SFA BILL ANALYSIS
Senate Fiscal Agency • Lansing, Michigan 48909 • (517) 373-5383

Senate Bill 324 (Substitute S-2 as passed by the Senate)
Sponsor: Senator Doug Carl
Committee: Finance

Date Completed: 7-27-89

RATIONALE

Alzheimer's Exemption

The costs associated with caring for a senior who has Alzheimer's disease and can no longer care for himself or herself, or who has a disorder that demands daily care, continue to rise. While there are many persons with Alzheimer's or a related disorder who are hospitalized or placed in senior centers and whose care is paid in whole or in part by the State, there are many others who are cared for in a relative's or other person's home. It has been pointed out that such care places a financial burden on the care-giver while relieving public agencies of much of the financial responsibility. Some people feel that the State could help such care-givers if it allowed them to claim an income tax exemption for caring for a senior with Alzheimer's or another affliction.

Lottery Tax

Public Act 516 of 1988, passed late last December, amended the Income Tax Act to require taxpayers to include lottery prizes as ordinary income, beginning with the 1988 tax year. Prior to the passage of Public Act 516, taxpayers were allowed to exempt lottery winnings from State and local taxes; winnings have always been subject to Federal income taxes. Some people argue, however, that the taxing of lottery prizes should not have been retroactive, that is, should not have applied to prizes that were won in 1988 or previous years. In fact, lawsuits reportedly have been filed against the State to challenge the ability of the State to tax lottery prizes awarded in 1988 or beyond but won in 1988 or previous years. It has been suggested that the tax on lottery prizes should apply only to prizes won after January 1, 1989.

MET Deduction

Under the Income Tax Act, a taxpayer can deduct payments he or she made to purchase an advance tuition payment contract from the Michigan Education Trust (MET) or a private sector investment manager. (In order to deduct a payment made for a contract purchased from a private investment manager, the contract must be certified by the MET board of directors and meet other criteria specified in the Act.) Representatives of the Department of Treasury have stated that when legislation was enacted to institute the MET program, it was not anticipated that the beneficiaries of MET contracts--students who have their tuition paid through the program--would have to pay income tax on the tuition payments because it was thought that the payments would not be considered income for Federal tax purposes. The Internal Revenue Service ruled in March 1988, however, that benefits received under a MET contract will be considered taxable income to the extent that the value realized exceeds the cost of the contract. Because Michigan's income tax is based on an individual's Federal adjusted gross income, then, inclusion of a tuition payment as Federal taxable income means that the payment is also subject to tax under the Income Tax Act. It has been suggested that the Act be amended to allow persons to deduct tuition payments made under a MET contract, for State income tax purposes.

CONTENT

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

- Provide that, in addition to the standard personal exemption, a taxpayer could claim an exemption ($1,000 in 1989, and $900 in years after 1989) if the taxpayer supported in his or her home a senior citizen who had been diagnosed or identified as having Alzheimer's disease or a "related disorder". "Related disorder" would mean an irreversible brain disorder that results in manifestation of symptoms and signs including, but not limited to, memory loss, aphasia, becoming lost or disoriented, confusion, and agitation with the potential for combativeness and incontinence. "Related disorder" would include, but not be limited to, multi-infarct dementia, Huntington's disease. ("Senior citizen" refers to a person who is at least 65 years old, or the unmarried surviving spouse of a person who was at least 65.)
- Allow a taxpayer to deduct, to the extent included in Federal adjusted gross income, money received as a result of a State lottery prize won before January 1, 1989. The bill would strike from the Act a provision that requires taxpayers to include, for the 1989 tax year and thereafter, lottery prizes as ordinary income. Prizes won after January 1, 1989, then, would be subject to the State income tax.
- Allow a taxpayer to deduct, to the extent included in Federal adjusted gross income, payments made to a State institution of higher education, or a public community or junior college in Michigan, on the taxpayer's behalf as provided by an advance tuition contract (either from the Michigan Education Trust or from a private investment manager under a contract allowed under the Act). The bill also would allow a taxpayer to deduct the proceeds of an advance tuition contract that the taxpayer uses to pay tuition at an in-state private degree granting college or university or community or junior college.

