 2025-26 Allocations	Proposed FY 2026-27 Allocations	Proposed FY 2027-28 Allocations	Proposed FY 2028-29 Allocations	Proposed FY 2029-30 Allocations
General Fund	$1.2 billion	$1.2 billion	$1.2 billion	$1.2 billion	$1.2 billion
MI Housing and Community Development Fund	Up to $50.0 million	Up to $50.0 million	Up to $50.0 million	Up to $50.0 million	Up to $50.0 million
Neighborhood Road Fund	Up to $688.0 million	Up to $776.0 million	Up to $864.0 million	Up to $952.0 million	Up to $1.0 billion

Remaining CIT revenue would have to be deposited into the General Fund.

Calculations; Federal Income

Generally, Federal AGI for individuals is a taxpayer's total gross income minus specific adjustments, calculated on a taxpayer's Federal income tax form. This includes additions, such as tips, capital gains, IRA distributions, and alimony, as well as subtractions, including capital gains losses, student loan interest, IRA contributions, alimony paid, and self-employment taxes. The Michigan Department of Treasury requires a taxpayer to add or subtract certain items from the taxpayer's Federal AGI to calculate State taxable income. As a taxpayer's Federal AGI serves as the basis for this calculation, changes made to Federal adjustments affect State revenue. Businesses calculate a similar concept termed Federal Taxable Income and the measure serves as the basis for computing business tax liabilities under the Act.

When used in computing Michigan liabilities, the bill would require Federal AGI or taxable income for tax years following the 2024 tax year to be calculated according to Sections 163(j), 168(k), 174, and 179 of the IRC, as those provisions were in effect on December 31, 2024.[1] (Generally, these sections concern deductible business interest expenses, special allowances for qualified property, deductible foreign research or experimental expenditures, and deductible depreciable business assets, respectively. For an overview of the Public Law 119-21's impact on these sections, see **BACKGROUND**)

The bill also would require the Federal income measures used for computing Michigan liabilities, as well as AGI calculations, calculated for tax years following the 2021 tax year to not apply Sections 168(n) and 174A of the IRC (see **BACKGROUND**). These sections cover depreciation deduction for qualified production property and deductions for domestic research and experimental expenditures. Both sections were introduced by Public Law 119-21.

Additional Deductions

In addition to other changes, Public Law 119-21 allows certain employees and self-employed individuals to deduct qualified tips and qualified overtime compensation (e.g., the pay that exceeds an individual's regular rate of pay) from their Federal income tax for tax years 2025 through 2028.

The bill would establish parallel deductions, allowing a taxpayer to deduct from the taxpayer's State income tax, to the extent not deducted in determining AGI, an amount equal to the qualified tip or qualified overtime compensation that the taxpayer claimed on the taxpayer's Federal income tax return, for tax years 2026 through 2028.

If a taxpayer were a nonresident, only qualified tips and qualified overtime compensation attributable to services performed in the State could be deducted as outlined above.

Social Security Changes

Under the Act, a taxpayer's birth year determines how that taxpayer's retirement income is taxed. For taxpayers filing jointly, the birth year of the older spouse determines the treatment of the taxpayers' retirement income. Currently, depending on the provisions under which a taxpayer chooses to file, an individual born after 1952 cannot deduct from the taxpayer's AGI retirement or pension benefits, excluding Social Security income.[2]

For a taxpayer choosing to file under these provisions, when an individual born after 1952 reaches the age of 67, that individual becomes eligible for a deduction of $20,000 (for a single return) or $40,000 (for a joint return) against all types of income; however, an individual who takes this unrestricted deduction becomes ineligible to deduct Social Security income or to

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[1] See the House Fiscal Agency's Fiscal Brief, "The One Big Beautiful Bill Act of 2025".

[2] Generally, this means 1) retirement or pension benefits received from a Federal, State, or local public retirement system, 2) retirement or pension benefits received from another state's public retirement system, if the income tax laws of the other state permitted a similar or reciprocal deduction or exemption to a system in the State, and 3) other retirement or pension benefits from any other retirement or pension system or benefits from a retirement annuity policy in which payments are made for life to a senior citizen.

claim a personal tax exemption.[3] An individual may elect to continue deducting Social Security income and claim the personal tax exemption, foregoing the unrestricted deduction, if that individual's tax liability would be lower.

The bill would modify these provisions to account for changes made by Public Law 119-21 regarding the taxation of Social Security benefits at the Federal level. As these Federal changes only affect tax years 2026 through 2028, the bill would only modify the Michigan provisions for those tax years.

MCL 206.12 et al.

