



CITIZENS RESEARCH COUNCIL OF MICHIGAN

Economic and Revenue Outlook and Governor's Tax Proposal

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Administrative Officers Association
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Citizens Research Council

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- Promotes sound policy for state and local governments through factual research – accurate, independent and objective
- Relies on charitable contributions of Michigan foundations, businesses, and individuals
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The State of the National Economy



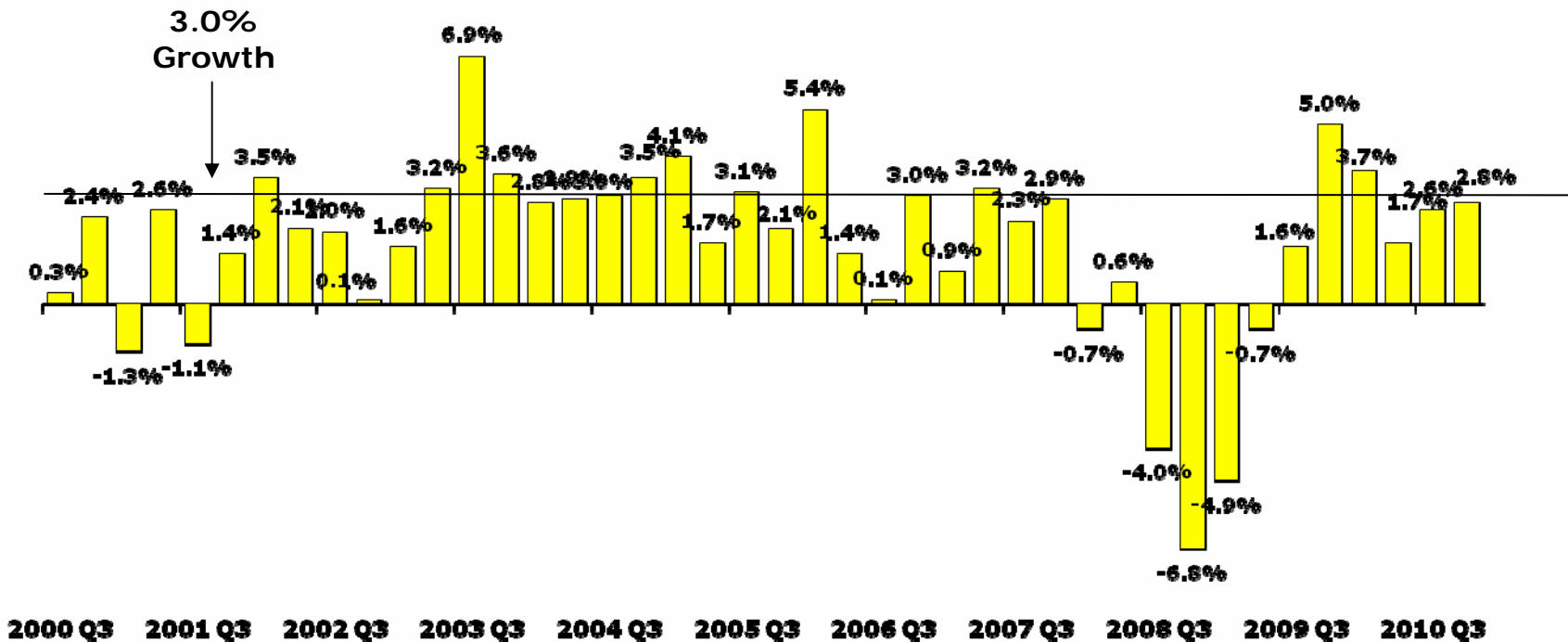
Recession is Over – Sort of...

- National recession ran from December 07 to June 09
- National recession lasted 18 months, longest post-war recession
- Output has been growing since 2009Q3
- It took 6 quarters of growth to reach old peak
- Job growth has been minimal making it feel like the recession is still occurring
- While economic recovery has been disappointing and uneven, growth appears to be improving



