

Budget Tradeoffs of Tax Relief: What is “Sustainable”?

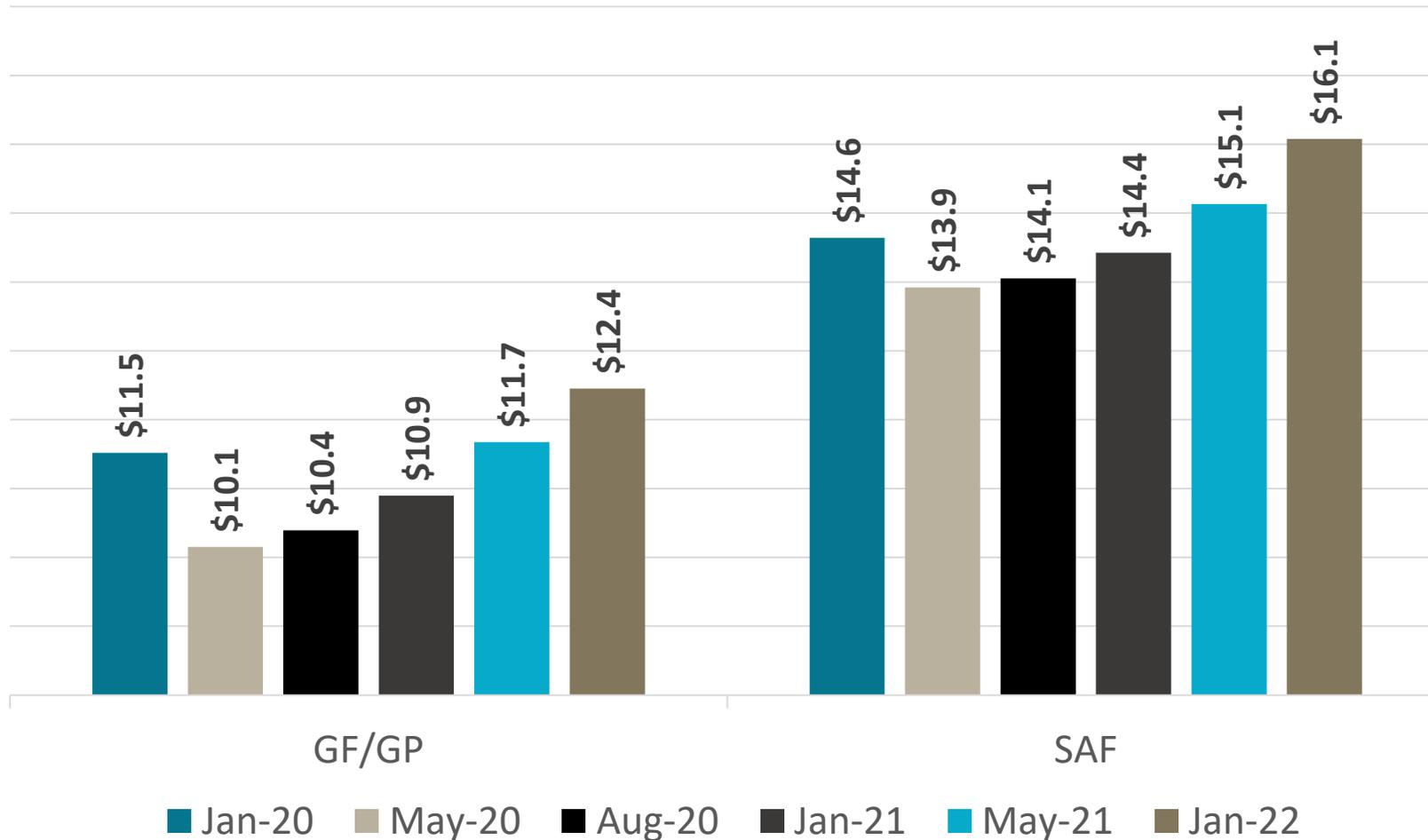
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State Revenue Picture

Revenue Trends Before Any Tax Relief

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	\$13,423	\$12,228	\$12,337	\$12,500
Revenue Minus Spending	(\$976)	\$662	\$975	\$1,152

