

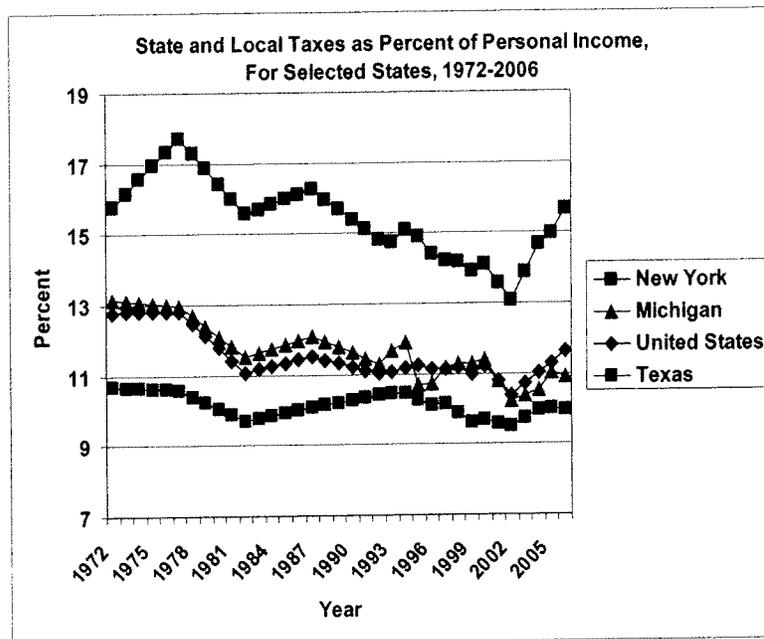
Tax Reform for Michigan

**Presented to
House Tax Policy Committee
June 10, 2009**

**Charles L. Ballard
Department of Economics
Michigan State University
East Lansing, MI
ballard@msu.edu**

State and Local Taxes As Percent of Personal Income:

- Michigan Remains Quite Close to
the National Average**
- The National Average Has Fallen
Substantially**



Taxes in Michigan are NOT high, compared with other states, or compared with our own experiences from recent decades.

The Structural Deficit:

Out of the major revenue sources for state and local governments in Michigan, NOT A SINGLE ONE keeps up with the economy.

We will not grow our way out of this problem. The only way to deal with it is to fix the structural deficiencies in our tax system.

Revenue-Side Sources of The Structural Deficit (1)

- **Income Tax:**
 - **A. Flat Rate Makes the Tax Less Responsive to Income Growth**
 - **B. Low Taxation of Pension Income Becomes More of a Problem as Population Ages**

Revenue-Side Sources of The Structural Deficit (2)

- **Sales Tax: Most Services Are Not Taxed**
- **Excise Taxes on Beer and Wine: Levied as Unit Taxes, So Real Revenue-Raising Capacity Erodes Over Time**

Reasons to Enact a Graduated Income Tax in Michigan

1. **Increase in Income Inequality: Ability to Pay Taxes is Increasingly Concentrated**
2. **Federal Deductibility: We Leave Money on the Table**
3. **Revenue Responsiveness: A Flat Rate Contributes to the Structural Deficit**
4. **Public Support**

Public Support For a Graduated Income Tax in Michigan

State of the State Survey Round 47
(1012 Michigan Adults,
Interviewed January – March 2008)

57.2% Favor Graduated Income Tax
37.4% Opposed
5.3% Neutral

Graduated-Rate Taxes in Three Fast-Growing States

<u>State</u>	<u>Top Tax Rate</u>	<u>Income Tax Rank</u>	<u>Population Growth Rank '00-'08</u>
Georgia	6.00%	23	4
No. Carolina	7.75%	12	9
Virginia	5.75%	8	14

• Sources: Income Tax Rank is tax per-capita as computed by Office of Revenue and Tax Analysis, Michigan Department of Treasury. Population growth is from the U.S. Census Bureau.

Michigan's Sales Tax applies to relatively few services, but services have grown more important over time. Thus, the tax base for the sales tax is decreasing every day.

For the sake of both economic efficiency and fairness, it makes no sense to tax hardware at 6%, and to have no tax on a trip to the tanning salon.

We could REDUCE the sales-tax RATE, and still collect substantially more revenue, if we broaden the tax base to include services.

The Michigan Business Tax: Why Tax Businesses At All?

Businesses do not pay taxes.

People pay taxes.

A tax on business income will be paid by consumers (in higher prices), investors (in lower returns), or by workers (in lower wages).

Thus, if we were to eliminate the Michigan Business Tax, and introduce a graduated income tax, we would:

- **Increase the overall progressivity of Michigan's tax system.**
- **Simplify our tax system, removing administrative and compliance headaches.**
- **Increase the amount of taxes exported to other states, through federal deductibility.**

A Tax-Reform Package for Michigan

- **Establish a Graduated Income Tax**
- **Extend the Sales Tax to All Services**
- **Eliminate the MBT**
- **Reduce or Eliminate the Tax Preference for Retirement Income**
- **Restore the Excise Taxes on Beer and Wine to Earlier Levels, and Convert to Percentage Basis**
- **Close Loopholes**