

Tax Cut Proposals and the State Budget

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Tax Treatment of Retirement Income

Long-Term Budget Outlook

Snapshot: Treatment of Retirement Income

	Old Rules	New Rules
Public pensions	exempt	For taxpayers born after 1952:
Private pensions IRA distributions Annuities Employer and mandated 401k contributions	exempt up to \$113K in 2022	Before age 67: SS benefits exempt other income taxed At age 67: May exempt up to \$20k/\$40k (single/joint) of all income
Elective 401k contributions 457 plans	no special tax treatment	

Governor's FY23 Proposal

Proposal 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	FY2023	FY2024	FY2025	FY2026
Estimated Foregone Revenue	\$13M	\$107M	\$285M	\$495M

Two Views of Fairness: Disparate Treatment of Income under Old Rules

Affluent retired couple with \$50k in IRA distributions and \$40k public pension income to supplemental Social Security

- \$90K in retirement income is fully tax exempt under “old rules”

Retired couple had modest incomes and little retirement savings until later in life; elective catch-up payments as they neared retirement age support most of \$20k distribution from 401(k)

- 401(k) distributions that don't come from employer or from employer-mandated contribution are taxable under “old rules” after personal exemption and any other deductions/exemptions

Two Views of Fairness: Changing the Rules

Single person was able to take early retirement at age 55 in 2010 (born in 1955). Draws \$40k each year from IRA and another \$40k from 401(k) to supplement Social Security

Expectation: \$80k in supplemental income would be tax exempt under "old rules"

Reality after 2011: Since person was born after 1952, no special exemption for any of this supplemental income under "new rules". When person turned 67 (in 2022), limited exemption of \$20k is available against all income (including Social Security); or could just keep personal exemption and SS exemption

Tax Proposals and the Budget

Spending Decisions Will Determine What's Left for Tax Relief

Income Tax Trigger

- State income tax rate is likely to drop from 4.25% to 4.05% for tax year 2023

	FY21	FY22	Growth
GF/GP Revenue*	\$12,997.7	\$15,805.5	21.6%
U.S. CPI	266.616	287.723	7.9%