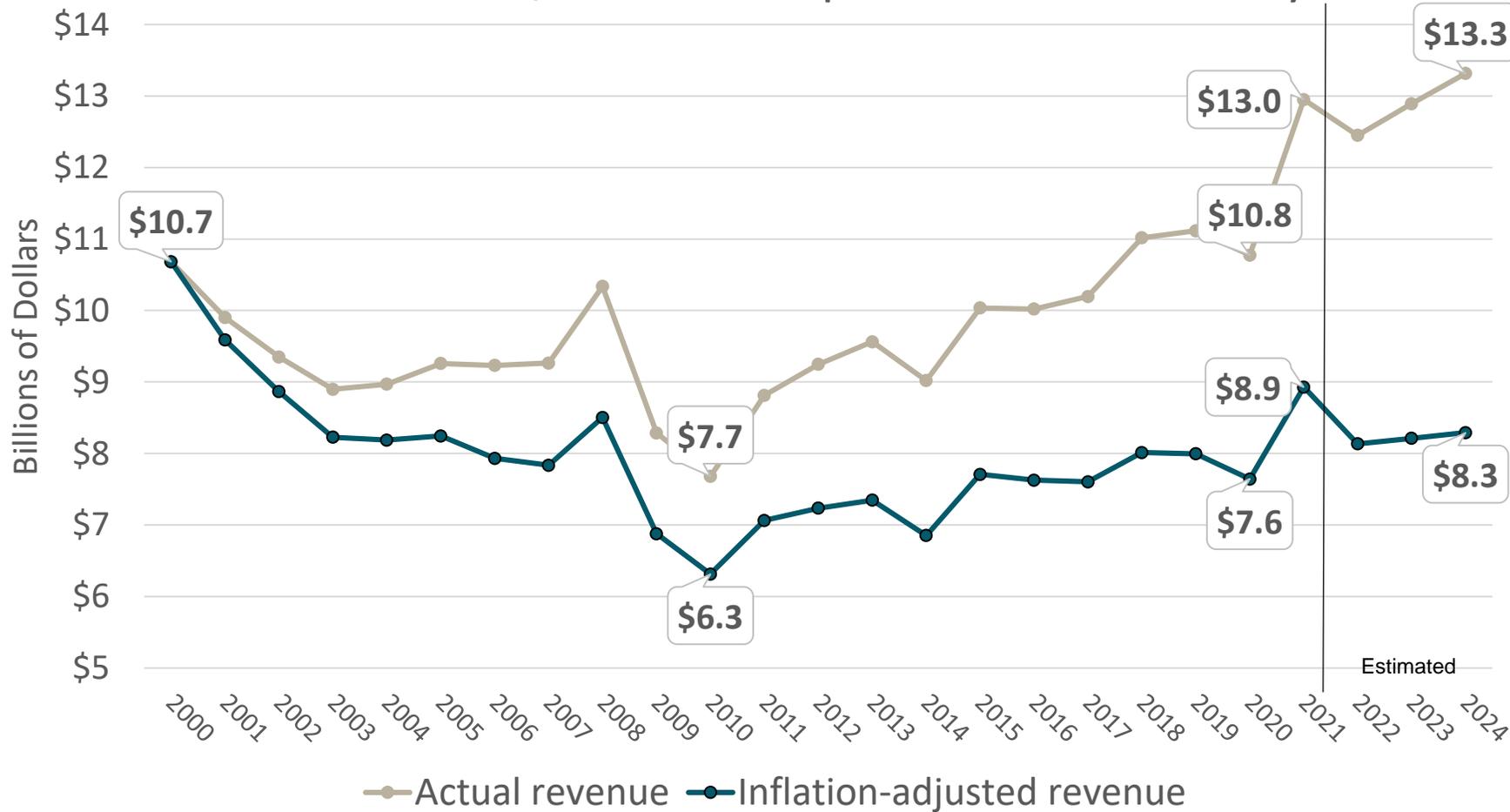
School Aid Fund	<u>FY22</u>	<u>FY23</u>	<u>FY24</u>	<u>FY25</u>
Revenue projections	\$18,782	\$18,788	\$19,059	\$19,431
Baseline spending	\$17,447	\$16,893	\$16,807	\$16,807
Revenue Minus Spending	\$1,335	\$1,895	\$2,252	\$2,624

Large gap between ongoing revenues and baseline spending for both GF/GP and School Aid Fund

Options for policymakers: New spending priorities? Tax relief?

Historical Perspective: When Things Were Bad

General Fund/General Purpose Revenue 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.

