

Legislative Analysis



INCOME TAX AND PROPERTY TAX AMENDMENTS

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House Bill 4568 (S-1) as passed by the Senate
Sponsor: Rep. Matt Hall

Analysis available at
<http://www.legislature.mi.gov>

Senate Bill 784 (S-2) as passed by the Senate
Sponsor: Sen. Jon Bumstead

House Committee (HB 4568): Tax Policy
Senate Committee: Finance
Complete to 5-19-22

SUMMARY:

House Bill 4568 and Senate Bill 784 would respectively amend the Income Tax Act and the General Property Tax Act to do all of the following:

- Reduce the individual income tax rate from 4.25% to 4.0% beginning January 1, 2023. (HB 4568)
- Annually increase the personal exemption amount by \$1,800, after inflation adjustments, beginning with the 2023 tax year. (HB 4568)
- Increase the earned income tax credit from 6% of the federal credit to 20% of the federal credit beginning with the 2022 tax year. (HB 4568)
- Provide a \$500 nonrefundable child tax credit for tax years beginning on or after January 1, 2023. (HB 4568)
- Increase the standard deduction against all types of income for taxpayers who are 67 years old or older to \$21,800 for a single return and \$43,600 for a joint return beginning January 1, 2023. (HB 4569).
- Require limitations on deduction amounts for certain taxpayers to be adjusted annually for inflation beginning with the 2024 tax year. (HB 4568)
- Provide a mechanism for the state to reimburse local units of government for the property tax exemption available to veterans classified as 100% disabled and their surviving spouses and extend those exemption provisions to include the surviving spouses of servicemembers killed in action. (HB 4568 and SB 784)
- Provide a credit of up to \$2,000 (adjusted annually for inflation) for property taxes paid by veterans who are at least 50% disabled but less than 100% disabled and their surviving spouses. (HB 4568 and SB 784)

House Bill 4568 would amend Part 1 (individual income tax) of the Income Tax Act.

The income tax rate under Part 1 is currently 4.25%. The bill would reduce this rate to 4.0% beginning January 1, 2023.

The act now requires the personal exemption amount to be adjusted for inflation and then, for the 2022 and subsequent tax years, increased by an additional \$600. The bill would require the adjusted amount to be increased by an additional \$1,800 for the 2023 and subsequent tax years. Under both current law and the bill, the adjusted and increased exemption amounts are then

rounded to the nearest \$100. (For reference, the personal exemption for the 2021 tax year is \$4,900.)

Currently, a taxpayer may claim an amount against the tax that equals 6% of the earned income tax credit (EITC) the taxpayer can claim on their federal taxes. The bill would increase this to 20% of the federal EITC amount for tax years beginning on and after January 1, 2022.

In addition, for tax years beginning on and after January 1, 2022, the bill would allow a taxpayer to claim a \$500 credit for each **qualified dependent** for which an exemption was claimed for the same tax year. If the credit allowed exceeded the tax liability of the taxpayer for the tax year, the portion exceeding the tax liability would *not* be refunded.

Qualified dependent would mean a dependent who is less than 19 years old on the last day of the tax year for which the credit is claimed.

Deduction amounts for certain taxpayers

Currently under the act, retirement income is taxed in a three-tier system, depending on the taxpayer's date of birth:

In the first tier, for taxpayers born before 1946, public pension and social security income is tax-exempt. Eligible taxpayers in this tier may subtract private retirement income, but the exemption for private retirement income or for a combination of private retirement income and tax-exempt public retirement income cannot exceed a specific limit, which for tax year 2021 is \$54,404 for single filers and \$108,808 for joint filers.

In the second tier, taxpayers born between 1946 and 1952 who have reached age 67 (currently everyone in this cohort) are eligible for an exemption against retirement income of \$20,000 for single filers or \$40,000 for joint filers. However, they are eligible for an exemption against all income of \$20,000/\$40,000 only if they do *not* choose to claim a military or railroad pension exemption.