BACKGROUND

Generally, Public Law 119-21 made significant changes to Federal business tax policy in the following ways:

-- Modified the definition of adjusted taxable income, effectively allowing businesses to increase their business interest expense deductions.
-- Increased the Section 179 (depreciable business asset) deduction limit.
-- Restored the 100% bonus depreciation for qualifying property from the Tax Cuts and Jobs Act, which allows an eligible firm to deduct 100% of the acquisition costs of an eligible property.
-- Allowed firms to immediately deduct domestic research and experimental expenditures, rather than amortizing these costs over a period of five years.
-- Allowed firms to expense qualified production property (generally, property used for manufacturing purposes) that met certain requirements.[4]

Legislative Analyst: Abby Schneider

FISCAL IMPACT

Broadly, the bill would affect revenue in three ways:

1) Separating, or decoupling, from recently enacted Federal provisions that would lower Michigan tax revenue under the Act.
2) Adding parallel provisions to recently enacted Federal legislation that would not otherwise affect Michigan tax revenue under the Act.
3) Altering the distribution of revenue collected under the Act.

Regarding decoupling, Public Law 119-21 made numerous changes to the Federal tax code. Some of the changes affect the computation of Federal income numbers that are used when calculating Michigan tax liabilities. As a result, absent changing Michigan statute, the impact of the Federal changes will automatically be carried over to affect Michigan tax liabilities. On several occasions over the last 30 years, Michigan has enacted statutory changes to prevent Federal changes from affecting Michigan revenue. A relatively recent example would be Public Act 38 of 2018, which addressed issues related to the personal exemption.

The bill would decouple Michigan's tax base from five provisions in Public Law 119-21 estimated to potentially have the greatest impact on Michigan tax revenue. These Federal provisions concern accelerated depreciation, research and experimentation expenses,

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[3] For tax year 2025, the exemption equates to $5,800 per filer.
[4] Koorstra, Kevin, "The One Big Beautiful Bill Act of 2025", House Fiscal Agency Fiscal Brief, July 21, 2025.

qualified production property, the business interest deduction, and the expensing of certain depreciable business assets. Some of the changes in the Federal law are retroactive. Decoupling from these changes would prevent a revenue loss of approximately $540.0 million in FY 2025-26, $443.0 million in FY 2026-27, $433.0 million in FY 2027-28 as well as additional losses in later fiscal years. Of these potential revenue losses, approximately $10.0 to $15.0 million each year would represent a loss to the SAF, with the remaining impact falling on the General Fund.

Public Law 119-21 also changes Federal law in ways that would not automatically flow through to affect Michigan tax liabilities, including provisions reducing the Federal taxes due on selected overtime wages and certain tip income over the next three years. The bill would add parallel provisions to allow taxpayers able to claim these deductions at the Federal level to reduce their Michigan taxes as well. The bill also would make technical changes to resolve interactions between the Federal tax changes and taxpayers born after 1952 filing under certain retirement income provisions. The fiscal impact assumes the dates for those changes are corrected to correctly exclude the three-year period for which the Federal changes are valid. Combined, these "follow-on" provisions are expected to reduce State revenue by approximately $158.0 million in FY 2025-26, $178.0 million in FY 2026-27, and $163.0 million in FY 2027-28, of which approximately $20.0 million per year would be SAF revenue and the remainder would reduce General Fund revenue.

For revenue collected under Act, the bill would change the distribution of revenue. These changes would not affect the total amount of revenue collected by the State; however, the provisions would increase General Fund revenue by $250.0 million in FY 2024-25, and then lower General Fund revenue by $88.0 million in FY 2025-26, $176.0 million in FY 2026-27, $264.0 million in FY 2027-28, $352.0 million in FY 2028-29, and $440.0 million per year for FY 2029-30 and later years. Among the other distributional changes, in FY 2024-25 the bill would reduce revenue to the SOAR Fund by $500.0 million and increase revenue to the Healthy Michigan Fund by $250.0 million. For FY 2025-26 and later, the bill would repeal the earmark of $600.0 million of IIT to the Michigan Transportation Fund, thereby increasing General Fund revenue by the same amount. Offsetting that change in the IIT earmark, the bill would earmark $688.0 million of CIT revenue to the Michigan Transportation Fund in FY 2025-26, thereby reducing General Fund revenue by the same amount. The CIT earmark would increase by $88.0 million per year through FY 2029-30. The distributional changes under the bill would not affect SAF revenue.

Summary of Combined General Fund/SAF Impact of <u>House Bill 4961 (H-1)</u>, in millions of dollars						
Provision Category	**FY 2024-25**	**FY 2025-26**	**FY 2026-27**	**FY 2027-28**	**FY 2028-29**	**FY 2029-30**
Decoupling	$0	$540.0	$443.0	$433.0	$349.0	$275.0
Follow-on	0	-158.0	-178.0	-163.0	0	0
Distribution	250.0	-88.0	-176.0	-264.0	-352.0	-440.0
Total	$250.0	$295.0	$89.0	$6.0	-$3.0	-$165.0

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This analysis was prepared by nonpartisan Senate staff for use by the Senate in its deliberations and does not constitute an official statement of legislative intent.