Governor's Tax Relief Proposal

Tax Relief: 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

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

	FY2022	FY2023	FY2024	FY2025
Estimated Foregone Revenue	\$13M	\$107M	\$285M	\$495M

Taxpayer Examples under Governor's Plan

60-year-old retiree
with \$40,000 annual
public pension

New Rules	Phase In to Old Rules	
No special exemption for any public pension income	TY22	N/A
	TY23	N/A
	TY24	75% exempt
	TY25	100% 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

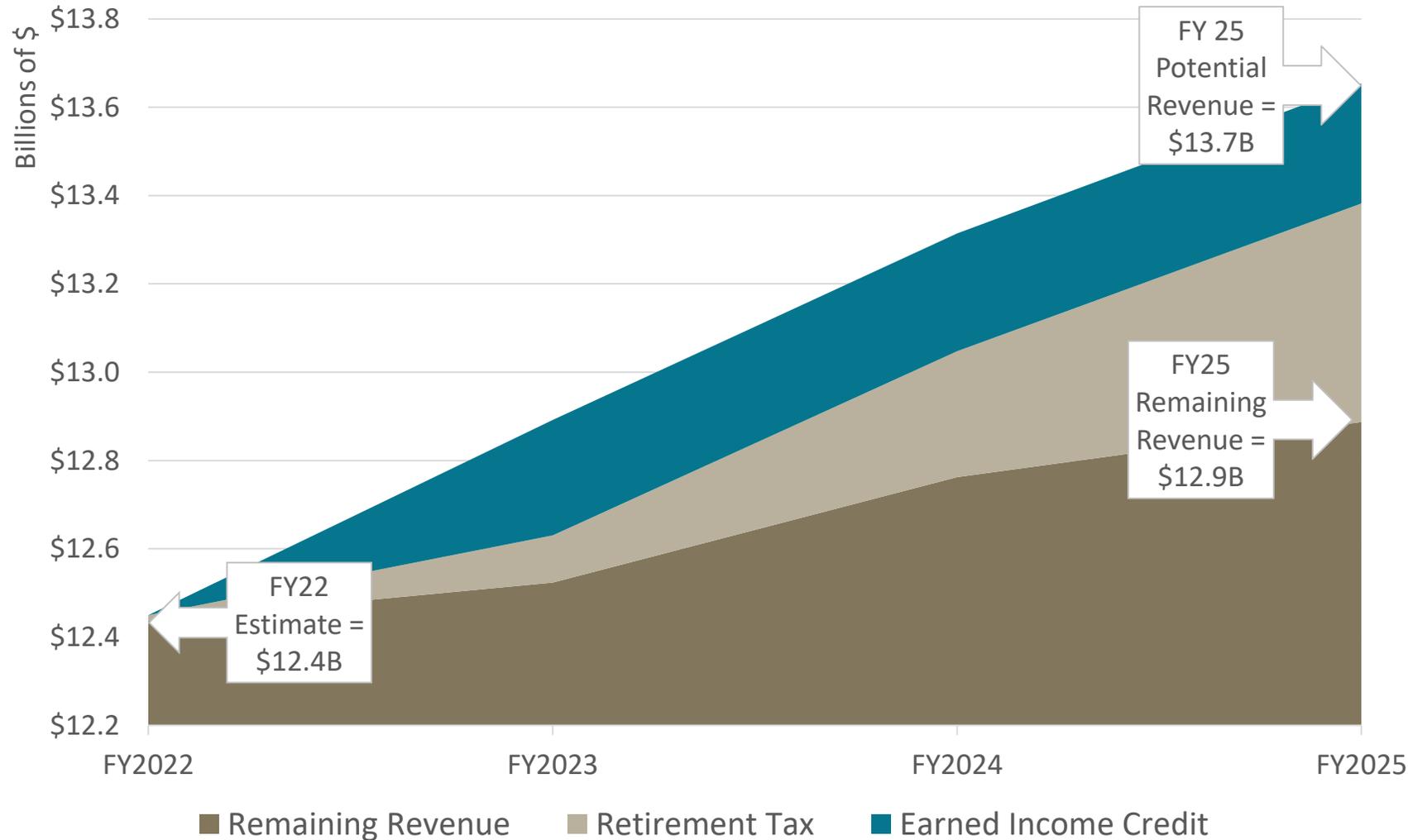
New Rules	Phase In to Old Rules	
No special exemption for any IRA deductions or private pension income	TY22	N/A
	TY23	\$60K
	TY24	\$92K
	TY25	\$125K

Taxpayer Examples under Governor's Plan

69-year-old single retiree with \$50,000 in retirement income from private pension

