Senate Fiscal Agency
P.O. Box 30036
Lansing, Michigan 48909-7536

BILL ANALYSIS

Telephone: (517) 373-5383
Fax: (517) 373-1986

House Bill 4001 (as enrolled)
Sponsor: Representative Angela Witwer
House Committee: Tax Policy
Senate Committee: Committee of the Whole

Date Completed: 3-6-23

INTRODUCTION

The bill would amend the Income Tax Act to allow a taxpayer, beginning in the 2023 tax year, to choose between the current limitations on the deductibility of retirement and pension income or the limitations specified in the bill. The bill would increase, from 6.0% to 30.0%, the Earned Income Tax Credit (EITC), beginning with the 2023 tax year, and specifies that a taxpayer who claimed the EITC in the 2022 tax year would be eligible for an additional credit equal to 24% of the amount he or she would be allowed to claim as a Federal EITC in the 2022 tax year. The bill specifies that if it took effect before April 18, 2023, an eligible taxpayer could receive a rebate of his or her individual income tax (IIT) for 2022. (Note: the bill did not receive sufficient votes for immediate effect, thus, these changes would not take effect by the date specified). The bill also would modify the distribution of IIT revenue to the School Aid Fund (SAF), and the distribution of corporate income tax (CIT) revenue to various funds.

BRIEF FISCAL IMPACT

The bill would make changes to Sections 30, 51, 272, and 695 of the Act, as well as add new sections to create the Michigan Taxpayer Rebate Fund (MTRF) and provide tax rebates against tax year 2022 liability. Because the bill was passed without immediate effect, several provisions of the bill would not have any fiscal impact and other provisions would have a different impact than if the bill had been passed with immediate effect. The bill's changes would combine to have no fiscal impact in fiscal year (FY) 2021-22 and to reduce General Fund revenue by $560.0 million in FY 2022-23, $1,729.2 million in FY 2023-24, $1,391.6 million in FY 2024-25, $944.6 million in FY 2025-26, and approximately $983.6 million per year in later fiscal years. The changes also would increase revenue to several funds. Strategic Outreach and Attraction Reserve (SOAR) Fund revenue would increase by $460.0 million in FY 2022-23, $465.0 million in FY 2023-24, and $500.0 million in FY 2024-25; Michigan Housing and Community Development Fund revenue would increase by $50.0 million per year beginning in FY 2022-23; and Revitalization and Placemaking Fund (RPF) revenue would increase by $50.0 million per year in FY 2022-23, FY 2023-24, and FY 2024-25. The bill's proposed increase in revenue to the MTRF in FY 2021-22 would not occur.

PREVIOUS LEGISLATION

(Please note: The information in this summary provides a cursory overview of previous legislation and its progress. It does not provide a comprehensive account of all previous legislative efforts on the relevant subject matter.)

The EITC portions of the bill are, in part, a reintroduction of Senate Bill 417 of the 2021-2022 Legislative Session. The bill received hearings in the Senate Committee on Finance but saw no further action. Another bill from that session, House Bill 4568, would have increased the specified percentage to 20% (in addition to proposing several tax changes). It was vetoed by Governor Gretchen Whitmer in June 2022.

MCL 306.30 et al.

Legislative Analyst: Jeff Mann
Fiscal Analyst: David Zin

CONTENT

Modifications to Limitations & Restrictions of Retirement Income

Under the Act, "taxable income" means, for a person other than a corporation, estate, or trust, adjusted gross income (AGI) as defined in the Internal Revenue Code, subject to the adjustments specified in the Act. These adjustments generally include a deduction to the extent included in AGI for certain retirement or pension benefits. Under current law, the specific deduction that a taxpayer may claim depends on the year in which he or she was born, particularly with respect to seniors and those who receive retirement or pension benefits. The deductions for these types of income are subject to various limitations and restrictions specified in the Act, which are discussed in **BACKGROUND**.

Under the bill, to determine taxable income, a taxpayer could use the following limitations and restrictions for deductibility of retirement income instead of those currently applicable:

-- For the 2023 tax year: a taxpayer who was born after 1945 and before 1959 could deduct an amount of retirement or pension benefits not to exceed 25% of the maximum amount of those benefits that the taxpayer would be allowed to deduct for the tax year for other retirement benefits or annuity income (i.e., not military, State, or Federal retirement benefits) if the taxpayer were subject to the limitations for those born before 1946.
-- For the 2024 tax year: a taxpayer who was born after 1945 and before 1963 could deduct an amount of retirement or pension benefits not to exceed 50% of the amount described above.
-- For the 2025 tax year: a taxpayer who was born after 1945 and before 1967 could deduct an amount of retirement or pension benefits not to exceed 75% of the amount described above.
-- For the 2026 tax year and subsequent tax years: a taxpayer could deduct Social Security benefits, and a maximum of $42,240 for a single return and $84,480 for a joint return, as adjusted for inflation since 2007, for eligible retirement or pension benefits received from a Federal or State public retirement system or for retirement benefits from another retirement or pension system or a retirement annuity policy.