GDP Has Grown for 6 Straight Quarters

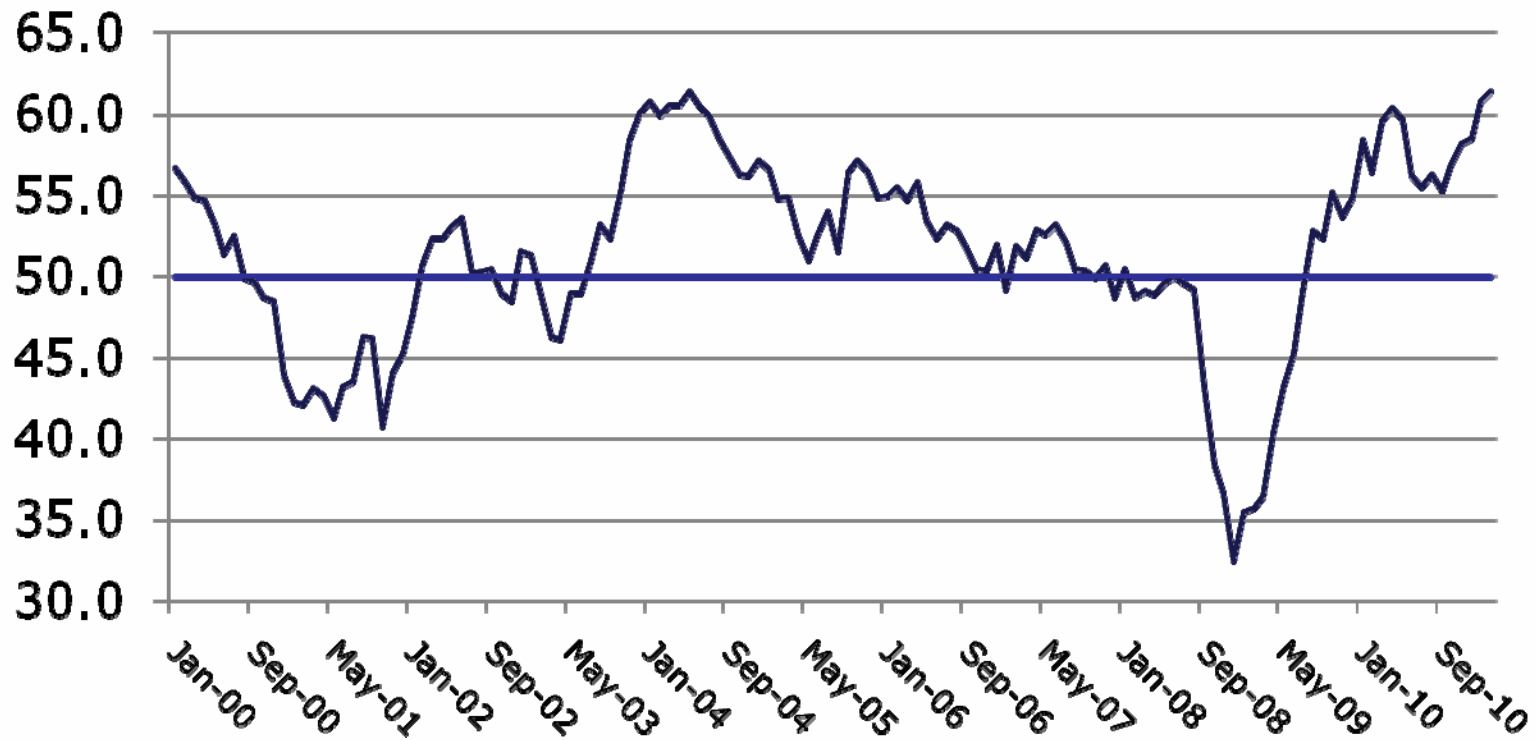
Real GDP Growth





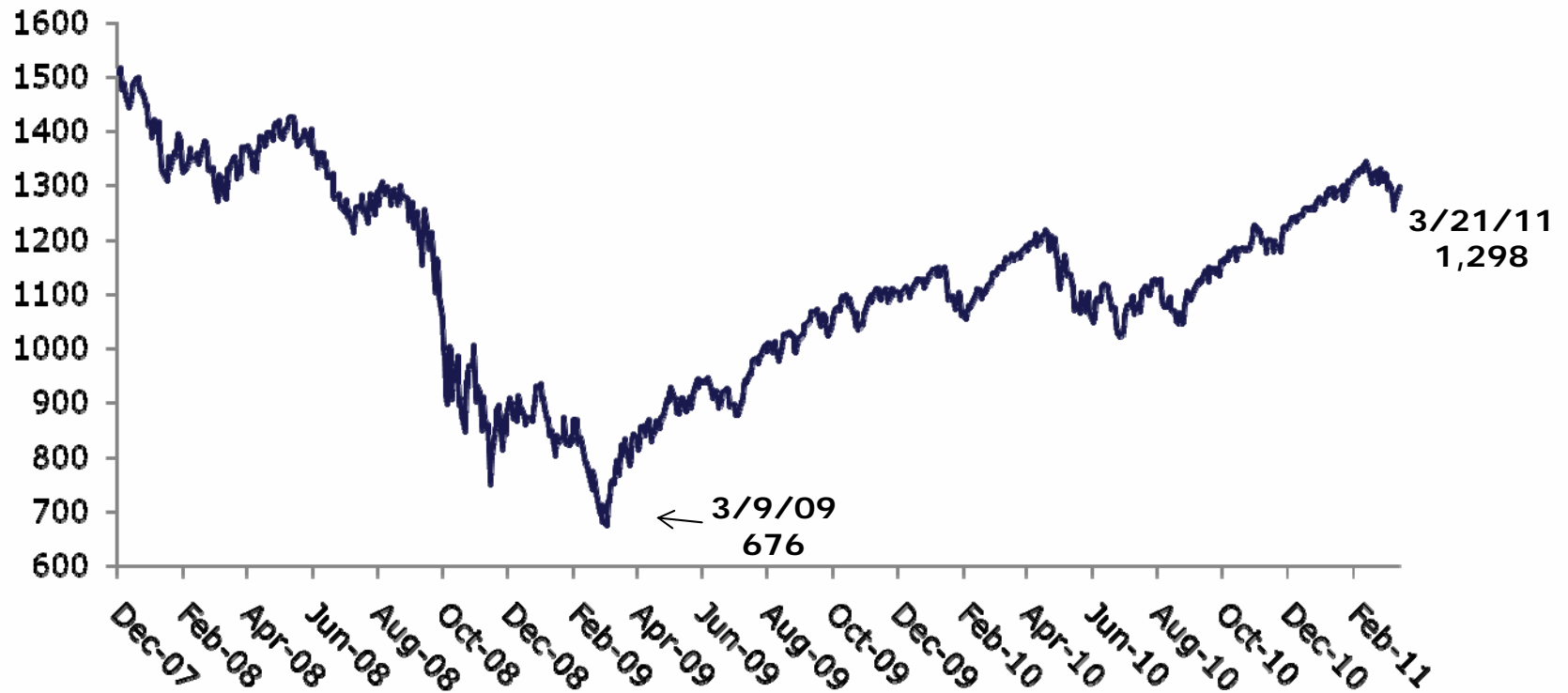
Manufacturing Has Been Growing

Institute For Supply Management Index





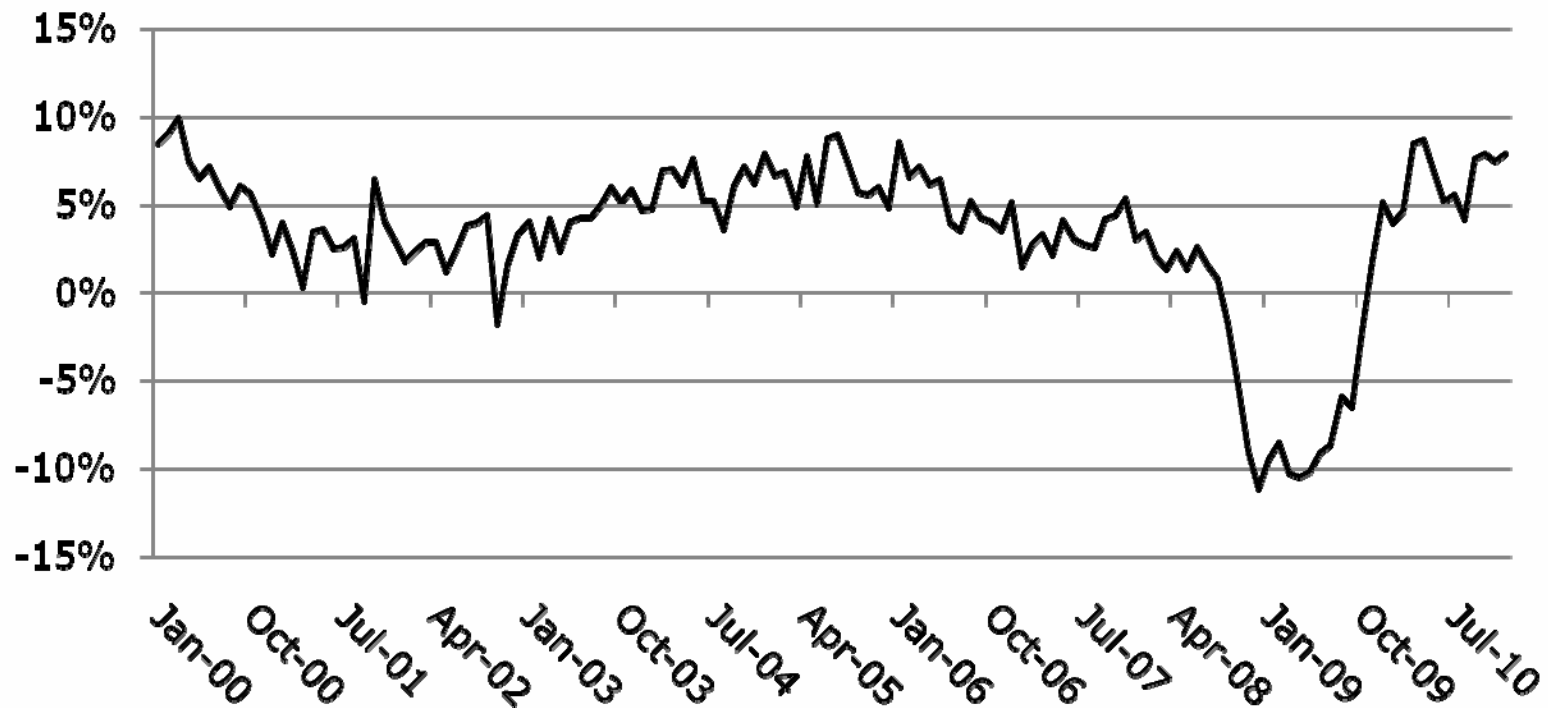
S&P 500 Up 90% From March 09 Low But Still Down 10% From January 2008