In the third tier, for taxpayers born after 1952, taxation once again varies based on whether the taxpayer has reached the age of 67. For those younger than 67 (currently the majority of those in this cohort), social security, railroad pension, and military pension income is tax-exempt. These taxpayers also are ineligible for retirement income exemptions. Like taxpayers in Tier 2, once they turn 67, they are eligible for an exemption against all income of \$20,000 for single filers and \$40,000 for joint filers if they claim no military or railroad pension exemption. However, unlike Tier 2 taxpayers, they would also be unable to claim a social security or personal exemption. Or, they may choose to receive the social security, military or railroad pension, and personal exemptions, but not the overall exemption of \$20,000/\$40,000. As such, Tier 3 taxpayers are subject to less favorable tax treatment than Tier 2 taxpayers.

The bill would increase the \$20,000/\$40,000 exemptions described above for taxpayers who have reached the age of 67 to a \$21,800/\$43,600 exemption. In addition, for the 2024 and subsequent tax years, the maximum deduction amounts described above would have to be adjusted by multiplying the 2023 tax year deduction by a fraction whose numerator is the U.S. Consumer Price Index for all urban consumers for the state fiscal year ending in the tax year prior to the tax year for which the adjustment is being made and whose denominator is the U.S.

Consumer Price Index for all urban consumers for the 2021-22 state fiscal year, and then rounding to the nearest \$100 increment.

Section 521 (disabled veteran credit)

The bill would add section 521 to the act to provide, for the 2023 and subsequent tax years, that a claimant who is a disabled veteran, the widow or widower of a disabled veteran, or the widow or widower of a veteran killed in action is entitled to a credit against the tax in an amount equal to 100% of the property taxes levied on the taxpayer's homestead that are deductible for federal income tax purposes, subject to the following:

- The property taxes levied must be calculated as if section 164(b)(6)(B) were not in effect.
- The property taxes used to compute the credit cannot be greater than the amount levied for one tax year.
- The maximum amount of the credit allowed for a disabled veteran who has been determined by the U.S. Department of Veterans Affairs (VA) to be entitled to veterans' benefits on a rating equal to or greater than 50% disabled and less than 100% permanently and totally disabled is \$2,000. (This amount would have to be adjusted for inflation for the 2024 and subsequent tax years and rounded to the nearest \$100.)

A claimant could either claim the credit on their annual return on a form prescribed by the Department of Treasury or authorize a local tax collecting unit to claim it on their behalf (as provided by SB 784, below). For a return of less than 12 months, the amount of the credit allowed would be reduced proportionately. The portion of a claimed credit amount that exceeds the claimant's tax liability would, after examination and review, be approved for payment, without interest, to the claimant (or remitted to the local tax collecting unit, if applicable).

A claimant would not be eligible for a credit under section 520 of the act.

A claim would not be allowed if the Department of Treasury finds after examination and review that the claimant is not a disabled veteran, the widow or widower of a disabled veteran, or the widow or widower of a veteran killed in action or that the claimant has filed a claim under section 520 for the same tax year.

Notwithstanding section 30a of 1941 PA 122, the credit would be exempt from interception, execution, levy, attachment, garnishment, or other legal process to collect a debt, and no portion of the credit could be used to offset a liability under section 30a of 1941 PA 122 or any arrearage or other debt of the claimant.

MCL 206.30 et seq. and proposed MCL 206.277 and 206.521

Senate Bill 784 would amend the General Property Tax Act to change the current homestead property tax exemption for disabled veterans and their surviving spouses to a deferment of those taxes and an income tax credit based on those deferred taxes that can be claimed by the local tax collecting unit on behalf of the veteran or spouse. (That is, the Department of Treasury would pay the local tax collecting unit for the amount of the property taxes.) The bill also would extend these provisions to include the surviving spouses of veterans killed in action and (subject to the \$2,000 cap in HB 4568, described above) to include veterans (and their surviving spouses) who are determined by the VA to be entitled to veterans' benefits on a rating equal to

or greater than 50% disabled and less than 100% permanently and totally disabled. The bill would take effect December 31, 2022.

