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The State Income Tax Trigger: What Happens in 2023?

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Presentation to Michigan Chamber of Commerce – Tax Policy Advisory Committee

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https://crcmich.org/event/state-income-tax-trigger-2023

Coming Monday, May 17

2021 update of the *Outline of the Michigan Tax System*

https://crcmich.org/tax-outline

Refresher: History of the Income Tax Trigger

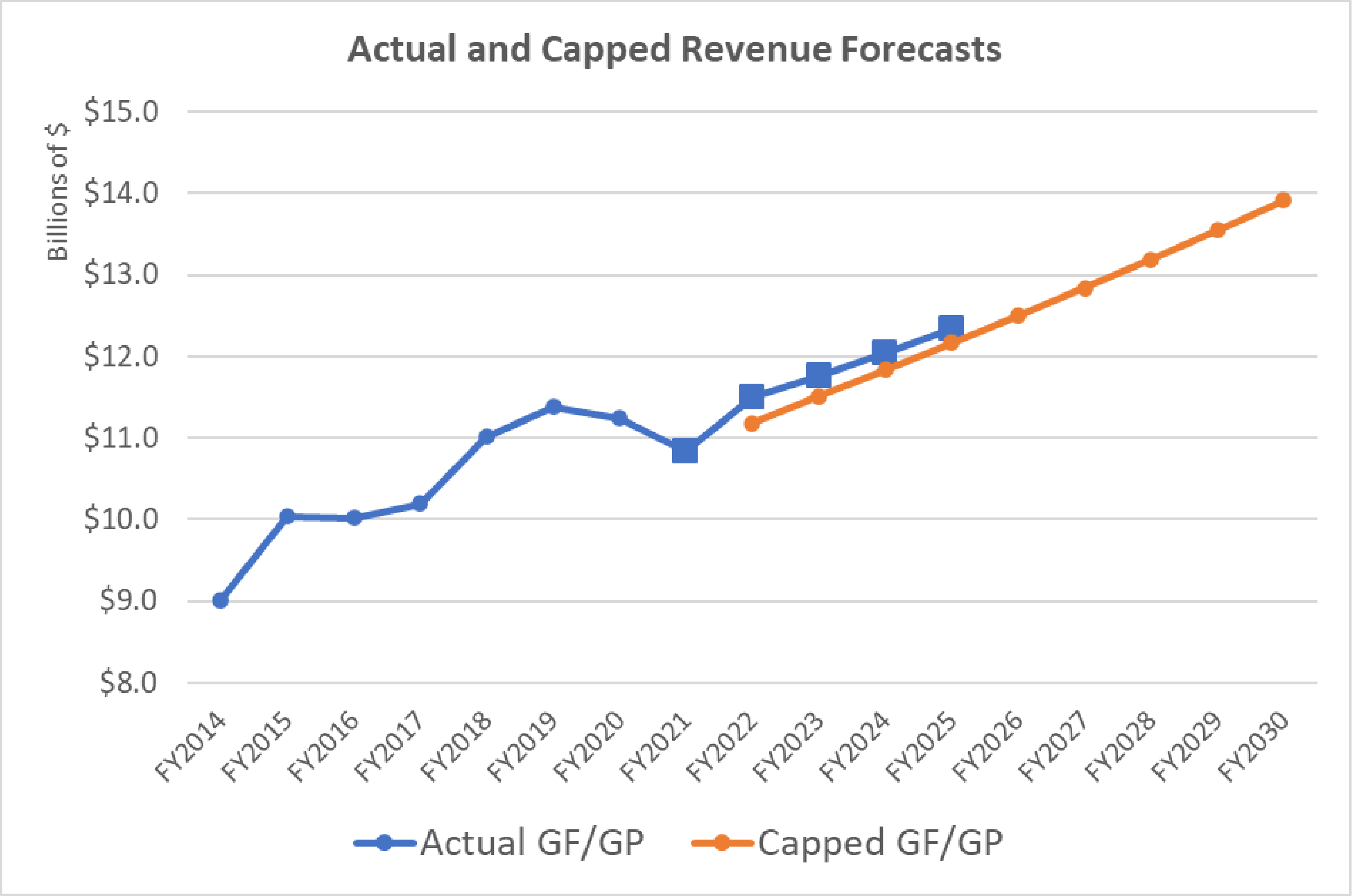
2015 Transportation Package

- Followed failed May ballot measure to raise motor fuel and sales taxes
- Gasoline and diesel tax to 26.3 cents per gallon; inflation adjustment begins in 2022
- 20% increase in vehicle registration fees
- Earmarked income tax revenue to roads: $150 million in FY2019 phased up to $600 million each year
- Expanded Homestead Property Tax Credit
- **Created an income tax trigger mechanism – income tax rate falls by a calculated amount if revenue growth exceeds inflation by a sufficient amount**