Retail Sales Have Been Recovering

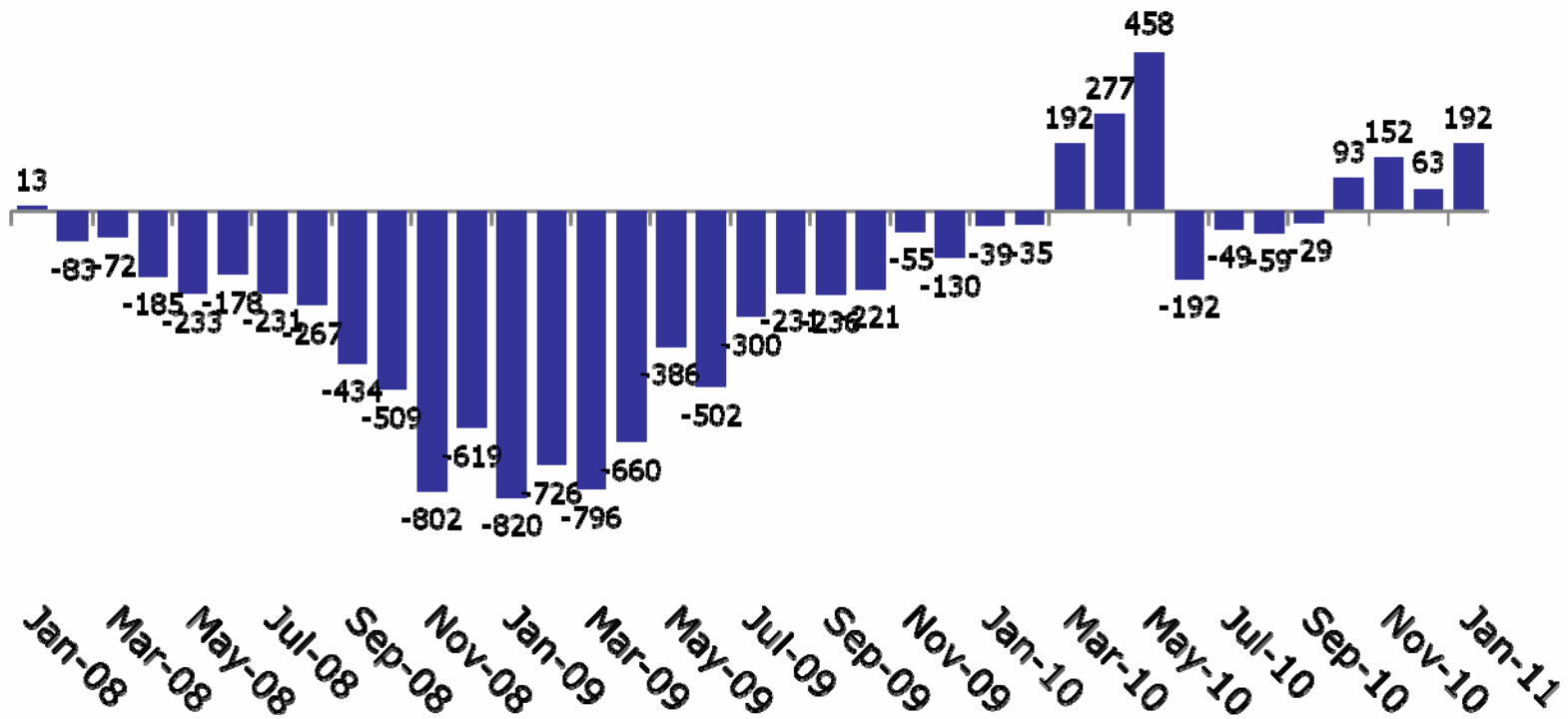
Retail Sales and Food Service
(Year over Year Pct Change)





The U.S. Has Not Recovered the 8 Million Jobs Lost in the Recession

Monthly Change in Total U.S. Employment (thousands)





What is Happening in Michigan?

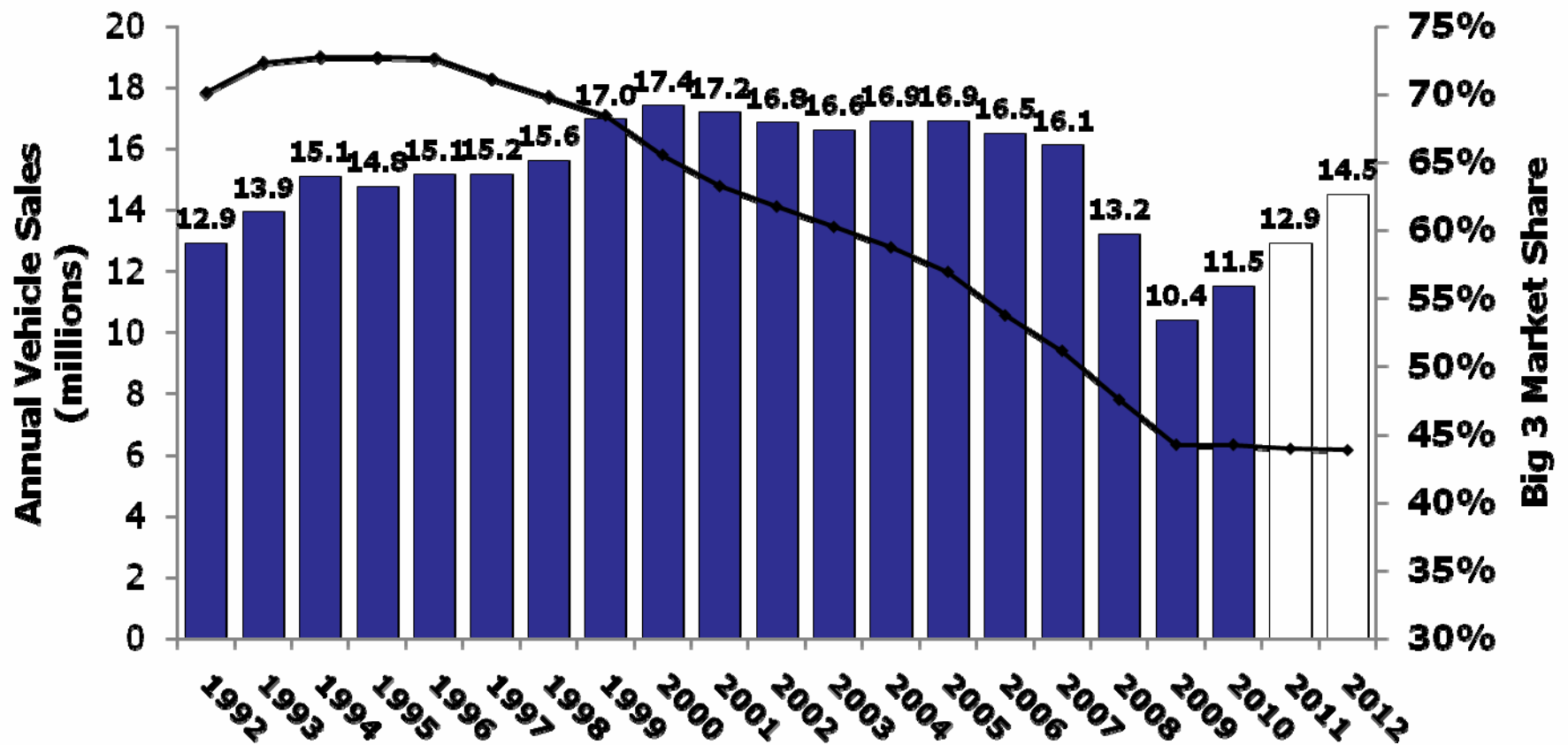


The Last Decade Was an Economic Disaster for Michigan

	Growth 2000 to 2009		Michigan
	<u>U.S.</u>	<u>Michigan</u>	<u>Rank</u>
Population	8.8%	0.1%	51
Real Per Capita GDP*	5.7%	-8.4%	50
Employment	-0.7%	-17.1%	51
Real Per Capita Income	3.6%	-7.1%	51