For tax years beginning on and after the 2023 tax year, in determining taxable income, a taxpayer with retirement or pension benefits received for services as a public police or fire department employee, an Michigan State Police trooper or sergeant, or a corrections officer employed by a county sheriff in a county jail, work camp, or other county facility that housed adult prisoners could elect to deduct retirement or pension benefits without any additional limitations or restrictions or could elect the current restrictions or those specified above.

For a joint return, the proposed limitations and restrictions would have to be applied based on the date of birth of the older spouse filing the return. If a deduction for State, Federal, or nonmilitary retirement or pension benefits were claimed on a joint return for a tax year in which a spouse died and the surviving spouse had not remarried since the death of that spouse, the surviving spouse would entitled to claim the deduction in subsequent tax years subject to the same restrictions and limitations that would have applied based on the date of birth of the older of the two spouses.

Earned Income Tax Credit

The Act allows a taxpayer to credit against IIT an amount equal to the specified percentages of the credit the taxpayer is allowed to claim as a credit the Federal EITC for a tax year on a return filed under the Act for the same tax year. For tax years that begin after December 31, 2011, the specified percentage is 6.0%. Under the bill, this would apply for tax years that

began after December 31, 2011, and before January 1, 2023. For tax years beginning after December 31, 2022, the specified percentage would be 30%.

The bill also specifies that, for the 2022 tax year only, a taxpayer who claimed the EITC on his or her IIT return for that year would be entitled to an additional credit of 24% of the Federal credit the taxpayer would be allowed to claim for that year. A taxpayer could not claim the additional credit on his or her return or on an amended return. Instead, the Department of Treasury would have to calculate the amount of the additional credit that each taxpayer would be entitled to receive. That amount would have to be refunded as soon as practical as specified in Section 30 of the Act in the form of a fully negotiable check.

Distributions to SAF

The Act currently requires that percentage of the gross collections before refunds from the IIT that is equal to 1.012% divided by the income tax rate (i.e., currently approximately 23.81% of gross collections) be deposited in the SAF. Under the bill, this would apply through FY 2022-23. After that, the following distributions would be required:

-- For FY 2023-24 only: the percentage of the gross collections before refunds from the IIT that is equal to 1.015% divided by the income tax rate.
-- For FY 2024-25 only: the percentage of the gross collections before refunds from the IIT that is equal to 1.023% divided by the income tax rate.
-- For FY 2025-26 only: the percentage of the gross collections before refunds from the IIT that is equal to 1.033% divided by the income tax rate.
-- For FY 2026-27 and subsequent fiscal years: the percentage of the gross collections before refunds from the IIT that is equal to 1.040% divided by the income tax rate.

Michigan Taxpayer Rebate Fund & Tax Rebate/Credit[1]

The bill would create the MTRF within the State Treasury. The State Treasurer could receive money or other assets from any source for deposit into the MTRF. The State Treasurer would have to direct investment of the MTRF and credit to it interest and earnings from MTRF investments. Money in the MTRF at the close of the fiscal year would have to remain in the MTRF and would not lapse to the General Fund; however, any money in the MTRF after all rebates had been issued as specified below would lapse to the General Fund.

Except as otherwise specified, if the bill took effect before April 18, 2023, the Department of Treasury would have to spend money from the MTRF to issue advance refund payments. If the bill took effect before April 18, 2023, each eligible taxpayer would be entitled to receive an IIT rebate for the 2022 tax year. The rebate would be an advance refund payment and would have to be claimed as a credit against the taxpayer's 2023 IIT. If the credit exceeded the taxpayer's IIT liability for the 2023 tax year, that portion of the credit that exceeded the liability would have to be refunded.