Trigger Implementation Timeline

- Statute calls for an initial determination on triggered rate reduction by the January 2023 Consensus Revenue Estimating Conference (CREC)
  - Any trigger rate reduction would apply to 2023 tax year
  - Conferees: State Treasurer, Directors of House and Senate Fiscal Agencies
- Determination based how FY2022 General Fund/General Purpose (GF/GP) revenue compares to inflation-adjusted GF/GP revenue from a fixed base year – FY2021
- Annual trigger determinations repeat every January; looking back to the FY2021 base year

Current Revenue Estimates Indicate Trigger Will Reduce Income Tax Rate in 2023



- Blue: GF/GP revenues (large boxes represent January 2021 CREC estimates)
- Orange: CRC estimates of capped GF/GP under the trigger (assumes 2% long-term inflation)
- January estimates call for revenue rebound from FY21 low; GF/GP up by about 6%
- Long term forecasts remain above trigger capped level for several years; and FY21 base revenue may go lower

Trigger Calculations: Revenues and Inflation

Step 1: Does annual GF/GP revenue growth exceed inflation?

General Fund/General Purpose Revenue (includes roads earmark)

- FY2022 Estimate: $11,497.1 million
- FY2021 Estimate: $10,837.5 million
- Growth Rate = 6.09%

U.S. Consumer Price Index (all urban consumers)

- FY2022 Estimate: 268.514
- FY2021 Estimate: 262.663
- CPI Inflation Rate: 2.23%

Yes, revenue growth exceeds inflation

Source: January 2021 CREC Executive Summary.

Trigger Calculations: Excess Revenue Amount

Step 2: By how much does GF/GP exceed statutory capped level?

Capped GF/GP Revenue

- Uses FY2021 GF/GP revenue as a starting point
- Revenue cap grows at CPI inflation times a fixed statutory multiplier (1.425)

$$\$10{,}837.5\text{ million} \times \frac{268.514}{262.663} \times 1.425 = \$11{,}181.5\text{ million}$$

$$\text{FY21 Base Revenue} \times \frac{\text{FY22 CPI}}{\text{FY21 CPI}} \times \text{Multiplier} = \text{Tax Year 2023 Cap}$$

Estimated FY22 revenue is $11,497.1M, which exceeds capped revenue by $315.6M

Source: January 2021 CREC Executive Summary.

Trigger Calculations: Rate Reduction

Step 3: Use excess revenue to calculate rate reduction

Income tax rate adjustment percentage is calculated by dividing excess revenue above capped amount by total gross income tax collections

Excess Revenue Over Cap / **FY22 gross income tax revenue**	**$315.6 million** / **$13,372.7 milllion**	**=**	**2.36%**
Tax Rate x adjustment percentage	**4.25% x 2.36%**	**=**	**0.10%**

Tax year 2023 income tax rate is reduced from 4.25% to 4.15%

Source: January 2021 CREC Executive Summary.