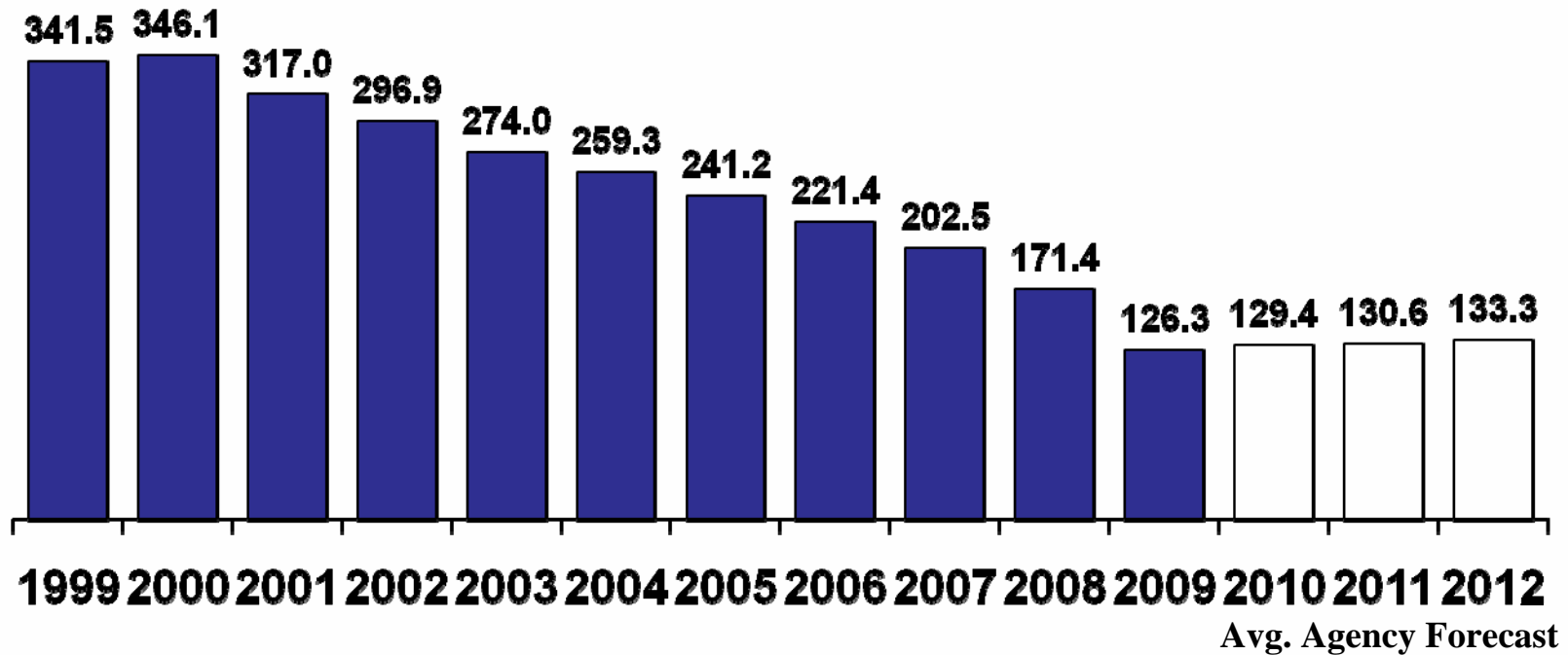
Big 3 Market Share Plummet





2 in 3 Auto Jobs Lost by 2011

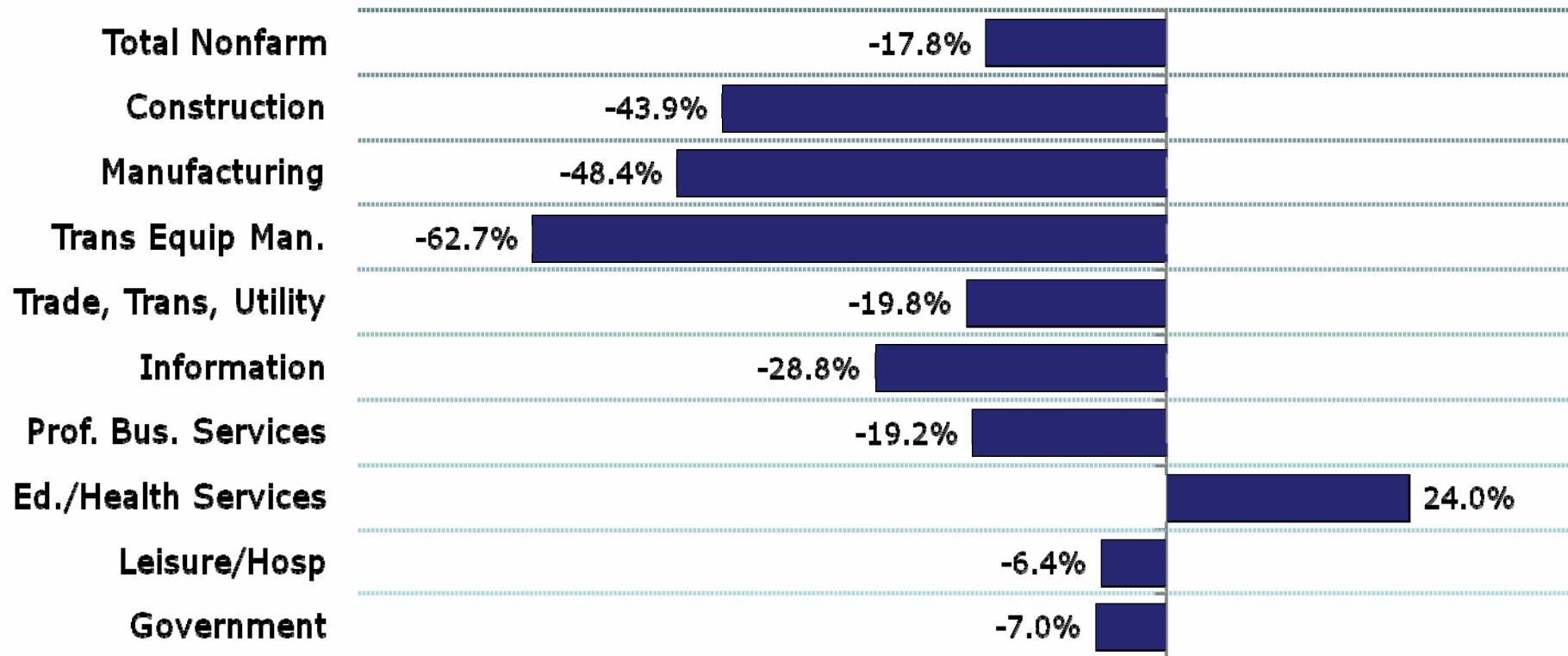
Michigan Transportation Equipment Employment
(In Thousands)