("Eligible taxpayer" would mean an individual taxpayer who was a resident of Michigan as of December 31, 2022, and who filed an IIT return for the 2022 tax year on or before October 18, 2023. The term would include a spouse if that taxpayer filed a joint State income tax return for the 2022 tax year and at least one of the individual filers listed on the return was a Michigan resident as of December 31, 2022. The term also would include a claimant who did not file a State income tax return for the 2022 tax year but filed a claim for a credit under Chapter 9 (e.g., a credit for home heating fuel costs) for the 2022 tax year on or before

[1] House Bill 4001 was passed by the Senate without receiving a two-thirds vote for immediate effect. Accordingly, if the bill is enacted, it will take effect on the 91st day after the Legislature adjourns sine die and not by April 18, 2023, the date required in order to trigger the rebates.

October 31, 2022. The term would not include a nonresident individual or an individual for whom a dependency exemption was allowable to another taxpayer for the 2022 tax year.)

The rebate/credit would be $180 for each eligible taxpayer. For an eligible taxpayer who was married but did not file a joint return for the 2022 tax year, the rebate/credit would be $90. For an eligible taxpayer who filed a joint State income tax return for the 2022 tax year, the amount of the credit for the 2023 tax year for each individual filer listed on the return would be $90. The amount of the credit for the 2023 tax year would have to be reduced by the amount of the advance refund issued to the eligible taxpayer, but not below $0.

In a manner determined by the Department, an advance refund payment of the credit would have to be issued automatically to each eligible taxpayer as soon as practical. The rebate and advance payment could be disbursed electronically to an account at a financial institution of the eligible taxpayer's choice to which he or she authorized the direct deposit of a 2022 IIT refund. If the eligible taxpayer did not include a direct deposit authorization, the Department would have to issue the payment by negotiable check sent by first-class mail to the address shown on his or her 2022 IIT tax return. The payment would have to be made from the MTRF. The Department would be prohibited from issuing any advance refund payments after December 31, 2023.

The advance refund payment would be exempt from interception, execution, levy, attachment, garnishment, or other legal process to collect a debt. No portion of the payment or any rights existing under these provisions could be applied as an offset to any eligible taxpayer's liability under Section 30a (which pertains to the calculation of taxable income by applying personal exemptions), or any arrearage or other debt of the eligible taxpayer. The Department could establish procedures and could require the submission of any information from the eligible taxpayer as needed to administer the rebate and advance refund payment.

Revitalization and Placemaking Fund

The bill would create the RPF within the State Treasury. The State Treasurer could receive money or other assets from any source for deposit into the RPF. The State Treasurer would have to direct investment of the RPF and credit to it interest and earnings from RPF investments. Money in the RPF at the close of the fiscal year would have to remain in the RPF and would not lapse to the General Fund.

Beginning in FY 2022-23, and each subsequent fiscal year, the Michigan Strategic Fund (MSF) would have to spend money from the RPF only to create and operate the Revitalization and Placemaking Grants Program to invest in projects that enabled population and tax revenue growth through rehabilitation of vacant and blighted buildings and historic structures, rehabilitation and development of vacant properties, and development of permanent "placed-based" infrastructure associated with social zones and traditional downtowns, outdoor dining, and place-based public spaces. If grant funds were used to support residential projects, those projects would have to comply with other program guidelines and eligibility as determined by the MSF. By December 31 annually, the MSF would have to prepare and submit to the Senate and House Appropriations Committees a report detailing the revenue received by and expenditures from the RPF during, and the RPF balance at the end of, the previous fiscal year.

Corporate Income Tax Earmarks

Generally, revenue collected under the CIT must be distributed to the General Fund. Under the bill, if it took effect before April 18, 2023, then, for FY 2021-22 only, $800.0 million of CIT revenue would have to be deposited into the Michigan Taxpayer Rebate Fund; the remainder would have to be deposited in the General Fund. Beginning with FY 2022-23 through FY 2024-25, up to $1.2 billion of CIT revenue would have to be deposited into the

General Fund. After that distribution, up to $50.0 million, if available, would have to be distributed to the Michigan Housing and Community Development Fund. After those two distributions, up to $50.0 million would have to be distributed to the Revitalization and Placemaking Fund. After those three distributions, $500.0 million would have to be distributed to the SOAR Fund. The balance of any revenue collected after these distributions would have to be deposited into the General Fund. Beginning with FY 2025-26, $50.0 million of CIT revenue would have to be distributed to the Michigan Housing and Community Development Fund. The balance of CIT revenue would have to be distributed to the General Fund.

BACKGROUND

Retirement Income Deduction; Limitations

As noted above, an individual's taxable income is computed in part by deducting various retirement or pension income. The deduction for other retirement or pension income is subject to various limitations and restrictions specified in the Act, depending on age and date of birth. These are grouped and discussed below.