New Rules	Phase In to Old Rules	
Since already age 67, can deduct \$20K from all income	TY22	\$14K
	TY23	\$30K
	TY24	\$46K
	TY25	\$63K

Revenue Impact of Tax Proposals



The two tax reduction proposals would draw down about 63% of projected GF/GP revenue growth between FY2022 and FY2025

Long-Term Outlook with Governor's Plan

General Fund/General Purpose (millions of \$)

	<u>FY22</u>	<u>FY23</u>	<u>FY24</u>	<u>FY25</u>
Revenue projections	\$12,447	\$12,890	\$13,312	\$13,652
Executive tax relief proposals	(\$13)	(\$369)	(\$547)	(\$767)
Remaining Revenue	\$12,434	\$12,521	\$12,765	\$12,885
Baseline spending	\$13,423	\$12,228	\$12,337	\$12,500
Executive spending proposals	\$774	\$2,784	\$410	\$410
Proposed Spending	\$14,197	\$15,012	\$12,747	\$12,910
Annual Revenue Minus Spending	(\$1,763)	(\$2,491)	\$17	(\$26)

- Governor's spending proposals combined with tax relief proposal utilize the full \$4.2B GF/GP revenue surplus in FY22 and FY23
- Long term, spending and revenues are in balance after her tax proposal is fully phased in and large one-time spending proposals drop off

CRC Webinar on Executive Budget

- For more detail on the Governor's spending proposals, see our March 4 webinar
- www.crcmich.org and click on EVENTS
- <https://crcmich.org/event/webinar-analysis-of-governor-whitmiers-proposed-fy2023-budget>

Legislative Tax Proposal

Senate Bill 768

Summary of Senate Bill 768

- Income tax rate would fall from 4.25% to 3.9% (0.1% rate reduction ~\$340M)
- Provides immediate tax relief for retirement income to those aged 62 and over, but does not bring in younger retirees
- Non-refundable child tax credit of \$500 per eligible dependent
- Vetoed by the Governor last Friday

Foregone Revenue	FY2022	FY2023	FY2024	FY2025
Income Tax Rate Cut	\$498M	\$1.3B	\$1.1B	\$1.1B
Retirement Income Provisions	\$296M	\$754M	\$622M	\$622M
Child Tax Credit	\$581M	\$775M	\$775M	\$775M
Total Foregone Revenue	\$1.4B	\$2.9B	\$2.5B	\$2.5B

Long-Term Outlook under SB768

General Fund/General Purpose (millions of \$)

	<u>FY22</u>	<u>FY23</u>	<u>FY24</u>	<u>FY25</u>
Revenue projections	\$12,447	\$12,890	\$13,312	\$13,652
SB 768 tax relief proposal	(\$1,258)	(\$2,605)	(\$2,275)	(\$2,333)
Remaining Revenue	\$11,189	\$10,285	\$11,037	\$11,318
Baseline spending	\$13,423	\$12,228	\$12,337	\$12,500
Proposed Spending	\$13,423	\$12,228	\$12,337	\$12,500
Annual Revenue Minus Spending	(\$2,234)	(\$1,943)	(\$1,301)	(\$1,182)

- No room for any new spending, so Governor's proposals would have to be dropped. Revenue loss from tax relief would fully use up the \$4.2B GF/GP revenue surplus in FY22 and FY23
- Beginning in FY24, about \$1.3B would need to be cut from the General Fund budget (about 10% of baseline spending)

Just the Income Tax Rate Cut...

General Fund/General Purpose (millions of \$)

	<u>FY22</u>	<u>FY23</u>	<u>FY24</u>	<u>FY25</u>
Revenue projections	\$12,447	\$12,890	\$13,312	\$13,652
Income Tax Rate Cut Only	(\$498)	(\$1,343)	(\$1,118)	(\$1,147)
Remaining Revenue	\$11,949	\$11,547	\$12,194	\$12,505
Baseline spending	\$13,423	\$12,228	\$12,337	\$12,500
Proposed Spending	\$13,423	\$12,228	\$12,337	\$12,500
Annual Revenue Minus Spending	(\$1,474)	(\$681)	(\$144)	\$5

- Revenue isn't sufficient to support ongoing GF/GP budget increases, so Governor's proposed ongoing investments would have to be dropped without other cuts
- While spending exceeds revenues by \$2.3B across FY22, FY23, and FY24, that still leaves a revenue surplus of about \$2B; this would be available to support one-time spending proposals

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

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