

Tax Cut Proposals and the State Budget

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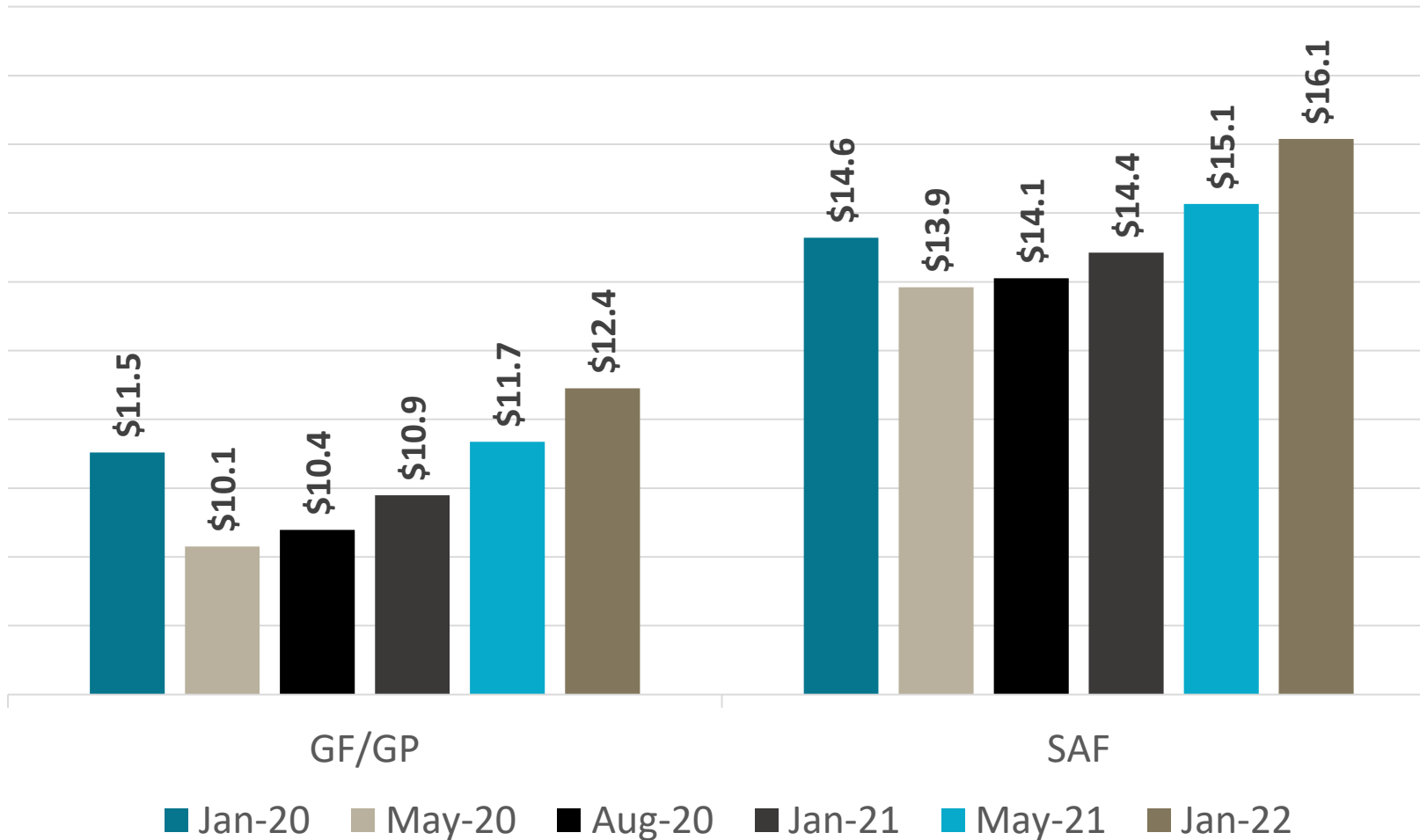
Legislative Training Session

MSU Institute for Public Policy and Social Research

State Revenue Picture

Long-Term Budget Outlook

Revenue Forecasts Come Full Circle



FY2022 Revenues

- Projections drop by \$2.1 billion in May 2020 due to the early economic disruptions from the pandemic
- In January 2022, forecasts are now a staggering \$2.4 billion above the last pre-pandemic forecast

Source: January 2021 CREC Final Summary.

