MEMORANDUM

HOUSE FISCAL AGENCY

DATE: July 8, 2011

TO: Interested Parties

FROM: Rebecca A. Ross, Senior Economist

RE: Description of Recently Enacted Personal Income Tax Changes with Taxpayer Examples

This memorandum provides a description and taxpayer examples of the personal income tax changes contained in Public Act (PA) 38 of 2011 (effective January 1, 2012). Business tax changes, which are specified in PA 39 and 40 of 2011, were also part of the recently enacted tax restructuring. In general, the business tax changes eliminate the Michigan Business Tax or MBT and replaced it with a 6% corporate income tax. For additional information and details on the business tax changes, see the legislative analysis of HB 4361-4362 on the House Fiscal Agency website at www.house.mi.gov/hfa or the Michigan Legislature website at www.legislature.mi.gov.

Description of PA 38 of 2011

PA 38 of 2011[1] contains several changes to the personal income tax, the most significant of which are freezing the personal income tax rate at 4.25%, modifications to the pension deductions, reducing the earned income tax credit (EITC), modifications to the homestead property tax credit (HPTC), and elimination of most of the credits. These changes, as shown in Table 1, are estimated to increase personal income tax revenue by an estimated $559.1 million in FY 2011-12 and $1,423.7 million in FY 2012-13. The total business tax changes are estimated to reduce revenue by $1,094.3 million in FY 2011-12 and $1,647.6 million in FY 2012-13. On a net basis by fund, these changes are estimated to increase General Fund/General Purpose (GF/GP) revenue by $154.7 million in FY 2011-12 and $438.0 million in FY 2012-13 while reducing School Aid Fund (SAF) revenue by $689.9 million in FY 2011-12 and $662.1 million in FY 2012-13.

Table 1
Estimated Fiscal Impact of Tax Changes Included in Public Acts 38 - 40 of 2011
Effective Date January 1, 2012 (millions of dollars)

	FY 2011-12 Estimates			FY 2012-13 Estimates		
Personal Income Tax Change	**GF/GP**	**SAF**	**Total**	**GF/GP**	**SAF**	**Total**
Freeze Income Tax Rate at 4.25% effective 1/1/13	$172.0	$0.0	$172.0	$223.0	$0.0	$223.0
Eliminate Senior & UI Special Exemptions	6.7	2.1	8.8	41.0	0.0	41.0
Eliminate Child Deduction	0.0	0.0	0.0	57.1	0.0	57.1
Phase Out Personal Exemption	42.0	13.1	55.1	63.1	20.3	83.4
Modify Public/Private Pension Deduction	177.4	47.5	224.9	259.6	83.7	343.4
Repeal Senior Investment Deduction (Age Based)	3.2	0.8	4.0	4.7	1.5	6.2
Eliminate Miscellaneous Subtractions	28.1	7.2	35.3	40.8	13.2	54.0
Single Sales Apportionment Factor	(11.9)	(3.1)	(15.0)	(16.5)	(4.2)	(20.7)
Reduce 20% Refundable EITC to 6%	0.0	0.0	0.0	261.6	0.0	261.6
Modify Homestead Property Tax Credit	0.0	0.0	0.0	270.2	0.0	270.2
Eliminate Most Credits	74.0	0.0	74.0	104.5	0.0	104.5
Total Personal Income Tax Changes	**$491.5**	**$67.6**	**$559.1**	**$1,309.1**	**$114.5**	**$1,423.7**
Total Business Tax Changes	**($336.7)**	**($757.6)**	**($1,094.3)**	**($871.0)**	**($776.6)**	**($1,647.6)**
Total Tax Changes	**$154.7**	**($689.9)**	**($535.2)**	**$438.0**	**($662.1)**	**($224.0)**

[1] The Governor has requested an advisory opinion on the constitutionality of PA 38 of 2011.
http://coa.courts.mi.gov/documents/sct/public/orders/20110615_s143157_3_143157_2011-06-15_or.pdf

Income Tax Rate

The current individual income tax rate is 4.35%. Under the enacted legislation, the rate will fall to and remain at 4.25% January 1, 2013. Prior to PA 38 of 2011, beginning October 1, 2011, the rate was scheduled to be reduced 0.1 percentage points each year until it reached 3.95%; then the rate would have been reduced to 3.9% effective October 1, 2015.

