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BILL ANALYSIS

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Senate Bill 96 (Substitute S-1 as reported)
Sponsor: Senator Bill Schuette
Committee: Finance

Date Completed: 1-31-95

RATIONALE

At the required biannual Consensus Revenue Estimating Conference (held on January 12, 1995), part of the consensus agreement was that the State will close the 1994-95 fiscal year $297.3 million in excess of the State's revenue limit. Article 9, Section 26 of the State Constitution prescribes the calculation of the limit, and provides that if total State revenues exceed the limit by 1% or more, the excess must be refunded to Michigan income and single business tax taxpayers. In the Governor's State of the State address, he proposed that, rather than simply waiting until the end of the fiscal year (September 30) to see how much the revenue limit is exceeded and refunding the excess, the projected surplus be used now, for permanent tax cuts. In addition to recommending changes to the single business tax and elimination of the intangibles tax, the Governor proposed that the personal exemption in the income tax be increased, and that in future years the exemption be adjusted for inflation.

CONTENT

The bill would amend the Income Tax Act to increase the personal exemption, and index the exemption to the rate of inflation.

Currently, a taxpayer may subtract from taxable income $2,100 for each personal exemption claimed. The bill would increase the personal exemption to $2,400 for the 1995 and 1996 tax years, and to $2,500 for 1997. After 1997, the exemption would have to be adjusted each year to reflect the annual average percentage increase or decrease in the U.S. Consumer Price Index. The adjustment would be made by multiplying the increase or decrease in the index for the immediately preceding tax year by the personal exemption allowed in the immediately preceding tax year; the result would have to be added to the personal exemption allowed in the previous year and then rounded off to the nearest $100 increment.

MCL 206.30

ARGUMENTS

(Please note: The arguments contained in this analysis originate from sources outside the Senate Fiscal Agency. The Senate Fiscal Agency neither supports nor opposes legislation.)

Supporting Argument

The State finds itself in the enviable position of having a projected substantial revenue surplus at the end of the current fiscal year. The Governor has proposed that the State should use this opportunity not only to return the surplus to the taxpayers, but also to enact permanent tax cuts, to the benefit of individual and business taxpayers in the future. Specifically, the Governor has proposed changes to the single business tax, the intangibles tax, and the income tax. Senate Bill 96 (S-1) offers immediate help to individual taxpayers by increasing the personal exemption, which reduces income tax liability. Further, and perhaps more importantly, the bill offers lasting tax relief by indexing the exemption to the rate of inflation. While the personal exemption has been increased in the past, the Income Tax Act has had no provision to tie the exemption to inflationary increases. This means that the exemption has remained constant in many years when the economy experienced substantial increases in inflation; as a result, the actual value of the exemption to individual taxpayers and their families was reduced. The bill not only would increase the exemption, it also would prevent the value of the exemption from eroding, thus putting more money in the hands of taxpayers now and in the future.

Supporting Argument

The Consensus Revenue Estimating Conference has projected that the State will exceed the constitutional revenue limit by $297.3 million at the end of the 1994-95 fiscal year. According to the Constitution, if the limit is exceeded by 1% or more, the excess must be refunded pro rata based on State income tax and single business tax annual returns. It has been suggested that refunding excess revenue in this manner could result in a costly, administrative nightmare. This bill, and the other proposed tax cuts, would remove the possibility that the revenue limit will be exceeded because it would allow taxpayers to keep the projected excess before it occurs.

Opposing Argument

While the bill has appeal, in that it offers a broad-based method of returning excess revenues and would benefit nearly all income tax payers, the approach contains some dangers. Michigan's economy historically has endured periods of low or no growth resulting in reduced or stagnant State revenues. Currently, the economy is perking and State revenues are following that trend, but the good times cannot be expected to last forever. By making the increased personal exemption a permanent change and indexing the exemption to inflation, the bill could have a substantial negative impact on the State's revenue in the future, especially in those years when the economy turned down. Perhaps a better response to the temporary problem of excess revenue would be to craft a temporary solution.

Response: The State should do more than offer a one-time rebate of surplus revenue; instead, it should take this opportunity to act decisively in favor of taxpayers. In the past, tax policy that resulted in the enrichment of State coffers usually meant the expansion of State government to accommodate disposal of the income. A permanent tax cut not only would put more money into the hands of taxpayers immediately, it also would help to prevent automatic expansion of State government in the future should the economy continue to grow.

Opposing Argument

The main thrust of the bill is to give individual taxpayers a reduction in income taxes, and that has great merit. Placed in the context of the Governor's entire proposal, however, the bill comes up short. Part of the Governor's proposal advocates changes to the single business tax to reduce business's tax burden. There are some who feel, however, that tax changes, particularly those designed to return surplus revenue, should concentrate on benefitting individuals and not businesses. Revenue from that portion of the proposal that would go to business should instead be used to expand the benefit to individuals, particularly people with families. The bill should include a greater increase in the personal exemption, or perhaps include an extra exemption for taxpayers who can claim young dependents and thus target tax relief to families.

Response: Both businesses and individuals pay taxes. The bill must be looked at in the context of the entire proposal, which offers a balance of tax relief among businesses and individuals. While some believe, as argued above, that tax relief should be directed at individuals, others point out that it is companies and employers that employ and pay the salaries of individuals, and therefore businesses must be included in this discussion of tax relief.

Legislative Analyst: G. Towne

FISCAL IMPACT

The increases in the income tax personal exemption that are proposed in this bill, as described above, would reduce income tax revenue by an estimated $69 million in FY 1994-95 and $91 million in FY 1995-96. This loss in revenue would have an impact on three areas of the State budget. General Fund/General Purpose (GF/GP) revenue would be reduced by an estimated $54 million in FY 1994-95 and $71 million in FY 1995-96. Under School Finance reform, 14.4% of gross income tax collections are earmarked to the School Aid Fund, so this bill would reduce School Aid Fund revenue by an estimated $10 million in FY 1994-95 and $13 million in FY 1995-96. A portion of income tax collections also is earmarked for revenue sharing with local governments. The reduction in income tax revenue that would result under this bill would reduce revenue sharing payments by an estimated $5 million in FY 1994-95 and $7 million in FY 1995-96.

This bill would index the personal exemption to the rate of inflation beginning in 1998. Under the indexing provisions in this bill, any increase in the personal exemption resulting from inflation would be rounded to the nearest $100 increment. Therefore, in order to increase the personal exemption in 1998 by $100, the inflation rate would have to be somewhere between 2% and 6%. In 1999, another $100 increase in the personal exemption would be generated by an inflation rate in the range of 2% to 5.7%.

The following table summarizes the revenue impact of this bill for FY 1994-95 through FY 1998-99.

S.B. 96 (S-1): Increase in Income Tax Personal Exemption
Estimated Revenue Impact, FY 1994-95 to FY 1998-99

Personal Exemption:					
Calendar Year	1995	1996	1997	1998	1999
Current Law	$2,100	$2,100	$2,100	$2,100	$2,100
Proposed	2,400	2,400	2,500	2,600*	2,700*
Revenue Impact (millions)					
Fiscal Year	FY 94-95	FY 95-96	FY 96-97	FY 97-98	FY 98-99
Total Tax Cut	$69	$91	$114	$141	$170
Revenue Loss by Fund:					
GF/GP	$54	71	89	111	133
School Aid	10	13	16	20	25
Revenue Sharing	5	7	8	10	12

*Estimated increases due to indexing to inflation.

Fiscal Analyst: J. Wortley

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