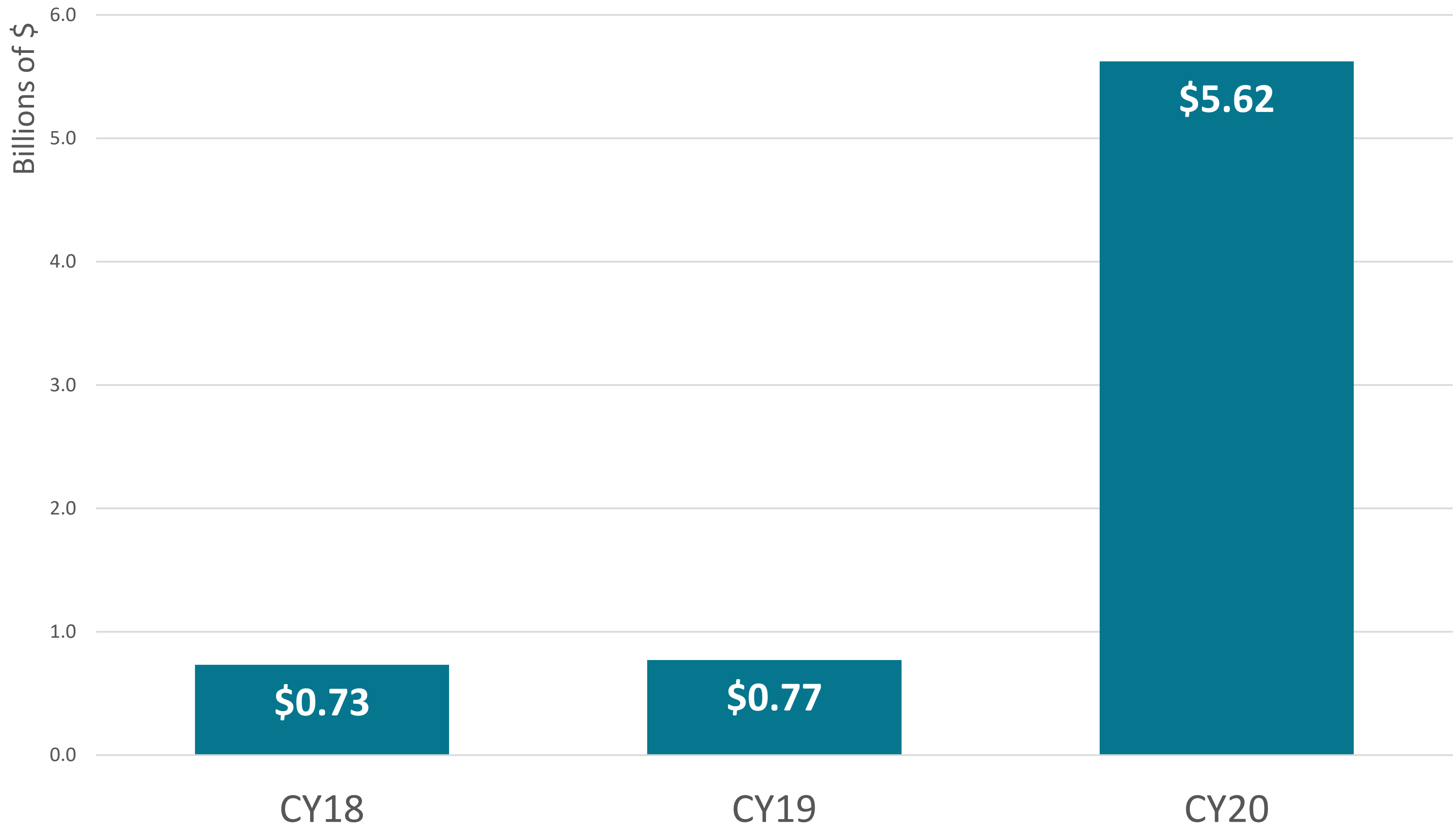
Will Thing Get Worse for FY2021 Revenue?

- Consensus Revenue Estimating Conference scheduled for Friday, May 21
- Good news: Revenues are generally tracking above monthly forecasts tied coming out of January 2021 estimates
- Bad news (at least for revenues): Federal exemption of Unemployment Insurance (UI) benefits will likely bring FY2021 GF/GP revenues further down
- Trigger Impact: The low revenue point used as the trigger's base likely gets even lower

