Citizens Research Council of Michigan

Recent Michigan Tax Changes

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- Promotes sound policy for state and local governments through factual research – accurate, independent and objective
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Public Act 38 of 2011

- Repealed the Michigan Business Tax
- Replaced with a 6% Corporate income tax
- New simpler business tax raises $1.6 billion **less**

- Income tax changes include
  - Freeze the rate at 4.25% starting 1/1/13
  - Eliminate, limit, and restructure various income tax deductions and credits
- Simpler income tax raises $1.4 billion **more**

Business Tax Changes

Business Taxation in Brief

Potential Reasons For Taxing Business

- Pay for services consumed by business
- Increase progressivity of tax structure (assumes owners bear most of burden – not workers or consumers)
- Export a portion of tax
- Hidden burden (political reason not a policy reason)

Potential Reasons for Not Taxing Business

- Tax may lead to reduced investment and economic growth
- Equity or tax burden issues

Why Was MBT So Unpopular?

- Tax complex and unique among states
- Initial revenue neutral swap with SBT meant many businesses saw a tax increase
- Addition of surcharge represented a large tax increase over the SBT (~30%)
- Noncorporate entities (partnerships, LLCs, etc.) paid both MBT and IIT (also present w/ SBT)
- Targeted tax incentives (MEGA, battery, film, etc.) created equity issues (also present w/ SBT)

MBT to Corporate Tax

- Flat 6% rate on C corps only (non corp exempt)
- Repeal all credits (accept certain legacy credits and one small business credit)
- Retain legacy credits already promised (MEGA, battery, etc.) totaling ~$500M per year
- Replace revenues with income tax increases
- FY2103 MBT net of legacy credits estimated to be $1,991M, corp tax net of legacy credits $343M (83% reduction in tax)

Full Year Estimate of Business Tax Change (millions of $)

	FY2013 Estimate
MBT Revenues	$1,990.6
6% Corporate Income Tax	$799.1
Financial Institutions Tax	$43.9
Legacy Credits	($500.0)
Net Corporate Tax Revenues	$343.0
Net Tax Change	**($1,647.6)**

Source: House Fiscal Agency

Broad Tax Relief vs. Targeted Incentives

- Business taxation in general discourages investment
- Broad tax relief reduces disincentive by lowering tax on everyone: tax relief for those who would have invested anyway, those who aren't investing, and those who are only going to invest if the tax burden is lower
- Targeted tax relief: attempt to identify those where the tax prevents the investment and direct the tax relief there (e.g., the "but for" test in MEGA)

Broad Tax Relief vs. Targeted Incentives

- <u>Targeted tax relief</u> is significantly cheaper **but** it presumes government can identify those firms whose investment decisions will change based on the tax relief

- <u>Targeted tax relief</u> can raise equity issues – e.g. credit provided to a firm making a new investment to locate in Michigan, but not to the longstanding MI firm that made its investment in the past

- MBT to Corporate change moves philosophically from targeted relief to broad relief

Income Tax Changes

Pension Changes

- Michigan had very generous tax exemptions for pension income; For tax year 2011 (old law):
  - Social Security was exempt
  - Public pensions were exempt
  - Private pensions: subtract up to $45,120 single return or $90,240 joint return
  - Subtraction allowed for portion of dividends, interest, and capital gains (approx. $10k/$20k but reduced by retirement exemption claimed)
- For new law exemptions vary by age:
  - Born before 1946
  - Born 1946 to 1952
  - Born after 1952

Source: Michigan Department of Treasury

Taxpayers Born Before 1946

- **No change in tax treatment for pension income from old law!**
- However, other non pension related tax changes described later (rate, homestead credit, etc., will apply)

Source: Michigan Department of Treasury

Taxpayers Born 1946 to 1952 Before Taxpayer Reaches 67

- Social Security is still exempt
- Exemption for public and private pensions limited to $20,000 for single return; $40,000 for joint
- Not eligible for dividend, interest, and capital gain subtraction
- Not eligible for pension exemption if household resources exceeds $75,000 for a single return or $150,000 for joint return

Source: Michigan Department of Treasury

Taxpayers Born 1946 to 1952 After Taxpayer Reaches 67

- Social Security is still exempt
- Subtraction against all income of $20,000 for single return; $40,000 for joint return (i.e. not just pension income)
- Not eligible for dividend, interest, and capital gain subtraction
- Not eligible for income exemption if household resources exceeds $75,000 for a single return or $150,000 for joint return

Source: Michigan Department of Treasury

Taxpayers Born After 1952 Before Taxpayer Reaches 67

- Social Security is still exempt
- Not eligible for pension exemption
- Not eligible for interest, dividend, and capital gain subtraction

Source: Michigan Department of Treasury

Taxpayers Born After 1952 After Taxpayer Reaches 67

- Not eligible for pension exemption
- Not eligible for interest, dividend, and capital gain subtraction
- **Choose Between:**
  - Exemption for $20,000 Single/$40,000 joint income exemption (but no separate Social Security exemption); not eligible if income greater than $75k/$150k
  - But no personal exemptions allowed

  OR

  - Elect to exempt Social Security
  - Personal exemptions allowed (but subject to income phase out)

Other Changes

- Earned income tax credit goes from 20% to 6%
- Property tax credit is scaled back, particularly for seniors
- Personal exemption phased out for high income taxpayers;
- $2,300 senior special exemption eliminated (approx. $100 tax increase per senior)
- Most nonrefundable credits eliminated

Full Year Estimate of Income Tax Change (millions of $)

	FY2013 Estimate
Freeze IIT Rate at 4.25%	$223.0
Repeal Nonrefundable credits	$104.5
Reduce EITC	$261.6
Reduce HPTC	$270.2
Reduce Pension Exemptions	$343.4
Phase out Personal Exemp.	$83.4
Other Changes	$137.6
Net Income Tax Change	**$1,423.7**

Source: House Fiscal Agency

Timing of Changes

- Tax changes effective January of 2012
- Will not affect returns filed in April of 2012 since these are for tax year 2011
- Safe Harbor: Penalties will not be assessed in April of 2013 as long as taxpayer pays as much in 2012 as their liability was in 2011
- If born after 1946 may see tax withholding from pension starting in January 2012

Will It Help Economic Growth?

- Reduction in business tax improves return on investment in Michigan
- Lower tax, simpler structure will improve MI's reputation among businesses
- Repeal of PPT credit means large multistate mfrs with a lot of personal property pay more
- Increase in income tax reduces consumption, net tax cut reduces govt spending
- ? Net Impact unknown but likely small (but small differences compounded over time can make a big difference)

For More Information

The Michigan Department of Treasury has detailed information on the tax changes, including a webinar, available on their webpage.

See: www.michigan.gov/treasury

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