Eliminate Senior and UI Special Exemption

The special $2,300 exemption (indexed to inflation) for seniors (age 65 or older) and taxpayers with unemployment compensation (unemployment insurance or UI) equal to or greater than 50% of their adjusted gross income (AGI) will be eliminated. AGI is Michigan's starting point from the federal return.

Eliminate Child Deduction

The child deduction of $600 for each dependent child age 18 or younger will be eliminated.

Phase Out Personal Exemption

Currently, the personal exemption is $3,700 (indexed to inflation) for each exemption claimed on the federal return, generally the number of individuals in a household. Effective January 1, 2012, the personal exemption will be phased out based on household resources (HHR) and filing status (single or joint returns). Household resources includes all income received by all persons in a household plus any subtractions due to net business, rental, or royalty losses. Taxpayers with total HHR less than $75,000 for single or $150,000 for joint returns receive the full $3,700 personal exemption (indexed to inflation beginning 2013); taxpayers with total HHR greater than $100,000 for single or $200,000 for joint returns receive no personal exemption (approximately 150,000 tax returns). Table 2 shows the new personal exemption phase-out for taxpayers between these income ranges (approximately 160,000 tax returns).

Table 2
Examples of Personal Exemption Phase-Out for Single and Married Taxpayers

Single Taxpayers - Exemption Per Person			Married Taxpayers - Exemption Per Person		
Household Resources	**% of $3,700 Eligible to Take**	**Personal Exemption**	**Household Resources**	**% of $3,700 Eligible to Take**	**Personal Exemption**
<$75,000	100%	$3,700	<$150,000	100%	$3,700
77,000	92%	3,404	154,000	92%	3,404
79,000	84%	3,108	158,000	84%	3,108
81,000	76%	2,812	162,000	76%	2,812
83,000	68%	2,516	166,000	68%	2,516
85,000	60%	2,220	170,000	60%	2,220
87,000	52%	1,924	174,000	52%	1,924
89,000	44%	1,628	178,000	44%	1,628
91,000	36%	1,332	182,000	36%	1,332
93,000	28%	1,036	186,000	28%	1,036
95,000	20%	740	190,000	20%	740
97,000	12%	444	194,000	12%	444
99,000	4%	148	198,000	4%	148
>$100,000	0%	0	>$200,000	0%	0

Calculation:
Personal Exemption Multiplied
($100,000 - Total HHR)/$25,000

Calculation:
Personal Exemption Multiplied
($200,000 - Total HHR)/$50,000

Repeal Senior Investment Deduction Based on Age
The investment income deduction, which is capped at $10,058 single/$20,115 joint (indexed to inflation), will be eliminated for seniors (age 65 or older) unless they were born in 1945 or earlier. Investment income includes interest, dividends, and capital gains.

Eliminate Miscellaneous Subtractions
Subtractions for political contributions; prizes won from bingo, raffle, or charity games; losses from the disposal of property; income from gas and oil royalty interest; certain distributions from IRAs used to pay higher education expenses; qualifying distributions from a retirement or retirement plan that is contributed to a charitable organization will be eliminated.

Single Sales Apportionment Factor
The Multistate Tax Compact (MTC) codifies certain provisions regarding the taxation of business taxpayers with activity in multiple state jurisdictions. The MTC allows a taxpayer to compute an apportionment factor by computing three separate factors, adding them together and dividing by three. The three factors are payroll, property, and sales, with each factor calculated by taking the amount of that factor attributable to the taxpayer within a state and dividing it by the total of that factor attributable to the taxpayer in all states. By dividing by three, the formula equally weights each of the factors. The Michigan business tax (MBT) and the new corporate income tax (CIT) use only a sales factor, taking Michigan sales and dividing that amount by the taxpayer's total sales. PA 40 of 2011 requires that all taxpayers use the 100%-sales factor apportionment.