  Provide that if a taxpayer purchased an advance tuition contract from the Michigan Education Trust or a private investment manager with the proceeds of a loan, and then defaulted on the loan, the taxpayer would have to add to taxable income the amount the lender received as reimbursement for the defaulted portion of the other loan. (Under an advance tuition contract purchased with a loan, the contract can be used as collateral so that the lender receives payment from the Michigan Education Trust for any portion of the loan that was defaulted.)

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FISCAL IMPACT

The bill would lead to an indeterminate reduction in GF/GP income tax revenues of at least $7 million to $9 million in the first few years. Exempting lottery prizes won before January 1, 1989, would reduce 1989 revenues by $5 million to $6 million. Assuming 20% of those persons identified as having Alzheimer's disease or a related disorder are supported by a taxpayer, the revenue loss to the State would be $2 million to $3 million per year. Excluding MET payments from taxable income would lead to an indeterminate reduction in GF/GP income tax revenues.

ARGUMENTS

Alzheimer's Exemption

Supporting Argument

The bill would give those people who care for Alzheimer's victims some financial assistance for the costs incurred for care, and would likely encourage others to take on such responsibilities. The cost of caring for those who must be cared for is expensive and increasing, either for the individual care-giver or, eventually, the State. For every person who can be cared for at home, there is one less person who requires hospital care or care in an institutional setting, and thus less demand on public funds.

Opposing Argument

Though granting a tax break to those who care for Alzheimer's victims may be desirable, it must be pointed out that such an action reduces State income tax revenue. No matter how great the worthiness of a proposal to craft a tax break may be, there are other proposals of tax breaks for which supporters may feel an equal or greater degree of justification. If every worthy cause were granted, the effect on the State's revenue level could be significant.

Lottery Tax

Supporting Argument

As a simple matter of fairness, the State should not tax the lottery winnings of persons who played lottery games and won prizes at a time when the State was prohibited from taxing lottery winnings. Passage of the retroactive tax on lottery winnings was not only unjust, it was an action that sent a harsh message to the residents of the State. The message was that the State runs the games and it makes the rules, and even if a person is fortunate enough to beat the tremendously low odds, the State can for its own convenience change the rules to diminish the amount winners thought they would be allowed to keep. The State should rescind the retroactive lottery tax before it is entangled in a mesh of legal challenges, and show the public that the State can forego some revenue for the sake of fairness.

Opposing Argument

The tax on lottery prizes was passed along with several other amendments that reduced income tax revenue. Public Act 516 also allowed low-income seniors, beginning in tax year 1989, to claim a credit for the cost of prescription drugs; in addition, it granted a $500 deduction for dependents who earn over $1,500 in 1988 and a $1,000 deduction for 1989 and beyond. Applying the tax on lottery winnings to only those prizes won after 1988 would drastically reduce the revenues the State had expected to be generated from the tax. If the bill is passed, other sources of revenue should be found to counteract the effect of the bill.

Opposing Argument

The tax is retroactive only to the extent that it taxes prizes awarded in 1988 but won in previous years--it does not apply to prizes awarded before 1988. While the State has had a prohibition against the taxing of lottery winnings since the lottery's inception, it has been viewed by some as an unfair and unnecessary restriction on the State's ability to tax income. The levying of the 4.6% income tax on lottery winners cannot be viewed as a tax that causes a hardship on the taxpayers. A person who won $1 million would, absent all deductions, be subject at the most to a tax bill of $46,000 over the 20 years in which the prize was awarded.

MET Deduction

Supporting Argument

A MET contract, in which a purchaser pays for a tuition payment plan for a beneficiary to receive tuition in the future is, in effect, exchanging money today for a service tomorrow. It was not expected that such an arrangement would have negative Federal income tax consequences for beneficiaries when they received tuition payments. The ruling by the Internal Revenue Service, however, declared that such tuition payments have to be included as part of a beneficiary's income. Unless the Income Tax Act is amended, therefore, tuition payments will also be subject to the State's income tax. While some people hope that someday the IRS ruling will be challenged and overturned so that MET payments will not have Federal tax consequences, in the meantime the bill would let MET tuition payments be considered deductible.

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