Implications for Budget and Tax Policy

Revenue Surge Results in Large Fund Surpluses

FY21 Year-End Fund Balances	
GF/GP	School Aid Fund
\$4.3 billion	\$2.9 billion

- After the onset of COVID-19, FY2020 and FY2021 appropriations were slashed to prepare for the worst. Instead, revenues boomed.
- Result: State has a revenue surplus over \$7B in its two major revenue funds
- Surplus is due to state revenue growth; none of this is tied to recent federal funding allocations

Long-Term Budget Outlook

(Millions of \$)

General Fund/General Purpose	<u>FY22</u>	<u>FY23</u>	<u>FY24</u>	<u>FY25</u>
Revenue projections	\$12,447	\$12,890	\$13,312	\$13,652
Baseline spending	\$13,995	\$12,228	\$12,337	\$12,500
Revenue Minus Spending	(\$1,548)	\$662	\$975	\$1,152

School Aid Fund	<u>FY22</u>	<u>FY23</u>	<u>FY24</u>	<u>FY25</u>
Revenue projections	\$18,782	\$18,788	\$19,059	\$19,431
Baseline spending	\$17,447	\$16,893	\$16,807	\$16,807
Revenue Minus Spending	\$1,335	\$1,895	\$2,252	\$2,624

Key Takeaways:

- Around \$1 billion in available ongoing GF/GP revenue
- More than \$2 billion in available ongoing SAF revenue
- Options for policymakers: New spending priorities? Tax relief?

Billion-Dollar Question: What Comes out of CREC???

- Consensus Revenue Estimating Conference scheduled for next Friday, May 20.
- Negatives:
 - Federal Reserve interest rate hikes to counter high inflation
 - Lots of uncertainty related to Russia/Ukraine
 - Continuing supply chain challenges
 - Likelihood of national recession seems significantly higher
- Positives:
 - Employment continues to grow and recover from the huge drop experienced at the beginning of the COVID-19 pandemic
 - As a result, FY2022 revenues are actually looking stronger than January forecasts
- Best guess: more one-time revenue; but less ongoing revenue after Friday

What About the Budget?

Spending Decisions Will Determine What's Left for Tax Relief

“Best Guess” at FY2023 Budget Deliberations

(\$ in millions)

	Executive	House	Senate*	Best Guess Deal
Ongoing General Fund	\$12,638	\$11,408	\$11,687	\$12,000
One-Time General Fund	\$3,148	\$2,999	\$730	\$3,000
Ongoing School Aid Fund	\$18,861	\$16,123	\$16,712	\$17,500
One-Time School Aid Fund	\$4,090	\$2,345	\$599	\$3,000

* = Senate figures do not include \$2 billion appropriated for tax relief

Long-Term Budget Outlook With “Deal”

(Millions of \$)

General Fund/General Purpose	<u>FY22</u>	<u>FY23</u>	<u>FY24</u>	<u>FY25</u>
Revenue projections	\$12,447	\$12,890	\$13,312	\$13,652
"Best Guess" Budget Deal	\$13,995	\$14,500	\$12,300	\$12,500
Revenue Minus Spending	(\$1,548)	(\$1,611)	\$1,012	\$1,152

School Aid Fund	<u>FY22</u>	<u>FY23</u>	<u>FY24</u>	<u>FY25</u>
Revenue projections	\$18,782	\$18,788	\$19,059	\$19,431
"Best Guess" Budget Deal	\$17,447	\$20,500	\$17,750	\$18,000
Revenue Minus Spending	\$1,335	(\$1,712)	\$1,309	\$1,431

Key Takeaways:

- Around \$1 billion in available ongoing GF/GP revenue
- Around \$1.3 billion in available ongoing SAF revenue
- Estimated Balances at end of FY23: \$1.2B GF/GP; \$2.5B School Aid Fund

Income Tax on Retirement Income

Tax Relief: Treatment of Retirement Income

2011 changes: Eliminates exemption of public retirement and pension benefits from state income tax; reduces general deductions for retirement benefits for persons born after 1945 and limits deductions to those reaching age 67

Governor's proposal would repeal these changes, giving retirees the option to apply either "old rules" or "new rules". Changes are phased in by tax year:

- Tax year 2022: aged 65 or older; 25% exemption of retirement income
- Tax year 2023: aged 62 or older; 50% exemption of retirement income
- Tax year 2024: aged 59 or older; 75% exemption of retirement income
- Tax year 2025: everyone; 100% exemption of retirement income

Governor's Retirement Proposal	FY2022	FY2023	FY2024	FY2025
Estimated Foregone Revenue	\$13M	\$107M	\$285M	\$495M

Tax Relief: Treatment of Retirement Income

Legislative proposal (SB 768)

- Standard deduction of \$20K (single filer) and \$40K (joint filers) for all income