Born before 1946. For an individual born before 1946, a taxpayer may deduct to the extent included in AGI, military, National Guard, or railroad pension and retirement income. A taxpayer also may deduct, to the extent included in AGI, eligible retirement and pension benefits received from a Federal or State public retirement system, Social Security benefits, and a maximum of $56,961 for a single return and $113,922 for a joint return for the 2022 tax year (the amounts in statute are set at $42,240 (single), $84,480 (joint), but are adjusted for inflation) for retirement benefits from another retirement or pension system or a retirement annuity policy.

Born in 1946-1952. For an individual born in 1946 through 1952, the sum of the deduction for the benefits described above, except for Social Security benefits, is limited to $20,000 for a single return and $40,000 for a joint return. After he or she reaches the age of 67, the deduction for those benefits does not apply and he or she is eligible for an unrestricted deduction of $20,000 for a single return and $40,000 for a joint return against all types of income. A person who takes the deduction for a military, National Guard, or railroad pension or retirement benefits is not eligible for the unrestricted deduction.

In addition, for these taxpayers, and for taxpayers born after 1945 and who retired as of January 1, 2013, if the taxpayer receives retirement or pension benefits from employment from a governmental agency not covered by the Social Security Act, the sum of the deduction is limited to $35,000 for a single return and $55,000 for a joint return. If both spouses on a joint return receive these benefits, the deduction is limited to $70,000. After he or she reaches 67 years of age, the restrictions do not apply and he or she is eligible for an unrestricted deduction of $35,000 for a single return, $55,000 for a joint return, or $70,000 for a joint return if applicable, against all types of income. A person who takes the deduction for a military or railroad pension or retirement benefits is not eligible for the unrestricted deduction.

Born after 1952. Except as noted above for those retired as of January 1, 2013, for a person born after 1952 who is 62 through 66 years of age and who receives retirement or pension benefits from employment with a government agency not covered by the Social Security Act, the deduction is limited to $15,000 for a single return and, generally, $15,000 for a joint return. If both spouses receive these types of benefits, the deduction is limited to $30,000.

Otherwise, when a taxpayer in this category reaches 67 years of age, he or she is eligible for an unrestricted $20,000 for a single return and $40,000 for a joint return. If the taxpayer takes this deduction, he or she may not take the deduction for Social Security benefits and may not claim a personal exemption; a taxpayer may claim the set of deductions/exemptions

that reduces his or her liability the most. A person who takes the deduction for military, National Guard, or railroad retirement or pension benefits is not eligible for the unrestricted $20,000/$40,000 deduction.

Joint Returns & Surviving Spouses

For joint returns, the limitations and restrictions listed above are applied based on the older spouse's date of birth. If a deduction for nonmilitary or nonrailroad retirement or pension benefits was claimed on a joint return for a tax year in which a spouse died and the surviving spouse has not remarried, the surviving spouse may claim the deduction for those benefits in subsequent tax years subject to the same restrictions and limitations, for a single return, that would have applied based on the date of birth of the older of the two spouses. Beginning with the 2020 tax year, a surviving spouse born after 1945 who has reached the age of 67 and has not remarried since the death of his or her spouse may take the unrestricted deduction subject to the same limitations and restrictions based on the surviving spouse's date of birth instead of the deduction allowed for nonmilitary/nonrailroad retirement or pension benefits for a single return, based on the date of birth of the older spouse.

FISCAL IMPACT

As noted above, the bill would make changes to Sections 30, 51, 272, and 695 of the Act, as well as add new sections to create the MTRF and provide for tax rebates against tax year 2022 liability. However, because the bill was adopted without immediate effect, several provisions of the bill would not have any fiscal impact and other provisions would have a different impact than if the bill had been adopted with immediate effect. Without immediate effect, the bill's changes would combine to have no fiscal impact in FY 2021-22 and to reduce General Fund revenue by $560.0 million in FY 2022-23, $1,729.2 million in FY 2023-24, $1,391.6 million in FY 2024-25, $944.6 million in FY 2025-26, and approximately $983.6 million per year in later fiscal years. The changes also would increase revenue to several funds: 1) SOAR Fund revenue would increase by $460.0 million in FY 2022-23, $465.0 million in FY 2023-24, and $500.0 million in FY 2024-25; 2) Michigan Housing and Community Development Fund revenue would increase by $50.0 million per year beginning in FY 2022-23; and 3) RPF revenue would increase by $50.0 million per year in FY 2022-23, FY 2023-24, and FY 2024-25. The bill's proposed increase in revenue to the MTRF in FY 2021-22 would not occur because the bill was not passed with immediate effect. The bill's revenue impact is summarized in Table 1.

