



# **Budget Briefing: State Tax Revenue Overview**

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# Briefing Topics

- Explanation of Terms
- Major State Taxes
- Recently Enacted Tax Changes
- Major State Funds
- Revenue Trends

# Explanation of Terms

**Fiscal Year:** The state's fiscal year (FY) runs from October to September. FY 2016-17 is October 1, 2016 through September 30, 2017.

**Earmark:** A specific designation for some or all of the revenue generated by a tax. Earmarks can be either constitutional or statutory.

**Deductions and Exemptions:** Deductions and/or exemptions are amounts subtracted from the tax base before the tax rate is applied to determine the tax liability. An exemption can also mean a specific item or activity that is explicitly excluded from taxation.

**Credits:** Unlike deductions and exemptions, which reduce the base of a tax, credits reduce the tax liability after the rate has been applied. Credits can either be refundable, in which case a taxpayer will receive a refund if the credit exceeds the tax liability, or non-refundable, in which a credit can only be used to the point where no tax liability remains.

Note: Unless otherwise indicated, historical revenue amounts in this presentation have not been adjusted for inflation.

# Major State Taxes

# Major State Taxes

- Individual Income Tax
- Consumption based taxes, which include sales, use, tobacco, beer and wine, and liquor taxes. Sales, use, and tobacco taxes are by far the largest components.
- Business taxes, which are comprised of the single business tax (SBT), the Michigan business tax (MBT), the corporate income tax (CIT), and insurance company taxes.
- Statewide property taxes, which are the state education tax (SET) and the real estate transfer tax (RET).
- Some of these taxes include specific earmarks to the School Aid Fund (SAF) or the Comprehensive Transportation Fund (CTF). In general, any monies not otherwise earmarked become General Fund/General Purpose (GF/GP) revenue.
- This overview does not include gasoline and diesel taxes because they are specifically earmarked to the Michigan Transportation Fund, and are highlighted in the Transportation budget briefing.

# Major State Taxes

Estimated FY 2016-17, \$ in Millions

Tax	GF/GP	SAF	Total
Individual Income Tax	\$6,995	\$2,756	\$9,752
Sales Tax	1,182	5,476	7,530
Use Tax	643	512	1,155
Tobacco Taxes	187	357	948
Business Taxes	537		537
State Education Tax		1,939	1,939
Real Estate Transfer Tax		288	288
<b>TOTAL</b>	<b>\$9,543</b>	<b>\$11,328</b>	<b>\$22,148</b>

## Notes

- 1) The GF/GP and SAF amounts may not sum to the total shown due to rounding, and/or because some taxes contain earmarks that direct revenues to other funds.
- 2) Business Taxes are comprised of the single business tax, the Michigan business tax, the corporate income tax, and insurance company taxes.
- 3) These taxes account for almost 98% of GF/GP and SAF tax revenue.

# Individual Income Tax

- The starting point for the tax base is adjusted gross income (AGI) from the taxpayer's federal tax return.
- Taxpayers receive a personal exemption of \$4,000 per dependent.
- Retirement income for most taxpayers born after 1946 is taxable.
- There are no deductions or credits for charitable contributions.
- The current tax rate is 4.25%.
- Both the Homestead Property Tax Credit (HPTC) and the Earned Income Tax Credit (EITC) are refundable.
- Net individual income tax revenue is the sum of withholding from wages and salaries, estimated quarterly payments, and annual payment, less refunds.
- 23.8% of gross income tax revenue (before refunds) is earmarked to the School Aid Fund.

# Sales Tax

- The sales tax is imposed on retailers' gross taxable sales of tangible personal property not exempt by law.
- The maximum rate is 4%, plus the additional 2% approved by voters in 1994.
- Major exemptions from the sale tax include food not for immediate consumption, prescription drugs, and most services.
- 100% of the net sales tax revenue from the additional 2% levy is earmarked to the School Aid Fund.
- 60% of net sales tax revenue from the 4% levy is earmarked to the School Aid Fund.
- 15% of net sales tax revenue from the 4% levy is earmarked to cities, villages, and townships, and is distributed on a per capita basis.
- Smaller distributions are made to the Comprehensive Transportation Fund and the Michigan Health Initiative.

# Use Tax

- The use tax complements the sales tax in that it applies to purchases subject to the sales tax but on which no sales tax was collected. In addition, the use tax applies to some services.
- The most significant example of transactions subject to the use tax are mail order or Internet purchases on which the seller does not collect and remit the sales tax.
- The use tax also applies to rental cars and automotive leases.
- The maximum rate is 4%, plus the additional 2% approved by voters in 1994.
- 100% of the net use tax revenue from the additional 2% levy is earmarked to the School Aid Fund.
- A portion of the 4% amount is levied by the Local Community Stabilization Authority to reimburse local units of government for the loss of personal property tax revenue due to the phase-out.
- The remainder of the 4% amount accrues to the General Fund.