Current Law: available at age 67

Legislative proposal: eligible at age 62

- Additional exemption of \$20K (single)/\$40K (joint) specifically for any retirement income not exempted by standard exemption
- Single semi-retiree w/ \$10K in earned income, \$40k in retirement income
 - Standard exemption exempts \$10K earned income plus \$10K retirement income
 - Additional exemption exempts another \$20K in retirement income

Legislative Retirement Proposal	FY2022	FY2023	FY2024	FY2025
Estimated Foregone Revenue	\$296M	\$754M	\$622M	\$635M

Taxpayer Examples Under Both Plans

60-year-old retiree with \$40,000 annual public pension; no other income

New Rules	Governor's Proposal		Legislative Proposal	
No special exemption for any public pension income	TY22	N/A	TY22	N/A
	TY23	N/A	TY23	N/A
	TY24	75% exempt	TY24	\$40K exempt
	TY25	100% exempt	TY25	\$40K exempt

Taxpayer Examples under Governor's Plan

63-year-old married couple with combined \$100,000 in retirement income from private pension and IRA deductions

New Rules	Governor's Proposal		Legislative Proposal	
	TY22		TY22	
No special exemption for any IRA deductions or private pension income		N/A		N/A
	TY23	\$60K exempt	TY23	\$80K exempt
	TY24	\$92K exempt	TY24	\$80K exempt
	TY25	\$125K exempt	TY25	\$80K exempt

Taxpayer Examples under Governor's Plan

69-year-old single retiree with \$60,000 in retirement income from private pension

New Rules	Governor's Proposal		Legislative Proposal	
Since already age 67, can deduct \$20K from all income	TY22	\$14K exempt	TY22	\$40K exempt
	TY23	\$30K exempt	TY23	\$40K exempt
	TY24	\$46K exempt	TY24	\$40K exempt
	TY25	\$63K exempt	TY25	\$40K exempt

Cutting the Income Tax Rate

Cutting the Income Tax Rate to 3.9%

- SB 768 had proposed cutting the state income tax rate from its current 4.25% to 3.9% effective April 1, 2022
- Household with \$50,000 in taxable income saves about \$175 each year
- Each 0.1% rate reduction reduces revenue by around \$340 million
- Statutory provisions ensure that 100% of revenue losses from income tax rate changes impact the General Fund

	FY2022	FY2023	FY2024	FY2025
Foregone Revenue	\$498M	\$1.3B	\$1.1B	\$1.1B

Income Tax Credits

Earned Income Tax Credit

- 2011 changes: EITC reduced from 20% of the existing federal credit to 6% of that federal credit
- Governor's proposal would return the EITC to 20% of the federal credit; maximum credit would rise from \$359 for tax year 2021 to \$1,233 for tax year 2022
- State Budget Office estimates average credit will increase by around \$300 to \$450 dollars per year for 738,000 eligible low-income households with earned income

	FY2022	FY2023	FY2024	FY2025
Foregone Revenue	\$0	\$262M	\$267M	\$272M

Child Tax Credit

- Legislature approved a non-refundable child tax credit of \$500 per eligible dependent aged 19 or under during a given tax year (about 1.5M eligible)
- Part of the package in SB 768 that was vetoed in March
- Long-term revenue impact of around \$775 million annually (SFA)
- GF vs SAF impact is difficult to predict; SFA estimates around 15% of the revenue would impact the School Aid Fund (about \$116M)

Foregone Revenue	FY2022	FY2023	FY2024	FY2025
Total Foregone Revenue	\$581M	\$775M	\$775M	\$775M

Summary: Menu of Income Tax Options

Long-Run Revenue Loss

Options	GF/GP	SAF	Total
Income Tax Rate to 3.9%	\$1.1B	\$0	\$1.1B
Retirement Tax Revisions (Hybrid)	\$440M	\$110M	\$550M
Increase Earned Income Tax Credit	\$272M	\$0	\$272M
New \$500 Child Tax Credit	\$659M	\$116M	\$775M
Total – All Options	\$2.5B	\$226M	\$2.7B

Remember from previous slide, surplus revenue available is:

- About \$1 billion GF/GP
- About \$1.3 billion SAF

Sales Tax Holiday for Gasoline

One-Time Tax Relief

Is a Sales Tax Holiday for Gasoline Coming?