Reduce Refundable EITC from 20% to 6%
The EITC is a refundable credit for working low income households (approximately 783,000 tax returns) and is equal to a percentage of the federal EITC. This percentage was reduced from 20% to 6%. The federal credit is equal to a percentage of the taxpayer's earned income based on the number of children in the household up to a certain amount and is adjusted annually for inflation.

Modified Public/Private Pension Deduction
Pension income includes employer-sponsored defined benefit and 401(k) plans, while retirement income is a broader definition that also includes Keogh plans (self-employment retirement accounts), IRAs, and annuities. For tax year (TY) 2011, all Social Security, public pension income, and most private pension income is deductible from the state income tax. Beginning in TY 2012, the tax treatment of retirement income will be largely based on the age of the taxpayer and income or HHR. Retirement/pension deductions will be based on the oldest spouse for married taxpayers.

Table 3 provides a detailed list of the tax treatment of pension and retirement income for TY 2011 and for TY 2012 when the changes incorporated in PA 38 of 2011 will take effect. Taxpayers who are 67 or older in 2012 (or born before 1946, approximately 480,000 tax returns) will have no change in the treatment of retirement/pension income. Taxpayers between 60 and 66 in 2012 (or born between 1946 and 1952, approximately 230,000 tax returns) and taxpayers under 60 in 2012 (or born after 1952, approximately 150,000 tax returns) will be able to take smaller deductions.

Table 3
Changes to the Treatment of Pension, Retirement, and Investment Income Under PA 38 of 2011

<u>Treatment Prior to PA 38 of 2011 (Tax Year 2011)</u>

Social Security and public pensions are deductible

Private pensions (defined benefit plans, IRAs, and private annuities) are deductible up to $45,120 single/$90,240 joint; indexed to inflation; the maximum allowable deduction is reduced by the public pension subtraction

401(k)s with no employer match are subject to tax

401(k) distributions attributable to employer contributions or to employee contributions that are matched by the employer are deductible, but distributions attributable to employee contributions that are not matched by the employer are subject to tax

Senior dividends, interest, capital gains deductible up to $10,058 single/$20,115 joint; indexed to inflation; the maximum allowable deduction is reduced by the private and public pension subtractions

<u>Treatment Under PA 38 of 2011 (Beginning in Tax Year 2012)</u>
1) People <60 in 2012 (born after 1952):

No pension or retirement deduction until age 67

No senior investment income deduction

Social Security deductible

All military and railroad pensions are deductible

When 67…….

Deduction of either (1) $20,000 single/$40,000 joint against all types of income - pension, retirement, investment, and salary and wages, but cannot also take the personal exemption or the additional deduction for Social Security or (2) take Social Security deduction and the personal exemption

If HHR exceed $75,000 single/$150,000 joint, then cannot take $20,000 single/$40,000 joint deduction

All military and railroad pensions are deductible, but this deduction effectively reduces the $20,000 single/$40,000 joint deduction by an equal amount

2) People 60 - 66 in 2012 (born between 1946 and 1952):

Deduction of $20,000 single/$40,000 joint against pension and retirement income

No senior investment income deduction

Social Security deductible and eligible to take personal exemption

If HHR exceed $75,000 single/$150,000 joint, then cannot take $20,000 single/$40,000 joint deduction

All military and railroad pensions are deductible, but this deduction effectively reduces the $20,000 single/$40,000 joint deduction by an equal amount

When 67…….