Stimulus Exempts UI Benefits from Income Tax

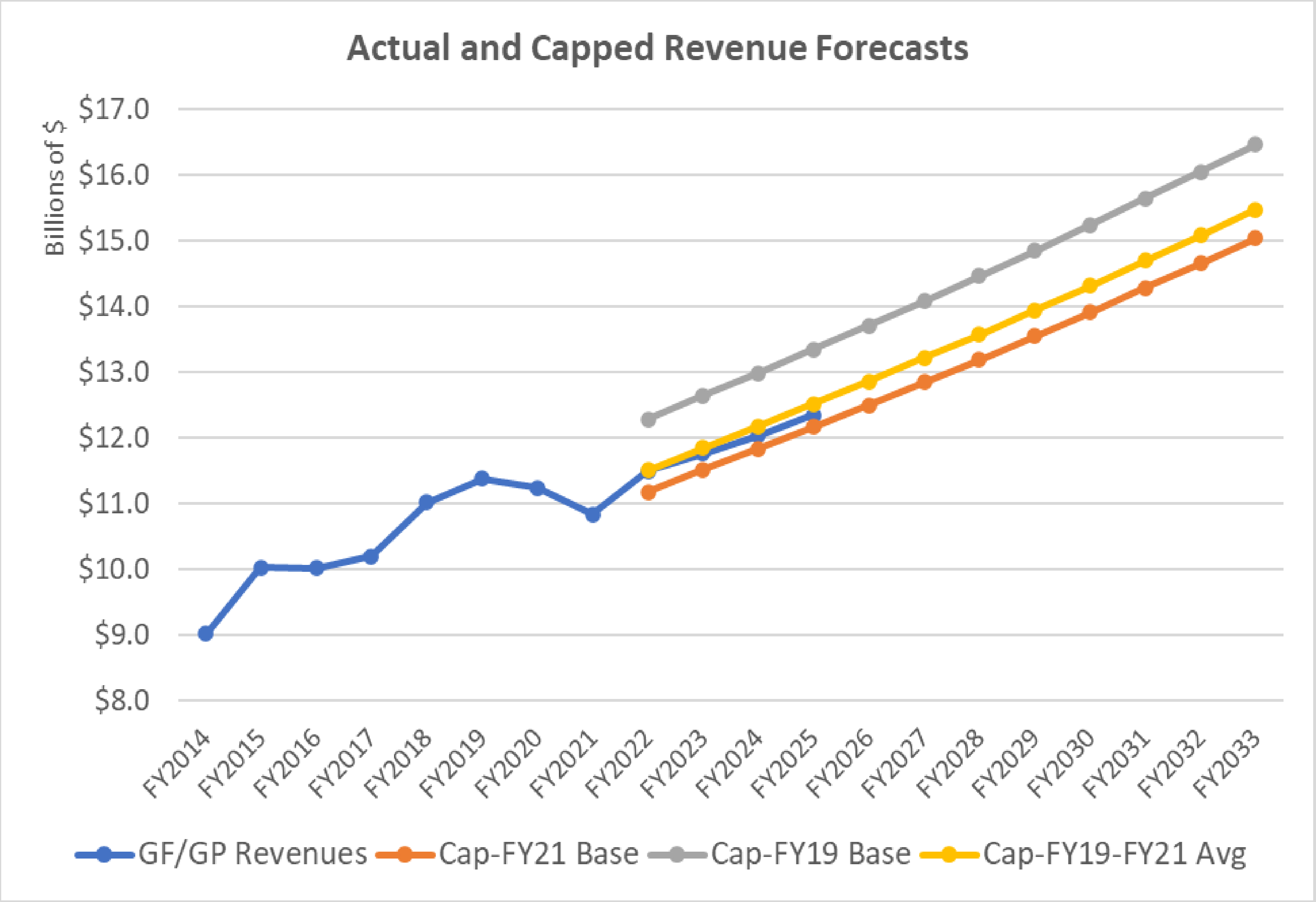
- For tax year 2020, Unemployment Insurance benefits will be partially exempt from federal income taxes to avoid April surprises for recipients; applies to Michigan income tax as well
  - Benefits of up to $10,200 are tax exempt
  - Applies to persons with Adjusted Gross Income below $150,000
- Implications for Michigan
  - Withholding alone from UI was $557 million
  - Estimated that only around half withhold from benefits
  - Many have filed already – amended returns would be needed
  - Impact is uncertain – additional stimulus dollars could be needed to cover revenue loss

UI Benefits in 2020 are 750% of Pre-COVID Levels



Source: U.S. Department of Labor data.

CRC Recommendation: Re-examine the Trigger's Base Year



- Orange: current law capped revenue
- Yellow: base year adjusted to three-year average (FY19-21)
- Gray: base year adjusted to FY2019

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