All parties appear to be amenable to suspending the sales tax on gasoline for a limited time period

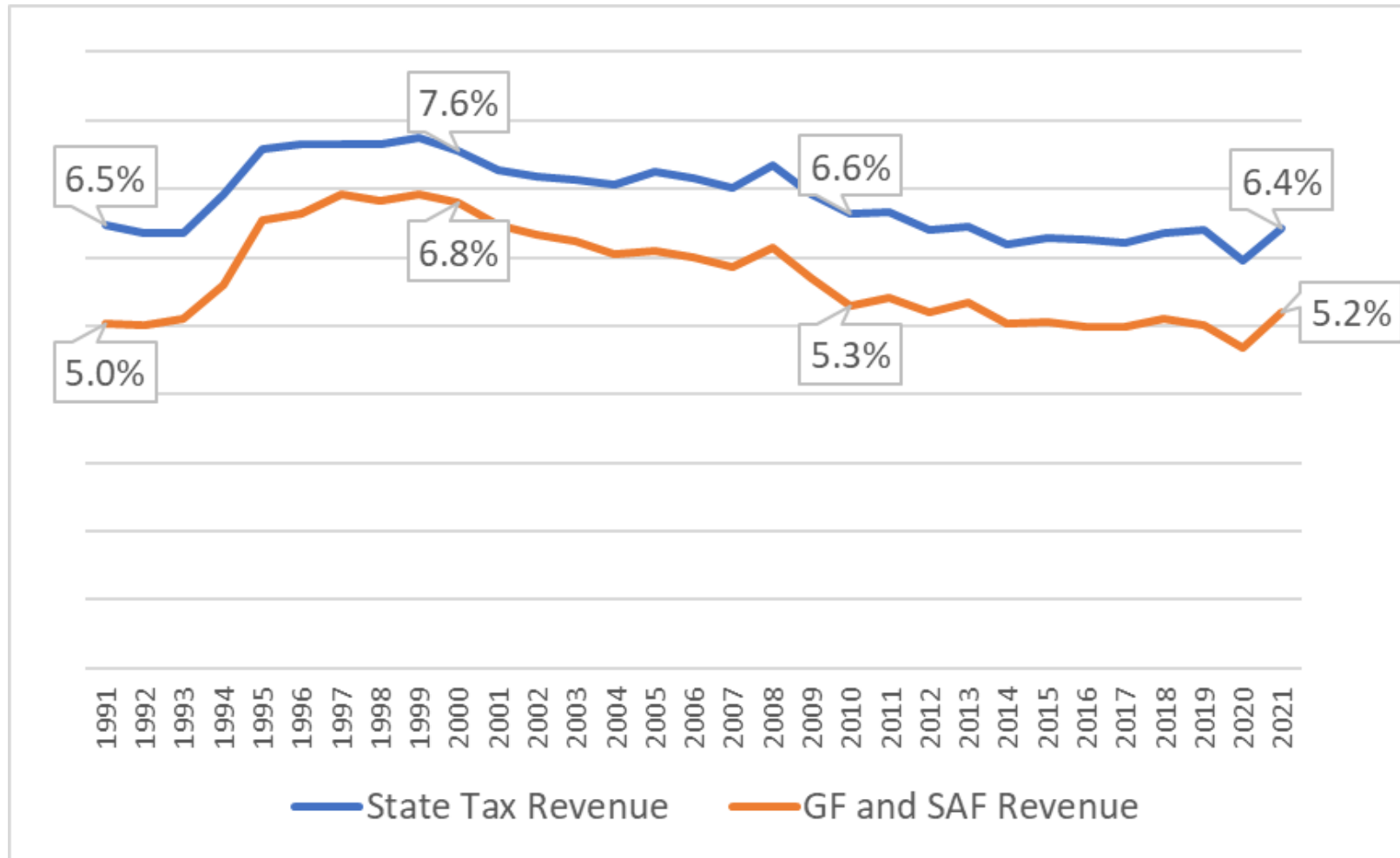
If gasoline prices remain in the \$4.00 - \$4.25 per gallon range, a six-month suspension of the sales tax on gasoline would result in reduced revenue of around \$650M to \$700M

Budget Implications with \$700M Revenue Loss	
School Aid Fund	\$511M
General Fund/General Purpose	\$87M
Constitutional Revenue Sharing	\$70M
Public Transit Funding	\$32M

Tax Burden in Michigan

Are We “High Tax” or “Low Tax”?

Michigan Tax Burden Since 1991



Proposal A (school finance reform) boosted tax burden in early mid-1990s

Since FY2000, tax burden has fallen back to pre-Proposal A levels

Source: Research Council calculations from Senate Fiscal Agency data.