Deduction of $20,000 single/$40,000 joint against ALL types of income - pension, retirement, investment, and salary and wages

Social Security deductible and eligible to take personal exemption

If HHR exceed $75,000 single/$150,000 joint, then cannot take $20,000 single/$40,000 joint deduction

All military and railroad pensions are deductible, but this deduction effectively reduces the $20,000 single/$40,000 joint deduction by an equal amount

3) People =>67 in 2012 (born before 1946):

Same as law prior to PA 38 of 2011

Modify Homestead Property Tax Credit

Currently or for tax year 2011, Michigan taxpayers with household income of $82,650 or less can claim the homestead property tax credit (HPTC). Household income is a broad definition that includes earned income, investment income, retirement income, social security, unemployment compensation, and other income. The credit is equal to 60% of the amount by which property taxes (or 20% of rent for renters) exceed 3.5% of household income, up to a maximum of $1,200. In the case of seniors (age 65 and older) and disabled filers, the credit is equal to 100% of the difference. For taxpayers with household income between $73,650 and $82,650, the credit is reduced by 10% for every $1,000 above the lower limit.

Beginning in TY 2012, taxpayers that currently take the HPTC with income between $50,000 and $82,650 or that have a homestead in which the taxable value exceeds $135,000 will no longer be able to take the credit (approximately 400,000 tax returns). In addition, for taxpayers with HHR between $41,000 and $50,000, the credit will be reduced 10% for every $1,000 above the lower limit. HHR replaces household income under PA 38 for determining the HPTC.

For non-senior taxpayers, the new credit will equal 60% of the amount by which property taxes (or imputed rent) exceed 3.5% of HHR. For seniors with HHR of $21,000 or less, the credit will equal 100% of the amount by which property taxes exceed 3.5% of HHR. For seniors with HHR over $21,000 and up to $22,000, the credit will equal 96% of the amount by which property taxes exceed 3.5% of HHR. The percentage that can be claimed will be reduced by 4% for each additional $1,000 in HHR ending with those with HHR <u>over</u> $30,000 able to claim 60% of the amount by which property taxes exceed 3.5% of HHR. Table 4 shows how the new HSPTC is calculated.

Table 4
Homestead Property Tax Credit Calculation
Under Public Act 38 of 2011

Step 1: Credit equals the amount by which 100% of property taxes paid exceed 3.5% of HHR, up to $1,200

Step 2: Non-Seniors - multiply credit from Step 1 by 60%; Seniors - multiply credit from Step 1 by the property tax factor schedule below

HHR Range	Property Tax Factor
$30,001 - $50,000	60%
30,000	64%
29,000	68%
28,000	72%
27,000	76%
26,000	80%
25,000	84%
24,000	88%
23,000	92%
22,000	96%
< = $21,000	100%

Step 3: All taxpayers - multiply the result from Step 2 by the phase-out schedule below to obtain the final credit

HHR Range	Phase-Out
> $50,000	no credit
50,000	10%
49,000	20%
48,000	30%
47,000	40%
46,000	50%
45,000	60%
44,000	70%
43,000	80%
42,000	90%
< = $41,000	full credit

Eliminate Non-Refundable and Some Refundable Credits
Non-refundable credits are limited to the extent they offset the income tax liability, while refundable credits are not and can exceed the tax liability. The following is a list of the credits that will be eliminated January 1, 2012.

City income tax credit. The city income tax credit is a non-refundable credit to partially offset the city income tax liability (levied in 22 cities). In TY 2008, 823,600 credits were allowed, and the average credit was $38.

Public contributions credit. The public contributions credit is a non-refundable credit equal to 50% of the amount contributed up to a maximum credit of $100 for single ($200 for joint) returns. Public contributions include gifts to Michigan colleges and universities, public libraries, museums, and public broadcasting stations. In TY 2008, 273,300 credits were allowed, and the average credit was $90.

Community foundations credit. The community foundations credit is a non-refundable credit equal to 50% of the amount contributed up to a maximum credit of $100 for single ($200 for joint) returns. In TY 2008, 35,200 credits were allowed, and the average credit was $93.

Homeless shelter/food bank credit. The homeless shelter/food bank credit is a non-refundable credit equal to 50% of the amount contributed up to a maximum credit of $100 for single ($200 for joint) returns. The credit is for cash donations to qualifying homeless shelters, food banks, and food kitchens whose primary purpose is to provide accommodations or food to indigent persons. In TY 2008, 234,100 credits were allowed, and the average credit was $81.