The act currently provides that real property owned and used as a homestead by a qualified disabled veteran is exempt from the collection of taxes under the act. If a qualified disabled veteran dies, the veteran's spouse can continue to claim the exemption unless they remarry. To qualify for the exemption, the disabled veteran must have been discharged under honorable conditions and must meet one of the following criteria:

- Have been determined by the VA to be permanently and totally disabled as a result of military service and entitled to veterans' benefits at the 100% rate.
- Have a certificate from the VA certifying that the veteran is receiving or has received monetary assistance due to disability for specially adapted housing.
- Have been rated by the VA as individually unemployable.

Under the bill, beginning December 31, 2022, a **disabled veteran**, the **widow or widower** of a disabled veteran, or the **widow or widower** of a veteran killed in action could defer collection of property taxes and authorize the local tax collecting unit to claim the homestead credit provided for in section 521 of the Income Tax Act (proposed by HB 4568) on the veteran's or surviving spouse's behalf. To do so, the disabled veteran or surviving spouse would have to file an affidavit under the bill (in a form prescribed by the Department of Treasury) with the local tax collecting unit where the homestead is located. The applicant could file the affidavit at any time in the calendar year during which the applicable property taxes are levied. The affidavit would have to include all of the following:

- A description of the property for which the credit is claimed.
- A statement that the property is owned and used by the applicant as the applicant's homestead.
- A statement that the applicant is a disabled veteran, the widow or widower of a disabled veteran, or the widow or widower of a veteran killed in action.
- A statement authorizing the local tax collecting unit to claim the homestead credit under section 521 of the Income Tax Act on behalf of the applicant.
- A statement authorizing the Department of Treasury to remit direct payment of the credit claimed on the applicant's behalf directly to the local tax collecting unit.
- Supporting documentation for the information described above as required by the local tax collecting unit under guidelines provided by the Department of Treasury. If the disability status of a veteran is established by a disability rating provided by the VA before the year in which the affidavit is filed, the affidavit must include a statement that the veteran's most recent disability rating is unchanged from that one.

Disabled veteran would mean a **veteran** who meets one of the following criteria:

- Has been determined by the U.S. Department of Veterans Affairs (VA) to be permanently and totally disabled as a result of military service and entitled to veterans' benefits at the 100% rate.
- Has been determined by the VA to be entitled to veterans' benefits on a rating equal to or greater than 50% disabled and less than 100% permanently and totally disabled.
- Has a certificate from VA certifying that the veteran is receiving or has received pecuniary assistance due to disability for specially adapted housing.
- Has been rated by the VA as individually unemployable.

Veteran would mean an individual who served in the United States Armed Forces, including the reserve components, and was discharged or released under conditions other than dishonorable. It would include an individual who died while on active duty in the United States Armed Forces.

Widow or widower of a disabled veteran would mean the unmarried surviving spouse of a disabled veteran (except a disabled veteran determined to be entitled to benefits on a rating between 50% disabled and 100% permanently and totally disabled) who was eligible for one of the following when the veteran died:

- If the death occurred before December 31, 2022, the exemption provided under the act before December 31, 2022 (described above), regardless of whether the exemption had previously been granted to the decedent.
- If the death occurred on or after December 31, 2022, the homestead credit provided in section 521 of the Income Tax Act on and after December 31, 2022, regardless of whether the exemption had previously been granted to the decedent.

Widow or widower of a veteran killed in action would mean the unmarried surviving spouse of a veteran who was killed in action while serving as a member of the United States Armed Forces.

The Department of Treasury would have to provide local tax collecting units with informational materials that the local tax collecting unit would have to distribute to applicants filing an affidavit as described above. The materials would have to explain how the affidavit will be processed and how the applicant's tax liability will be handled under the bill.

A local tax collecting unit that receives an affidavit described above would have to do both of the following:

- Defer collecting any property taxes levied on the homestead during the calendar year in which the affidavit was filed until the state either state pays those property taxes under section 521 of the Income Tax Act or rejects the claim for the credit under that section.
- Before February 1 of the year immediately following the calendar year in which the affidavit was filed, do all of the following in a form and manner as prescribed by the Department of Treasury (which, however, could not require electronic submissions):
 - Provide the Department of Treasury with a copy of the affidavit.
 - Provide the Department of Treasury with the information necessary to determine the amount of property taxes deferred on the applicant's homestead for the relevant calendar year.
 - File a claim for the homestead credit under section 521 of the Income Tax Act on behalf of the applicant and request payment of that credit.