Almost Every Sector in Michigan Has Lost Jobs

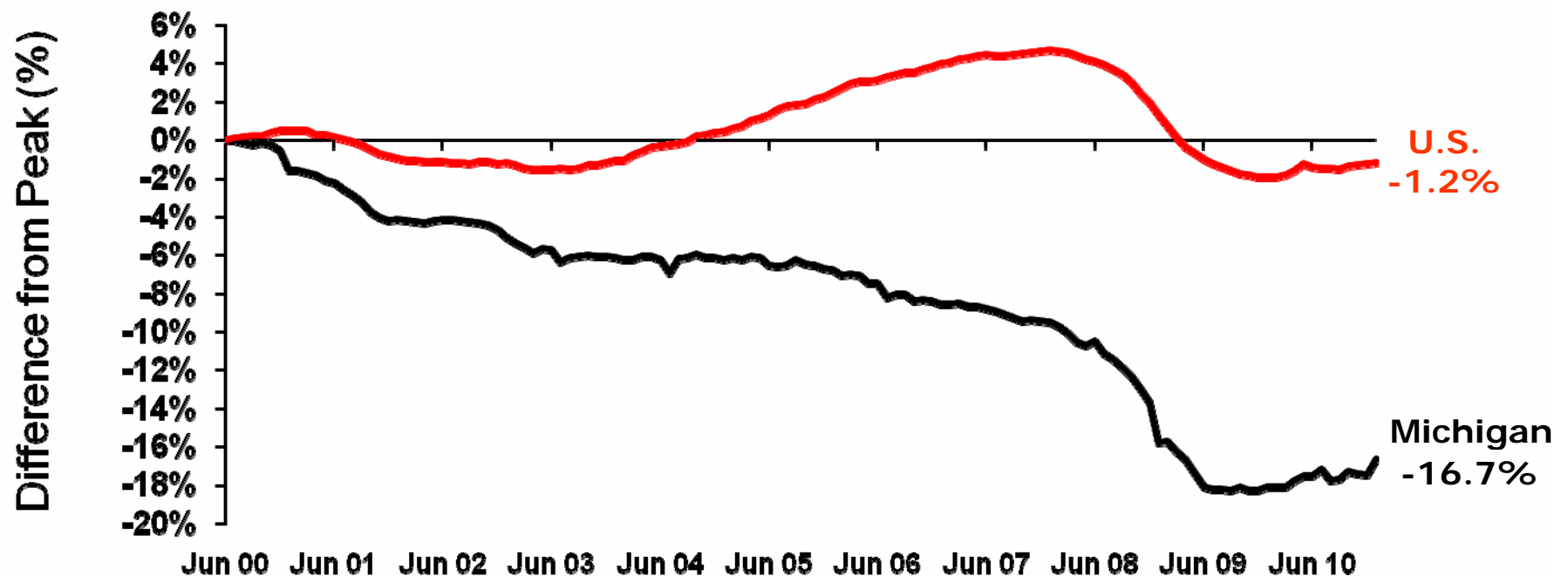
2000 to 2010





A Lost Decade of Michigan Employment

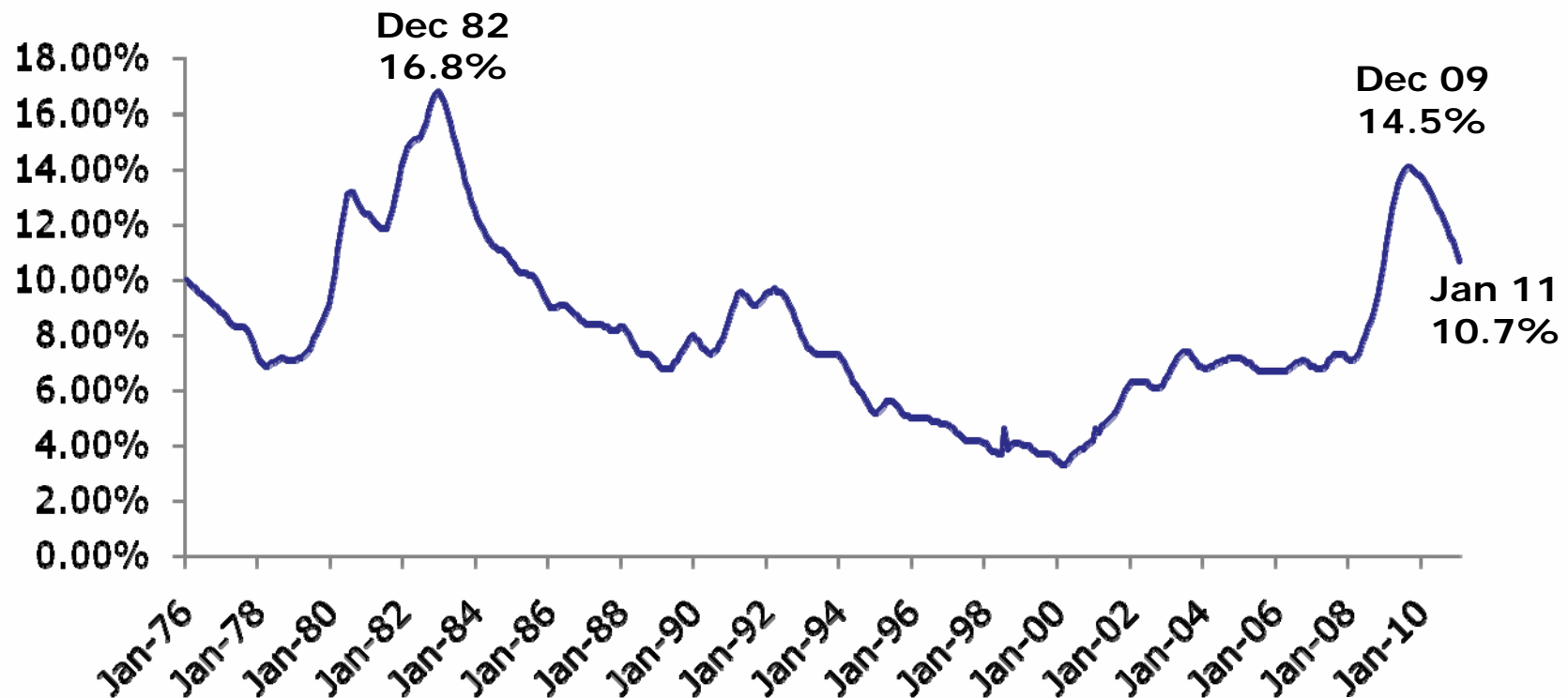
1 in 6 Jobs Lost Since June of 2000



15 Note: Peak is calculated from Michigan's June 2000 Peak. Data through Jan. 2011.
Source: Bureau of Labor Statistics and CRC calculations.



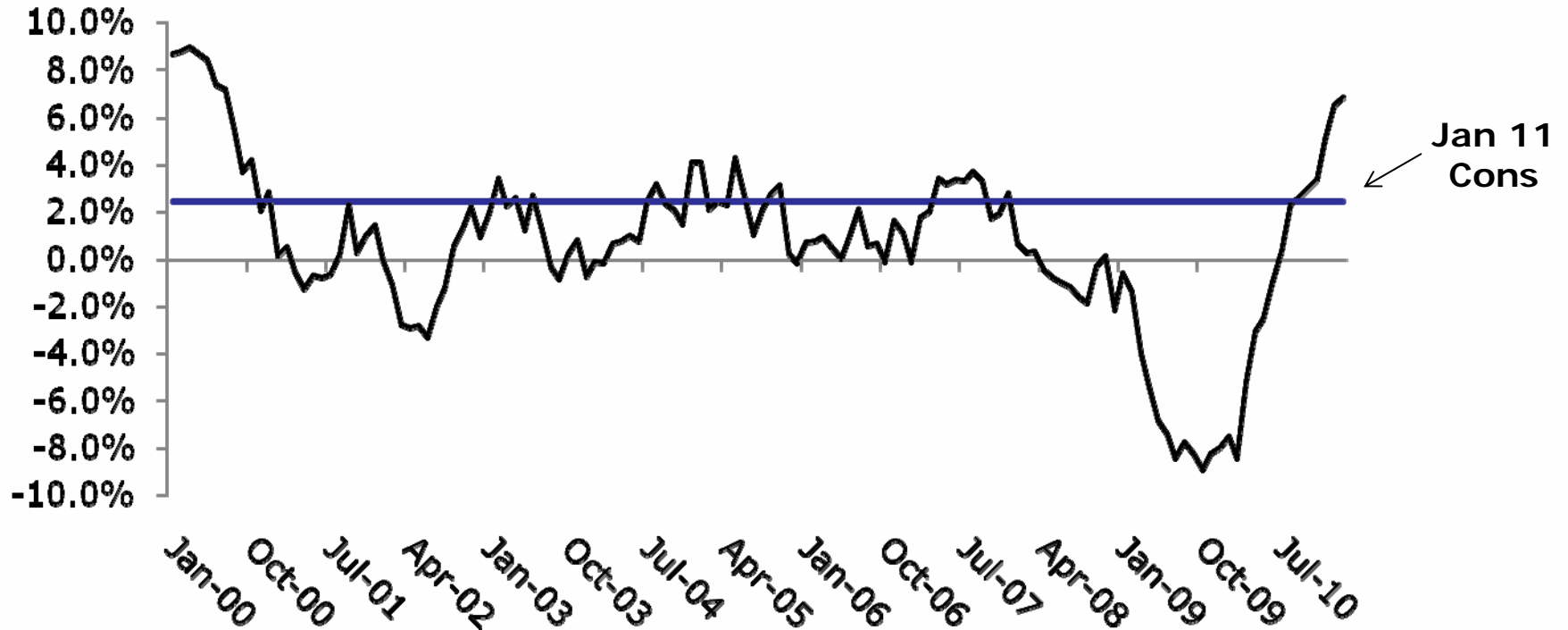
But Michigan's Unemployment Rate Appears to Have Peaked