Historic preservation credit. The historic preservation credit is a refundable and a non-refundable credit to rehabilitate historic sites and is equal to 25% of the qualified expenditures. In TY 2008, about 300 credits were allowed and the average credit was $4,581.

College tuition and fees credit. The college tuition and fees credit is a non-refundable credit for resident taxpayers with AGIs of less than $200,000 and is equal to a percentage of tuition and fees. To qualify, the school must have certified that tuition and fees will not increase by more than the rate of inflation. The amount of the credit is the lesser of 8% of the tuition and fees paid or $375 per student. The credit cannot be claimed for more than 4 years for any one student. In TY 2008, about 83,000 credits were allowed and the average credit was $146.

Vehicle donation credit. The vehicle donation credit is a non-refundable credit to equal to 50% of the fair market value of certain automobile donations to qualified charitable organizations. The credit is limited to up to a maximum credit of $100 for single ($200 for joint) returns. In TY 2008, about 2,200 credits were allowed and the average credit was $56.

Individual or family development credit. Individuals or families whose income is 200% of the federal poverty level can establish accounts for qualified expenses and receive a nonrefundable credit equal to 75% of the contributions made to the account. The accounts are used for education, the first-time purchase of a primary residence, or business capitalization.

Adoption credit. The adoption credit provides refundable credit of up to $1,200 per child, to the extent that qualified adoption expenses exceed the amount allowed under the federal adoption credit. In TY 2008, about 600 credits were allowed, and the average credit was $1,241.

Stillbirth credit. This refundable credit is available to taxpayers who have been provided with a Certificate of Stillbirth. The credit is equal to 4.5% of the personal exemption amount, rounded to the closest $10 increment. In TY 2008, about 200 credits were allowed, and the average credit was $160.

Taxpayer Examples

Tables 5 and 6 (see attached) depict examples of the impact of the tax changes for taxpayers with and without retirement income for TY 2013. The credits that will be eliminated are not included in the examples.

I hope this information is helpful. Please contact me (rross@house.mi.gov) if you have any further questions.

Table 5

Taxpayer Examples (Without Retirement Income) Under the Enacted Personal Income Tax Changes: Tax Year 2013

	Married Couple with two Children	Single Parent with two Children	Married Couple with one Child	Married Couple with two Children	Married Couple with three Children	Married Couple with two Children	Single Person with No Children	Married Couple with No Children
Income								
Pension/Retirement	$0	$0	$0	$0	$0	$0	$0	$0
Social Security	$0	$0	$0	$0	$0	$0	$0	$0
Earned Income (wages/salaries)	$32,000	$22,000	$45,255	$55,000	$110,000	$250,000	$85,000	$170,000
Other Income	$2,400	$0	$0	$250	$1,500	$0	$0	$0
Total Income	$34,400	$22,000	$45,255	$55,250	$111,500	$250,000	$85,000	$170,000
Property taxes	$1,840	$1,440	$2,250	$3,000	$3,500	$4,500	$4,000	$4,000
Tax Law Prior To Changes:								
Current personal/special/child exemptions (1)	$16,400	$12,600	$12,000	$16,400	$20,800	$16,400	$3,800	$7,600
Pre-Credit Tax = taxable income x 4.125%	$743	$388	$1,372	$1,603	$3,741	$9,636	$3,350	$6,699
Refundable credits								
Homestead property tax credit	$382	$402	$400	$640	$0	$0	$0	$0
EITC	$461	$429	$0	$0	$0	$0	$0	$0
Net Income Tax Prior To Changes	**($100)**	**($444)**	**$972**	**$963**	**$3,741**	**$9,636**	**$3,350**	**$6,699**
Tax Law With Enacted Changes:								
New personal exemption (2)	$15,200	$11,400	$11,400	$15,200	$19,000	$0	$2,280	$4,560
Pre-Credit Tax = new taxable income x 4.25%	$816	$451	$1,439	$1,702	$3,931	$10,625	$3,516	$7,031
New Refundable credits								
Homestead property tax credit	$382	$402	$200	$0	$0	$0	$0	$0
EITC	$138	$129	$0	$0	$0	$0	$0	$0
Net Income Tax With Enacted Changes	**$296**	**($80)**	**$1,239**	**$1,702**	**$3,931**	**$10,625**	**$3,516**	**$7,031**
Net Increase	**$396**	**$363**	**$267**	**$739**	**$190**	**$989**	**$166**	**$332**