Property taxes deferred as described above would not be subject to penalties or interest for the period of deferment. However, if the state rejects the claim, any unpaid balance becomes due and payable on that date, and any remaining unpaid balance is subject to interest and penalties under the act beginning 90 days after the rejection.

Upon the state's payment of property taxes or rejection of a claim, the local tax collecting unit would have to notify the applicant in writing of the payment or rejection and, if applicable, the amount of any unpaid balance due and payable and the date by which it must be paid to avoid penalties and interest.

Payments made by the state under section 521 of the Income Tax Act would be considered taxes paid by the applicable individual.

MCL 211.7b

Neither bill would take effect unless both bills were enacted.

FISCAL IMPACT:

As written, HB 4568 would increase the earned income tax credit from 6% of the federal credit to 20% of the federal credit, effective for TY 2022. It would also provide a nonrefundable child tax credit of up to \$500 per dependent child beginning with TY 2022.

In addition, beginning January 1, 2023, the individual income tax rate would be reduced from 4.25% to 4.0%, the personal exemption would increase by \$1,800, and the standard deduction against all income available to taxpayers 67 and older would increase to \$21,800 for a single return and \$43,600 for a joint return.

Finally, HB 4568 and SB 768 would create a mechanism to reimburse local units of government for the veteran's property tax exemption available to veterans classified as 100% disabled as well as provide an income tax credit up to \$2,000 for property taxes paid by veterans at least 50% disabled but less than 100% disabled.

The estimated impacts on a fiscal year basis are shown below:

Estimated Impact by Fiscal Year (in millions)

	<u>Effective Date</u>	<u>FY 2022-23</u>	<u>FY 2023-24</u>
Increase EITC from 6% to 20% of Federal Credit	1/1/2022	(\$262.0)	(\$262.0)
Provide \$500 Nonrefundable Child Tax Credit	1/1/2022	(\$709.0)	(\$727.4)
Increase Personal Exemption to \$7,100	1/1/2023	(\$371.8)	(\$505.5)
Decrease Income Tax Rate to 4.0% from 4.25%	1/1/2023	(\$581.4)	(\$791.4)
Increase Standard Deduction at 67 by \$1,800/\$3,600	1/1/2023	(\$29.9)	(\$39.9)
Veterans Property Exemption Tax Credit	1/1/2023	<u>\$0.0</u>	<u>(\$200.0)</u>
Fiscal Year Total		(\$1,954.2)	(\$2,526.2)
GF/GP Impact		(\$1,925.1)	(\$2,396.3)
SAF Impact		(\$29.1)	(\$129.9)

The estimates assume that the changes, if enacted, would only be in effect for a portion of FY 2022-23. Thus, due to timing, some of the FY 2022-23 impact would not be realized until FY 2023-24.

Under current law, the School Aid Fund receives approximately 23.81% of gross income tax revenue (withholding, flow through entity tax, quarterly payments, and annual payments). However, because the earmark percentage is a function of the income tax rate, the percentage adjusts automatically to hold the School Aid Fund harmless against rate changes. Decreasing the rate to 4.0% would increase the earmark to approximately 25.3% of gross income tax revenue.

The bill could also have implications for the federal State Fiscal Recovery Fund (SFRF) distributions received by the state. Pursuant to the American Rescue Plan Act and its associated rules, when evaluating tax reductions, actual tax revenue in any given year must exceed baseline tax revenue, which is defined in ARP and ARP rules as 2019 tax revenue adjusted annually for inflation, through December 31, 2024. Any amount below baseline tax revenue must be “paid for” or an equivalent amount of SFRF is subject to recoupment under the act. To “pay for” the reduction in tax revenues, the state can use alternative revenue increases or spending reductions as an alternative to having SFRF funds recouped.

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■ This analysis was prepared by nonpartisan House Fiscal Agency staff for use by House members in their deliberations and does not constitute an official statement of legislative intent.