Income Tax Withholding Growth Suggests Wages Are Growing Again

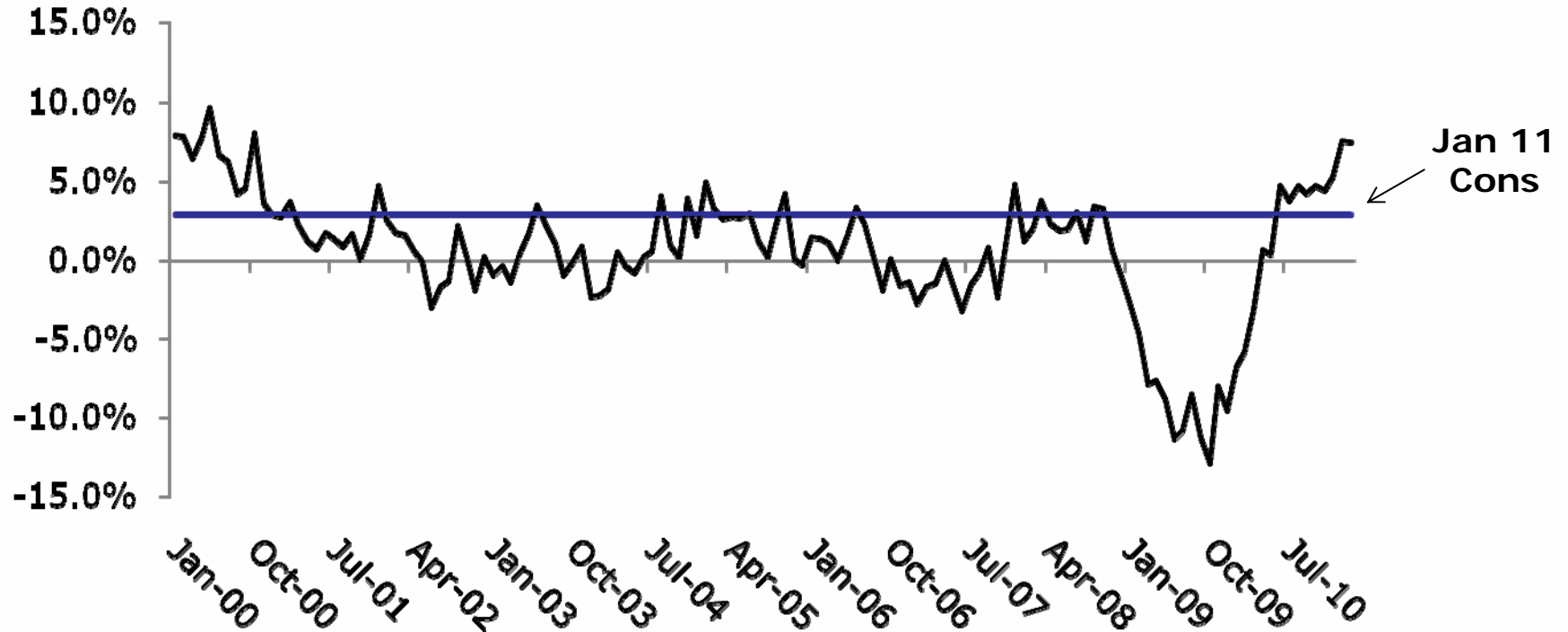
(Y-O-Y % Change 6 Month Average)





Sales Tax Growth Suggests Improvement in Confidence and Disposable Income (and Increase in Gas Prices)

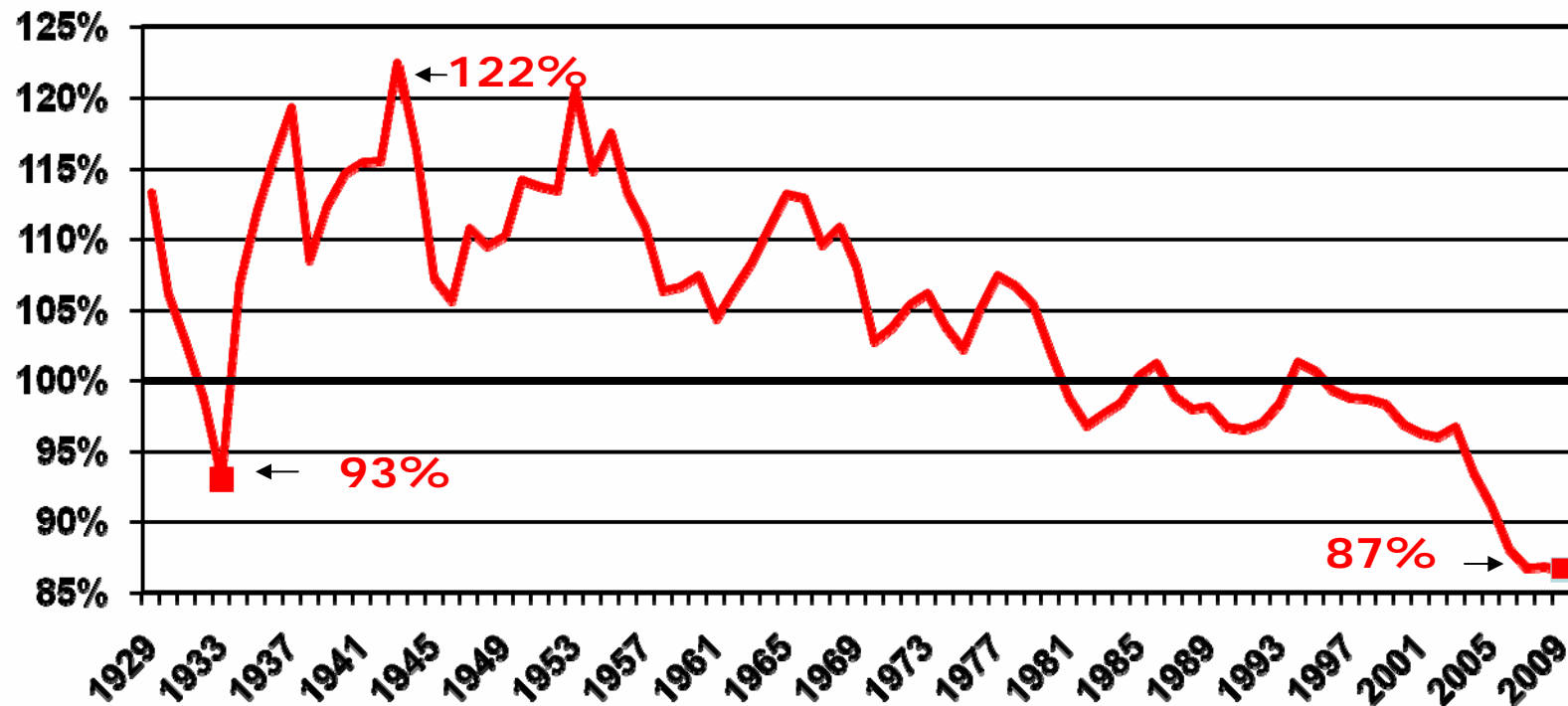
(Y-O-Y % Change 6 Month Average)