Revenue Impact of House Bill 4001 (CR-1) Without Immediate Effect						
	Fiscal Year					
Fund	2021-22	2022-23	2023-24	2024-25	2025-26	2026-27 & Later
General Fund	($0.0)	($560.0)	($1,729.2)	($1,391.6)	($944.6)	($983.6)
EITC Changes	0.0	(0.0)	(883.2)	(441.6)	(441.6)	(441.6)
Retirement Changes/SAF Earmark	0.0	(0.0)	(281.0)	(350.0)	(453.0)	(492.0)
CIT Earmark	(0.0)	(560.0)	(565.0)	(600.0)	(50.0)	(50.0)
Taxpayer Rebate Fund	0.0					
SOAR	0.0	460.0	465.0	500.0	0.0	0.0
Housing & Comm. Dev.	0.0	50.0	50.0	50.0	50.0	50.0
Revitalization/Placemaking	0.0	50.0	50.0	50.0	0.0	0.0
Net Revenue Change (All Funds)	$0.0	($0.0)	($1,164.2)	($791.6)	($894.6)	($933.6)

Based on estimates from the Department of Treasury, the bill's changes to Sections 30 and 51 would reduce General Fund revenue by approximately $281.0 million in FY 2023-24, $350.0 million in FY 2024-25, and $453.0 million in FY 2025-26. The bill's provisions would not be fully phased in by FY 2025-26. Consequently, FY 2026-27 would be the first full fiscal year to reflect the fully phased-in provisions and the revenue loss likely would near $500.0 million. The revenue loss would continue to increase in later years because of population demographics, which are projected to result in an aging population. These demographic changes will increase the share of total taxpayers affected by tax provisions on senior or retirement income, meaning that revenue losses from exempt senior or retirement income will not be fully offset by increased revenues from new entrants to the tax system.

Based on EITCs filed between tax year 2012 and 2019, the bill's changes to Section 272 would reduce General Fund revenue by approximately $441.6 million per year beginning in FY 2022-23. The total amount claimed under the Michigan EITC has remained relatively stable, averaging $110.4 million per year between tax year 2012 and 2019. The bill would not affect SAF revenue because IIT revenue to the SAF is based on gross collections, which exclude the revenue impact of tax credits. However, because of the bill's effective date, the EITC provisions for tax year 2022 would be paid from FY 2023-24 revenue and the EITC changes would have no fiscal impact on FY 2022-23 revenue.

The bill's changes to Section 695 would have reduced FY 2021-22 General Fund revenue and increased revenue to the MTRF by $800.0 million if the bill had received immediate effect. Instead, the bill's changes to Section 695 would have no effect on FY 2021-22 revenue. Revenue in the MTRF would have funded the rebates provided for in proposed Section 476, however, with the bill's effective date, no rebates would be distributed. Approximately 4.4 million rebates would have been distributed if the bill had received immediate effect. Effectively, the bill would have provided rebates to individuals who resided in Michigan as of December 31, 2022, and were not claimed as a dependent on another return. Eligible taxpayers would have received a $180 rebate, with single returns and married filing joint returns receiving the $180. For those married filing separately returns, each taxpayer would have received $90, effectively resulting in the couple receiving the same $180 as received by taxpayers with married filing joint returns.

Based on the January 2023 Consensus Revenue Estimates, the changes in Section 695 also would reduce General Fund revenue by $560.0 million and would increase revenue to the Michigan Housing and Community Development Fund by $50.0 million, the RPF by $50.0 million, and to the SOAR Fund by $460.0 million in FY 2022-23. In FY 2023-24, the General Fund reduction would increase to $565.0 million, the revenue increases to the Michigan Housing and Community Development Fund and the RPF would remain at $50.0 million for each fund, but the increase to the SOAR Fund would total $465.0 million. In FY 2024-25, the General Fund reduction would increase to $600.0 million, the revenue increases to the Michigan Housing and Community Development Fund and the RPF would remain at $50.0 million for each fund, and the revenue increase to the SOAR Fund would total $500.0 million. In fiscal years after FY 2024-25, the bill's proposed changes to Section 695 would reduce General Fund revenue and would increase revenue to the Michigan Housing and Community Development Fund by $50.0 million per year.

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This analysis was prepared by nonpartisan Senate staff for use by the Senate in its deliberations and does not constitute an official statement of legislative intent.