Combined State and Local Tax Burden

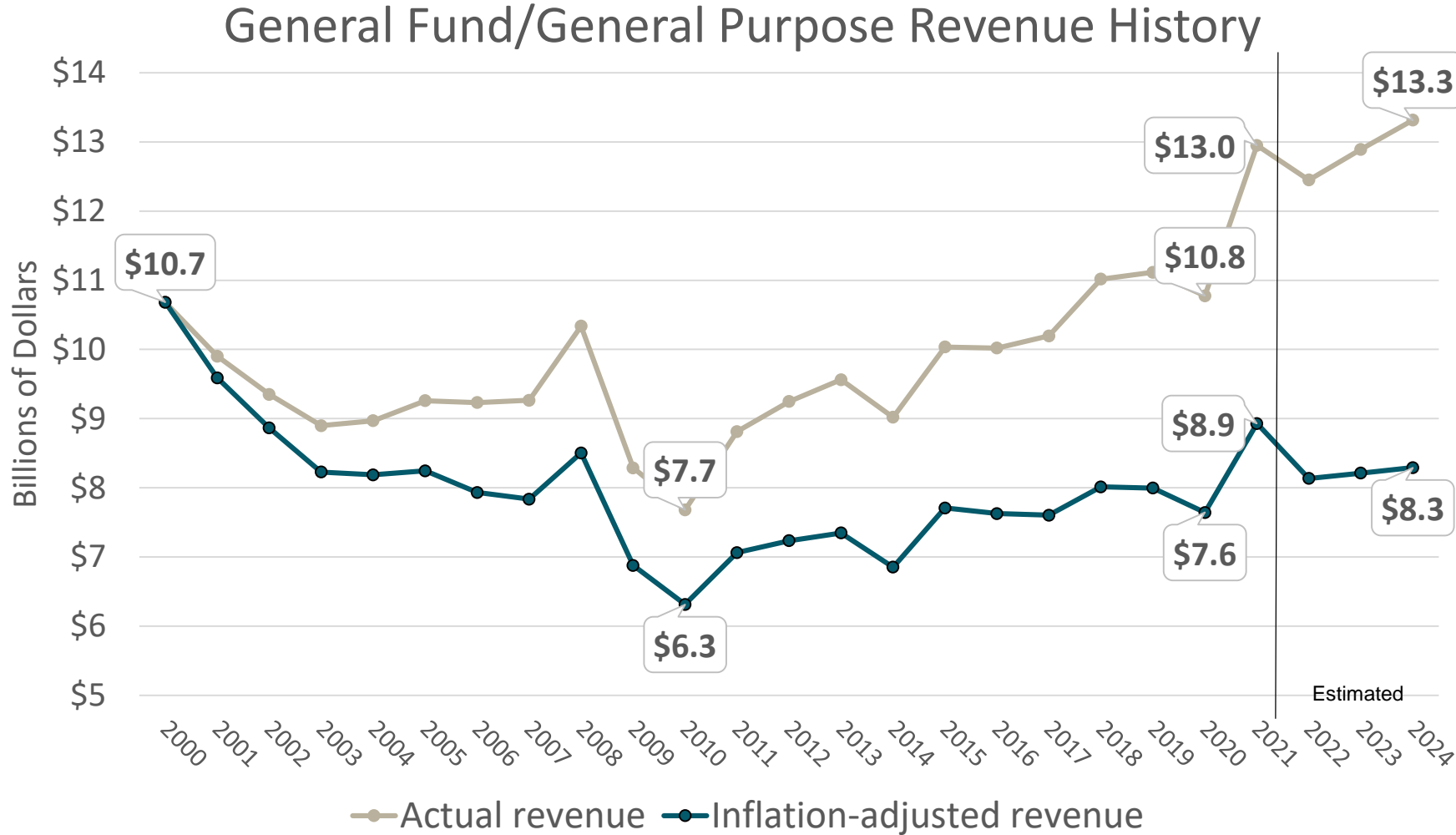
	<i>Effective Tax Rate</i>	<i>National Rank</i>
Illinois	12.9%	7
Minnesota	12.1%	12
Iowa	11.2%	17
Wisconsin	10.9%	19
Pennsylvania	10.6%	23
Ohio	10.0%	27
Kentucky	9.6%	34
Indiana	9.3%	37
Michigan	8.6%	46
Tennessee	7.6%	48

Estimates for calendar year 2022 from the non-profit Tax Foundation

Michigan ranks 46th nationally relative to all 50 states

Source: Tax Foundation, [State and Local Tax Burdens, Calendar Year 2022](#)

Budget Perspective: General Fund History



Revenue in FY2020 was effectively the same as it was two decades earlier in FY2000

Adjusted for inflation, FY2024 revenue is still expected to be down by more than 22% from FY2000

Source: Research Council calculations from Senate Fiscal Agency data.

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