Michigan Has Become Poorer Relative to Other States

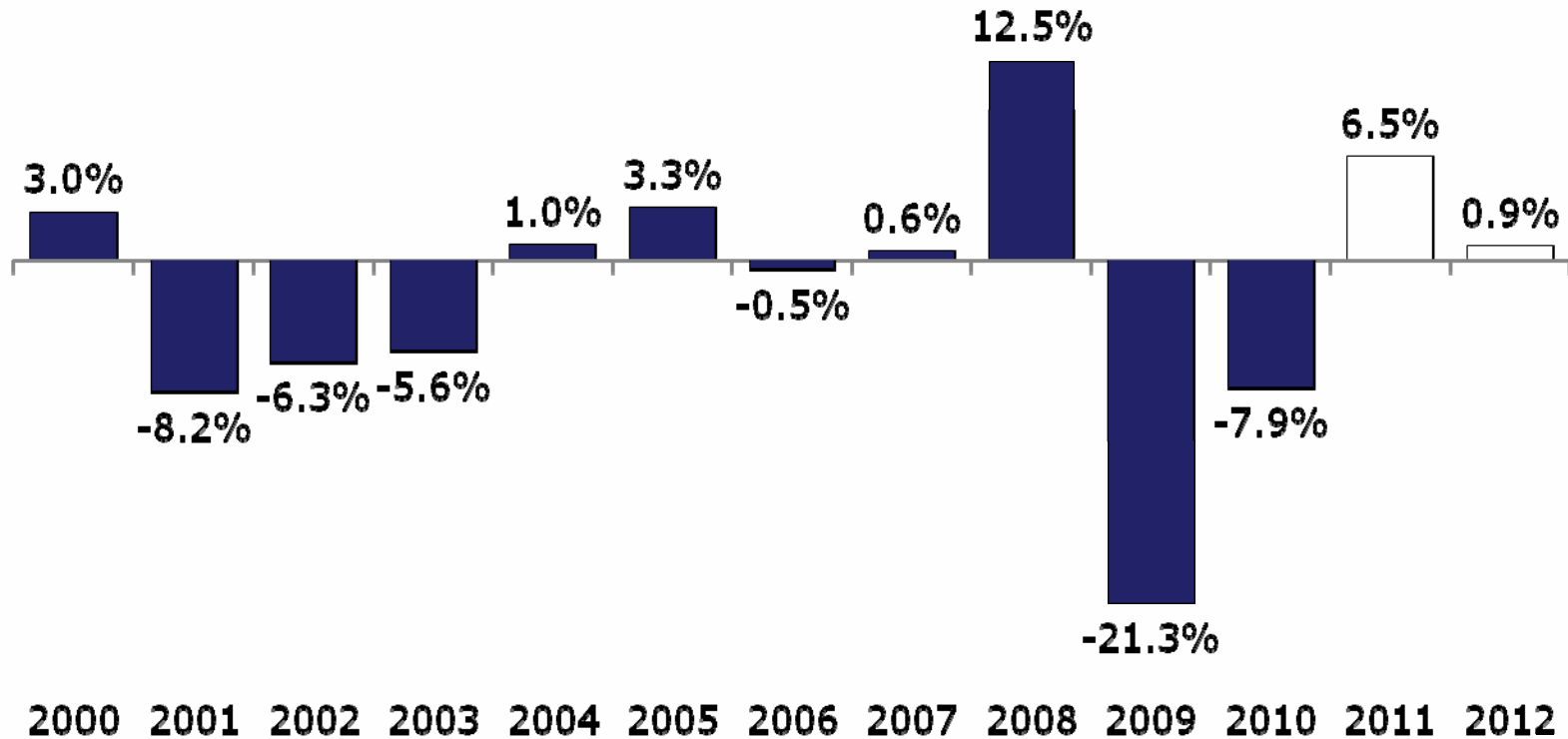
Michigan per Capita Income as a Percent of U.S. Per Capita Income Rank has fallen from 20th in 2001 to 37th in 2009





GF-GP Revenues Drop Sharply in FY 2009 and FY 2010

GF-GP Revenues
Year-Over-Year Pct. Change





Governor Snyder's Tax Proposal



Policy Objectives – Business Tax

“Michigan’s current system of business taxes, particularly the Michigan Business Tax (MBT), is highly complex, and includes an intricate web of incentives, credits, and deductions that unfairly favors some businesses or industries over others, hurts Michigan businesses and hampers growth. Replacing the MBT with a simple, fair, and efficient corporate income tax will even the playing field and enable all businesses, industries, large and small, to grow and create jobs.”

(source: Michigan Department of Treasury webpage)



Policy Objectives – Income Tax

“Further, Governor Snyder believes all taxpayers should pay the same rate regardless of their source of income.... The Governor recommends broadening the base to which the individual income tax is applied....

Consistent with his simple, fair approach to the Corporate Income Tax, the Governor also recommends that all credits and deductions related to the individual income tax, with the exception of the personal exemption, the exemption for individuals with disabilities, special provisions dealing with military personnel, the homestead property tax credit and a few other subtractions be eliminated. These changes are designed to provide equitable treatment for taxpayers.”



MBT Overview

- **Business income tax** of 4.95% & tax of 0.8% on **gross receipts** less purchases from other firms
- **Surcharge** of 21.99% before credits
- **Profits** apportioned to Michigan based on percent of sales occurring in Michigan
- Significant **credits** for compensation paid to Michigan workers (0.37%), investment in Michigan (2.9%) and Michigan R&D (1.9%); comp & investment credits capped at 52% of liability & all 3 capped at 65%
- Other significant credits include **MEGA, brownfields, personal property, film, and battery**
- Numerous other smaller credits
- **Financial institutions** and **insurance companies** have different tax bases



Corporate Tax Overview

- **6% flat rate income tax** only on corporate entities
- Apportionment still based on Michigan sales
- All credits (except small business alternate credit) are eliminated
- **Honors existing commitments** (\$500 million in FY 13) made through signed agreements (MEGA \$116M; battery \$293M; brownfield \$50M, film \$25M; other \$16M)
- Future economic development incentives awarded through appropriations process
- **Insurance** and **financial institution** taxes essentially unchanged
- **Net business tax cut of \$1.7 billion**



Income Tax Changes

- Rate fixed at **4.25%**
- **Private and public pension exemption** is eliminated
- **Personal exemption** phased-out for higher income (\$75k single; \$150k joint)
- **Special exemptions** for seniors (\$2,300), children (\$600), and unemployment comp (\$2,300) repealed
- **Credits repealed** include: EITC, city income tax, public contribution, homeless/foodbank, community foundation, college tuition
- **Homestead property tax credit** – credit lowered for seniors and raised for individuals; income phase-out lowered
- **Income tax increase of \$1.9 billion in FY 13**



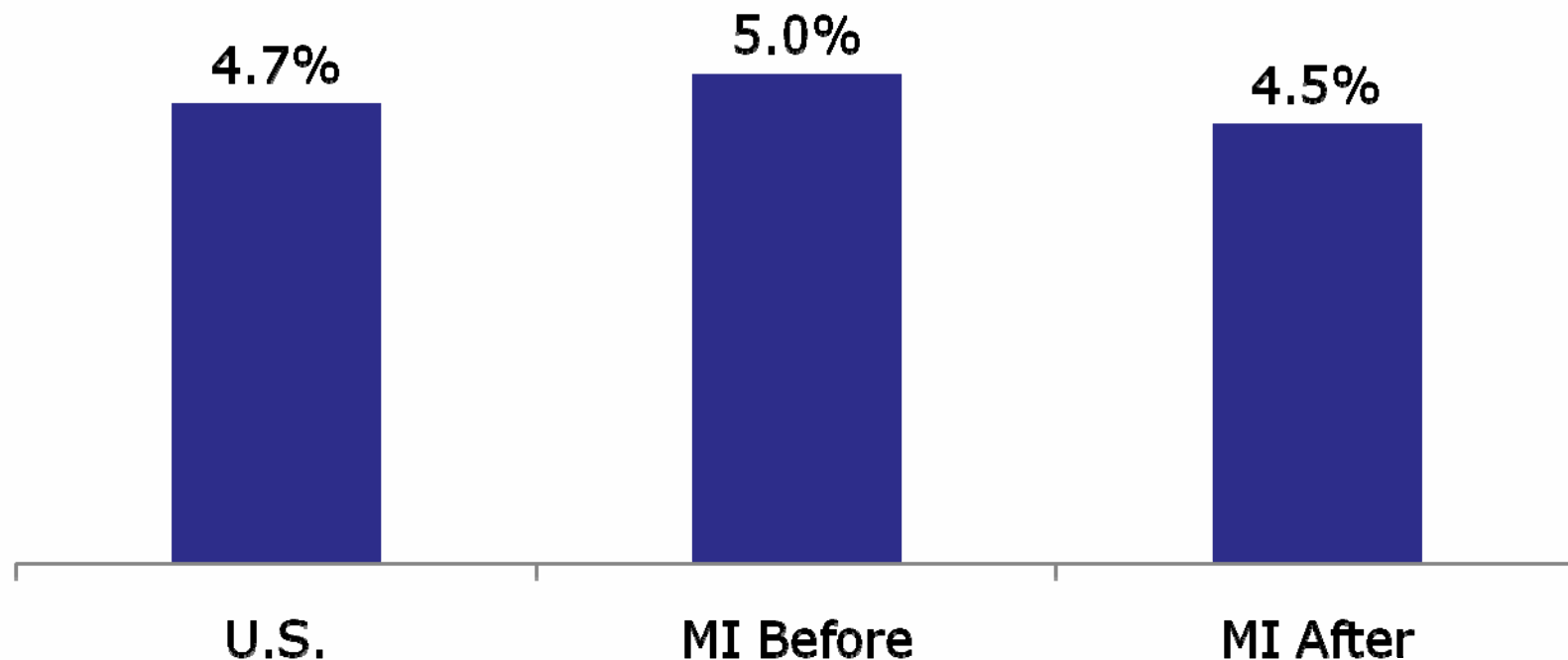
Summary of Tax Changes

	<u>FY 2012</u>	<u>FY 2013</u>
MBT Current Law	\$2,170.0	\$2,024.0
Revenues from Proposed Reforms		
MBT (4th quarter 2011 and annual pymts)	\$900.2	\$0.0
New Corp Tax	<u>\$194.8</u>	<u>\$292.7</u>
Bus. Tax Under Budget Proposal	\$1,095.0	\$292.7
Net Business Tax Cut	(\$1,075.0)	(\$1,731.3)
Income Tax Increases	<u>\$820.9</u>	<u>\$1,863.8</u>
Net Impact Proposed Changes	(\$254.1)	\$132.5 *

