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PA 116 CREDIT: ALLOW CARRYFORWARDS

House Bill 5585 with committee amendment
First Analysis (5-23-88)

Sponsor: Rep. Roland G. Niederstadt
Committee: Taxation

THE APPARENT PROBLEM:

Public Act 254 of 1987 (Senate Bill 506) made numerous changes to the Income Tax Act recommended by the Department of Treasury, some of which were intended to make the state law conform with the recently amended federal tax law. (The act also increased the personal exemption as a method of dealing with the so-called windfall to the state from federal changes.) One of the amendments affected the way net operating losses are treated for purposes of the homestead property tax credit, known as the circuitbreaker. The change required taxpayers to add to their income net operating loss carryforwards. (Carryforwards are losses that cannot be used to offset income in the year suffered and so are carried forward to offset income in the next tax year.) Previously, loss carryforwards were not included as income, so the change was expected to reduce the size of property tax credits. The rationale provided at the time was that because the property tax credit is based on the relation between a taxpayer's income in a given year and property taxes paid in the same year, losses from a prior year should not be used in calculating current year income. Tax specialists say the change has little effect on the typical household, but has had a significant effect on farmers, apparently unintended by the legislature. This is because the credit they receive under the Farmland and Open Space Preservation Act (Public Act 116 of 1974) is calculated by using the definition of household income in the Income Tax Act. Under Public Act 116, a farmer essentially enters a contract with the state that grants a special property tax credit in return for keeping farmland in agricultural use. With the change in the definition of household income, farmers were denied the use of operating loss carryforwards in determining their P.A. 116 credits. This reduced the tax credits of some farmers considerably for the 1987 tax year, over $2 million in aggregate, in great part because of the serious losses suffered from flooding in 1986. (In one case cited by the Farm Bureau, a farmer anticipating a credit of over $12,000, already promised to pay debts, received less than $4,000 due to this change.) Representatives of farm interests say that this complicated tax accounting change, made very late in 1987 with little understanding of its potential impact on farmers, ought to be reversed.

THE CONTENT OF THE BILL:

Under the bill, taxpayers calculating household income for purposes of the Farmland and Open Space Preservation Act would not have to add in carrybacks or carryforwards of net operating losses. The bill would also no longer require any taxpayer to add carrybacks or carryforwards of capital losses. These provisions would be effective for tax years beginning after December 31, 1986.

(Household income is determined by taking federal adjusted gross income and adding to it all income specifically excluded or exempt from the computations of adjusted gross income, plus carrybacks or carryforwards of net operating losses or capital losses. The bill would no longer require the addition of net operating losses for taxpayers calculating household income for purposes of the Public Act 116 credits and would no longer require the addition of capital losses by any taxpayer.)

MCL 206.510

FISCAL IMPLICATIONS:

The Department of Treasury has testified that its "best guess" is that the bill would result in an increase in tax credits to farmers of about $2.6 million for the 1987 tax year. In future years, the department said, the cost would be less. (5-11-88) The department supports an amendment that would reduce the cost of the bill by 10 to 20 percent.

ARGUMENTS:

For:

The bill would reverse a change in tax law made late in 1987 that inadvertently deprived farmers in the state of over $2 million in anticipated Public Act 116 (farmland preservation) property tax credits. The 1987 change disallowed the use of operating loss carryforwards; that is, the use of losses from past years to offset income in the current year. This meant that farmers had to increase their incomes by adding loss carryforwards when determining their Public Act 116 credits, which reduced the amount of the credits. While this change may have been justified for homestead property tax credits, it does not take into account that farm operations are businesses and that farmers' incomes are more volatile than most. The floods of 1986, which produced huge losses for some farmers, have driven this point home and have made the need for excluding loss carryforwards from household income more obvious. The legislature did not intend to apply this change in the tax law to farmers who have pledged under Public Act 116 agreements to keep land in agricultural use and ought to reverse the policy.

Against:

Some tax specialists, including treasury department officials, have urged the adoption of an amendment that would, in essence, limit the amount of income that could be offset by operating loss carryforwards to the amount of the carryforwards. They argue that because of the way the federal and state laws fit together, farmers would be able under the bill's current language to offset more in income over a three-year period than they suffered in losses. In one example provided, a farmer would be able to use $20,000 in operating loss carryforwards to offset $26,000 in income, something other taxpayers are not allowed to do. As the bill is written, farmers without operating losses are at a disadvantage compared to farmers who do suffer operating losses, as far as treatment under state tax law is concerned.

OVER

POSITIONS:

The Michigan Farm Bureau supports the bill. (5-18-88)

The Department of Treasury supports the bill, although it would prefer the adoption of an amendment limiting the income that loss carryforwards can offset to the amount of the carryforwards. (5-18-88)