Notes:
1. In TY 2013, the personal exemption is estimated at $3,800, the special exemption at $2,400, and the child exemption at $600.
2. Personal exemption is phased out between $75,000 - $100,000 for single households and between $150,000 - $200,000 for joint households.

Table 6
Taxpayer Examples (With Retirement Income) Under the Enacted Personal Income Tax Changes: Tax Year 2013

	Retired Couple Born after 1952	Retired Couple Born after 1952	Retired Senior Couple Born between 1946 - 1952	Retired Senior Couple Born between 1946 - 1952	Retired Couple Born on or before 1946	Retired Couple Born on or before 1946	Working/Retired Senior Single Born between 1946 - 1952	Working/Retired Senior Couple Born between 1946 - 1952
Income								
Pension/Retirement	$30,000	$48,000	$30,000	$48,000	$30,000	$48,000	$0	$0
Social Security (1)	$0	$0	$22,000	$27,000	$22,000	$27,000	$15,000	$27,000
Earned Income (wages/salaries)	$0	$0	$0	$0	$0	$0	$30,000	$42,000
Other Income	$5,000	$5,000	$0	$5,000	$0	$5,000	$0	$0
Total Income	$35,000	$53,000	$52,000	$80,000	$52,000	$80,000	$45,000	$69,000
Property taxes	$2,250	$4,000	$2,250	$4,000	$2,250	$4,500	$2,000	$2,500
Tax Law Prior To Changes:								
Current personal/special/child exemptions (2)	$7,600	$7,600	$12,400	$12,400	$12,400	$12,400	$6,200	$12,400
Pre-Credit Tax = taxable income x 4.125%	$0	$0	$0	$0	$0	$0	$982	$1,221
Refundable credits								
Homestead property tax credit	$615	$1,200	$430	$360	$430	$360	$425	$85
EITC	$0	$0	$0	$0	$0	$0	$0	$0
Net Income Tax Prior To Changes	**($615)**	**($1,200)**	**($430)**	**($360)**	**($430)**	**($360)**	**$557**	**$1,136**
Tax Law With Enacted Changes:								
New personal exemption (3)	$7,600	$7,600	$7,600	$7,600	$7,600	$7,600	$3,800	$7,600
New pension/retirement deduction (4)	*none, until age 67*		$40,000	$40,000	*no change from prior law*		$20,000	$40,000
Pre-Credit Tax =new taxable income x 4.25%	$1,165	$1,930	$0	$230	$0	$0	$1,114	$1,462
New Refundable credits								
Homestead property tax credit	$615	$0	$0	$0	$0	$0	$153	$0
EITC	$0	$0	$0	$0	$0	$0	$0	$0
Net Income Tax With Enacted Changes	**$550**	**$1,930**	**$0**	**$230**	**$0**	**$0**	**$961**	**$1,462**
Net Increase	**$1,165**	**$3,130**	**$430**	**$590**	**$430**	**$360**	**$404**	**$326**

Notes:
1. Taxpayers in the born between 1946 - 1952 group are assumed to be 66 and collecting Social Security.
2. In TY 2013, the personal exemption is estimated at $3,800, the special exemption at $2,400, and the child exemption at $600.
3. Personal exemption is phased out between $75,000 - $100,000 for single households and between $150,000 - $200,000 for joint households.
4. See Table 3.