* Budget Indicates \$100 million of FY 2013 revenues will be reserved for tax cuts

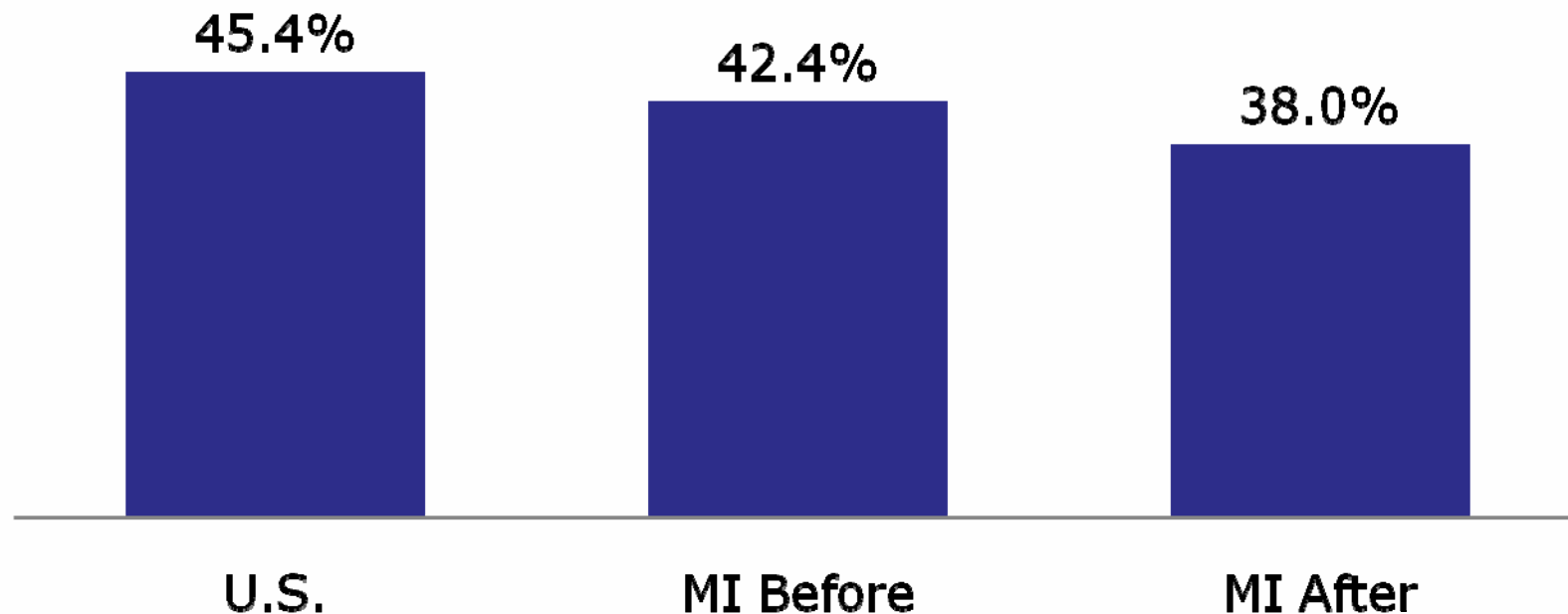


Michigan's S&L Business Taxes as % of GSP Would fall from 19th to 35th Highest





S&L Business Taxes as % of All State and Local Taxes from 35th to 45th Highest





Who Pays the MBT?

- Statutory incidence of the MBT is on corporate and non-corporate entities
- Ultimately, burden of any tax is borne by individuals
- Possible ways MBT burden is borne by individuals:
 - Lower rate of return on capital for shareholders and other capital owners
 - Reduced wages received by workers
 - Higher prices paid by consumers
- While it is reasonable to assume that most of the MBT burden is borne through a reduced rate of return on capital for those doing business in Michigan, this has not been established empirically, so while a reasonable
30 conjecture, it is an assumption



How Would the Statutory Burden on Business Change?

- **MBT to corporate tax represents an 86% cut** in FY 13. Looking at all state and local taxes paid by businesses (using COST estimates) roughly a 10% cut.
- **Non-corporate entities** currently subject to MBT and individual income tax; they now would only be subject to individual income tax (**go from tax disadvantaged to tax advantaged**)



How Would the Statutory Burden on Business Change (cont)?

- Large cut means that most businesses should pay less – however, **loss of personal property tax credit means that some firms will pay more**, especially multistate manufacturing firms based in Michigan
- **MBT** has significant credits for Michigan based activity in **an attempt to export the tax**; rescinding these credits means the share of tax cut received by out-of-state firms likely greater than share of MBT they pay



How Does the Burden Change on Individuals?

- Income tax increases concentrated among **seniors** (loss of pension exemption, reduction in HPTC) and **low-income individuals with wage income**
- EITC approx. \$350M claimed by over 700,000 Michigan taxpayers; MI credit started in 2008



How Does the Burden Change on Individuals (cont)?

- While repealing the pension exemption is a move towards treating taxpayers with similar income similarly, the repeal of exemption represents a **significant tax increase on seniors** (\$800M)
- Repeal of non-refundable credits raises individual taxes by \$85 million with increase concentrated among those paying city income taxes (\$32M) and those making contributions to certain charities (\$45M)



Will the Tax Changes Improve Economic Growth?

Positive Impacts

- The new lower tax should increase the return on capital invested in Michigan leading to greater investment and economic growth (assuming MBT is a tax on capital)
- Money appropriated for economic development will work to offset the effect of removing investment credits
- Simpler and lower business tax should improve Michigan's reputation among businesses, encouraging firms to invest here



Economic Impact Continued

Negative Impacts

- Overall tax change is revenue neutral: tax increase on seniors and low income workers will reduce their consumption which has a negative impact on Michigan's economy
- Repeal of EITC reduces return to low wage workers for participating in the labor market
- Tax relief will be spread across new investment and existing capital, while this improves fairness, tax relief for existing capital does not improve growth



Economic Impact Continued

Negative Impacts (continued)

- Repeal of personal property tax credit means that taxes for some types of investment may be higher than under the MBT
- Repeal of brownfield credit and loss of personal property tax credit will reduce the incentive to invest in urban areas



Economic Impact Bottom Line

- Overall impact is unclear: tax change will improve Michigan's reputation in the business community and increase the rate of return for investing in Michigan
- If this effect is greater than the drag on consumption from the higher income taxes, overall changes should have a net positive impact on growth



Other Factors To Consider

- The new business tax will be easier to administer for both taxpayers and the state
- There is merit in moving economic development from tax expenditures to the appropriations process
- The constitutionality of taxing public pensions and phasing-out the personal exemption for high income taxpayers will likely be challenged in court
- Shifting \$1.8B in taxes from businesses to individuals will make Michigan's tax system more regressive



Other Factors To Consider

- Removal of the pension exemption will improve growth rate of the income tax and will increase equity among income taxpayers, but it represents a large tax increase on seniors
- The income tax will grow faster under the proposed changes because Michigan's population is aging and pension income will represent an increasing share of Michigan personal income.
- In the long run, low-income households could come out ahead if the tax changes lead to significantly higher economic growth



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