* = includes \$600M redirected to Michigan Transportation Fund

	FY2023	FY2024
Foregone Revenue	\$435M	\$657M

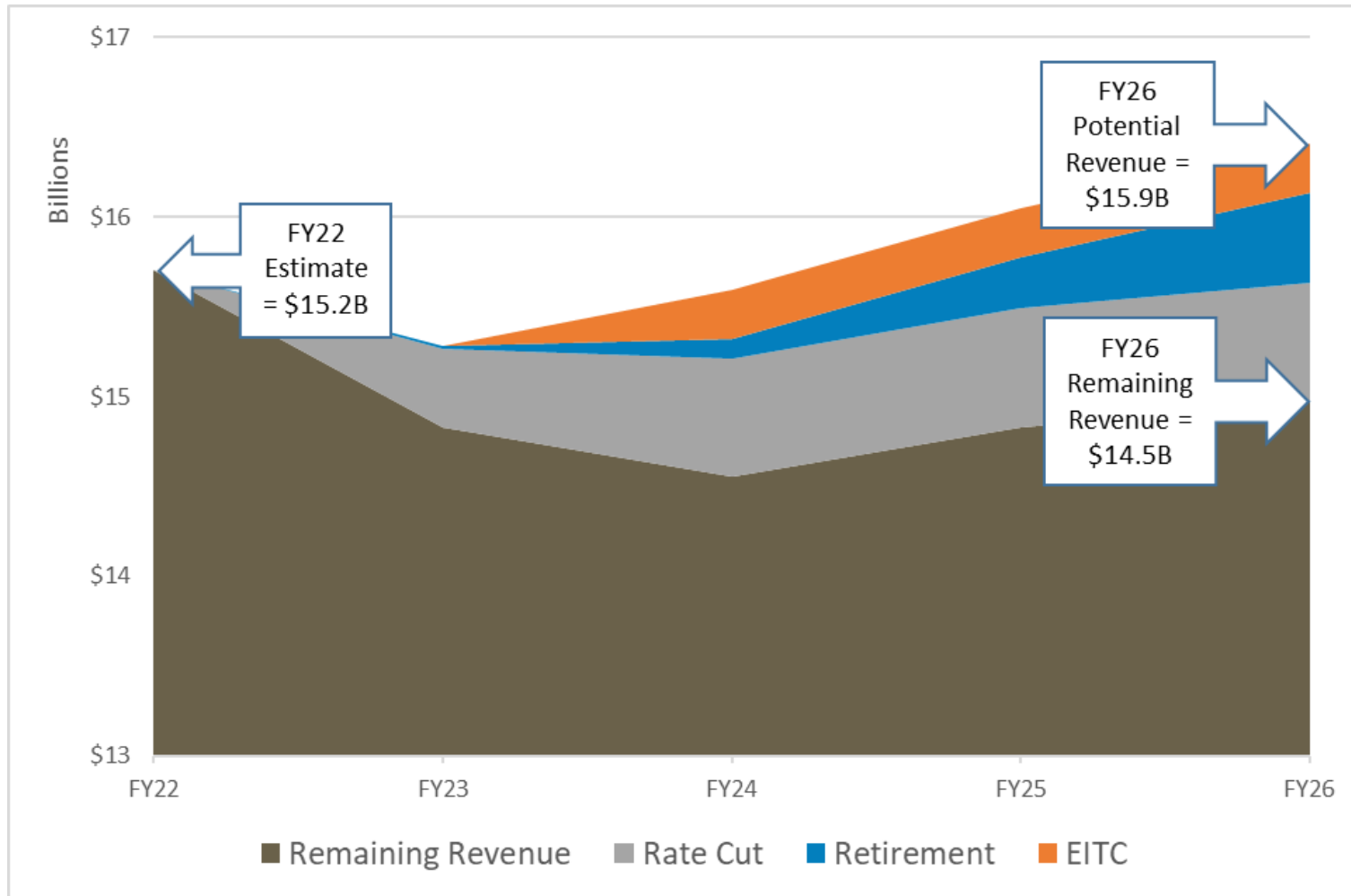
Earned Income Tax Credit

- 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

	FY2023	FY2024	FY2025	FY2026
Foregone Revenue	\$0	\$270M	\$270M	\$270M

Three Views of Revenue Impact

Policy changes eat up all GF/GP revenue growth... and more

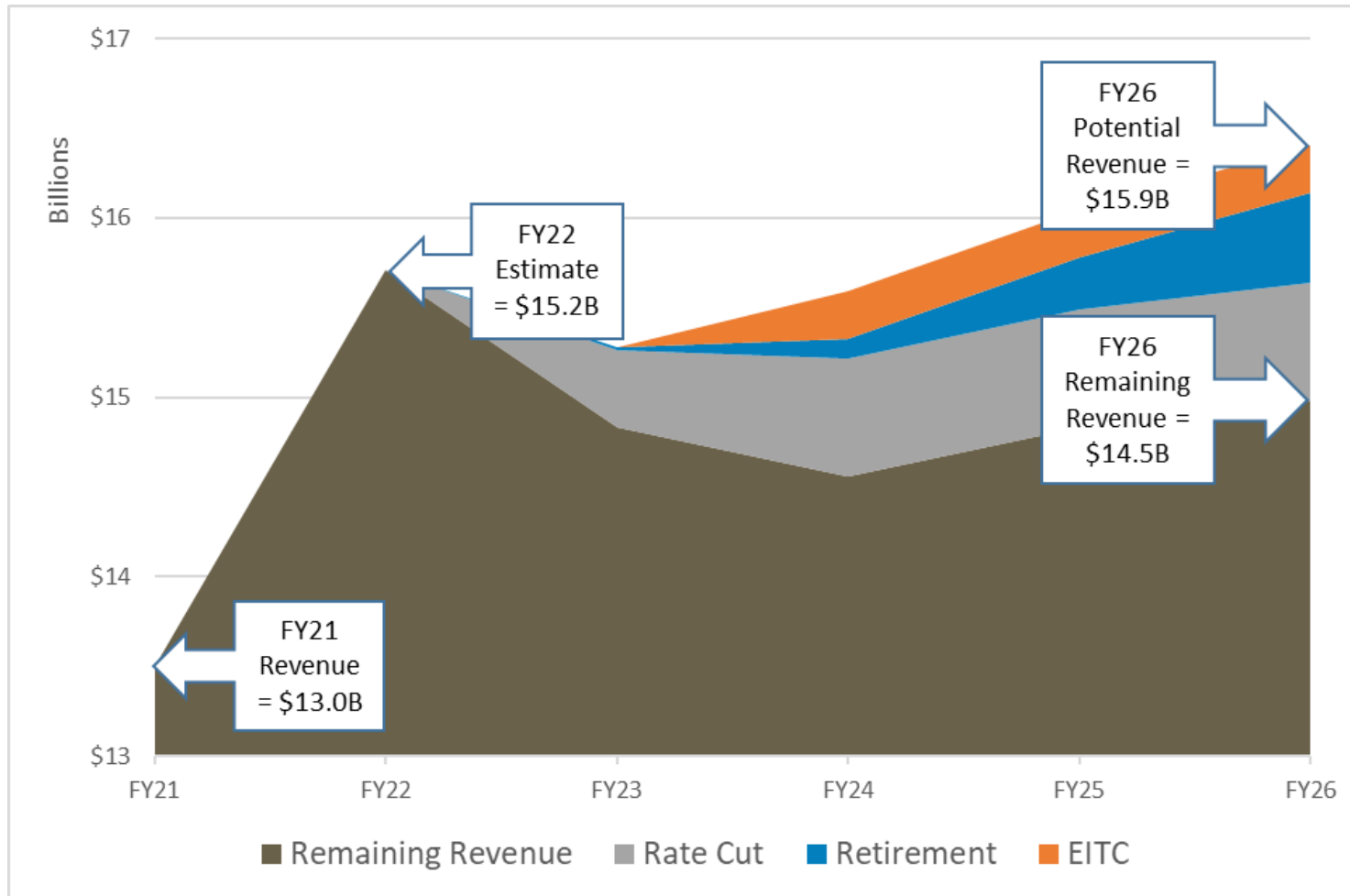


Estimated GF/GP Revenue:

Combined revenue impact of the three tax policy changes means FY26 GF/GP revenue is below FY22 level by around \$700M

Three Views of Revenue Impact

Looking Back to FY21 Presents a Much Different Picture



Estimated GF/GP Revenue:

Estimated five-year growth from FY21 to FY26 after tax changes: 4.12% per year

Trend GF/GP growth from FY11 to FY21: 3.96% per year

Three Views of Revenue Impact

FY24 GF/GP Revenue Surplus is Still Over \$1 Billion

Tax Policy Implications on FY24 GF/GP Revenue Surplus

	Retirement Tax Changes	
	Phased-In	All-at-Once
Ongoing GF/GP Revenue Surplus	\$2.5B	\$2.5B
Income Tax Rate to 4.05%	\$657M	\$657M
Retirement Tax Revisions	\$107M	\$500M
Increase Earned Income Tax Credit	\$270M	\$270M
Remaining Ongoing Surplus	\$1.4B	\$1.0B

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Tax Relief: Treatment of Retirement Income

Legislative proposal (SB 768 from 2022)

- 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