# Tobacco Taxes

- Both cigarettes and other tobacco products (cigars, pipe tobacco, smokeless tobacco, etc.) are subject to tobacco taxes.
- Cigarettes are taxed at a rate of \$2.00 per pack while other tobacco products are taxed at 32% of the wholesale price.
- Approximately 41.5% of cigarette tax revenue is earmarked to the School Aid Fund. The SAF receives about 38.1% of all tobacco tax revenue.
- Approximately 19.2% of cigarette tax revenue is earmarked to the General Fund. The GF receives about 19.7% of all tobacco tax revenue.
- Approximately 31.4% of cigarette tax revenue and 34.9% of all tobacco tax revenue is earmarked to the Medicaid Trust Fund.
- Smaller distributions are earmarked to the Healthy Michigan Fund, the Health and Safety Fund, the Michigan State Capitol Historic Site Fund, and to Wayne County for indigent health care.

# Business Taxes

- The single business tax was enacted in 1976, but was later repealed effective December 31, 2007.
- It was a value added tax imposed on all business activity in Michigan, regardless of business classification (sole proprietorship, partnership, S Corporation, C Corporation, etc.).
- The SBT was replaced by the Michigan business tax effective January 1, 2008, although the MBT was subsequently repealed effective December 31, 2011.
- Like the SBT, the MBT was broad-based in that it applied to all business activity in Michigan, regardless of organizational structure.
- Although the MBT was been repealed, taxpayers with existing certificated credits issued by the Michigan Economic Growth Authority (MEGA) must continue filing under the MBT to receive the credits.
- The credits could reduce GF/GP revenue by as much as \$750 million in FY 2016-17.

# Business Taxes

- The Corporate income tax replaced the MBT effective January 1, 2012.
- Unlike the SBT and MBT, the CIT only applies to C Corporations, which has significantly reduced the number of taxpayers.
- The CIT rate is 6%, and it applies to business income apportioned to Michigan.
- While the SBT and MBT both allowed several types of credits, the only CIT credit is for small businesses.
- The transition from the MBT to the CIT reduced revenue derived from business taxes by over \$1.0 billion.
- Both Michigan and foreign (non-Michigan based) insurance companies are taxed at a rate of 1.25% of gross direct premiums written.

# State Property Taxes

- The state education tax is a 6-mill levy against the taxable value of real property (land and structures) and personal property not otherwise exempt.
- The real estate transfer tax is assessed at 0.75% of the fair market value of real property.
- All revenue from state property taxes is earmarked to the School Aid Fund.

# Recently Enacted Tax Changes

# Personal Property Tax Changes

- Major changes to the treatment of business personal property were enacted in Public Acts 397-404 and 406-408 of 2012.
- Personal property is defined as property that is movable, which makes it distinct from real property (land and buildings). Business personal property is typically comprised of machinery and equipment.
- All commercial and industrial personal property owned by a single taxpayer in a local unit is exempt provided the combined market value is \$80,000 or less, effective January 1, 2014.
- Any property classified as “eligible manufacturing personal property,” which is a new term defined in the legislation, that was acquired before 2006 or after 2012 is exempt from property taxes, effective January 1, 2016.
- Eligible manufacturing personal property acquired between 2006 and 2012 will be exempted one year at a time so that by 2023, all eligible manufacturing personal property will be exempt.

# Personal Property Tax Changes

- In August 2014, a statewide election approved legislation that allowed the Local Community Stabilization Authority (LCSA) to levy a portion of the 4% use tax. The LCSA began levying specific dollar amount contained in statute beginning with FY 2015-16.
- The LCSA will use this revenue to reimburse local taxing authorities for the loss of property tax revenue resulting from the personal property tax exemptions.
- In addition, effective January 1, 2016, the state will levy a special assessment against those taxpayers benefitting from the exemption of eligible manufacturing personal property to partially offset some of the revenue loss to the state.
- The overall net revenue impact to the state is estimated to be a reduction of roughly \$90 million in FY 2015-16, \$350 million in FY 2016-17, and \$375 million in FY 2017-18.
- When fully implemented, the annual revenue loss to the state will be approximately \$500 million per year.

# Transportation Package

- Public Acts 174-180 of 2015 implemented a number of tax changes with the intent of generating new revenue as well as redirecting existing revenue for road maintenance.
- Existing per gallon tax rates of \$0.19 for gasoline and \$0.15 for diesel will increase to \$0.263 on January 1, 2017. After the first year, the rate will be adjusted for inflation, with a maximum annual increase of 5%.
- Registration fees will increase by about 20% effective January 1, 2017. An additional surcharge will also apply to electric and hybrid vehicles.
- A portion of GF/GP income tax revenue will be earmarked to the Michigan Transportation Fund. The legislation redirects \$150 million in FY 2018-19, \$325 million in FY 2019-20, and \$600 million in subsequent years.
- Beginning in 2023, if GF/GP revenue increases by more than 1.425 times the rate of inflation relative to FY 2021, the income tax rate will automatically be reduced to offset the revenue increase.

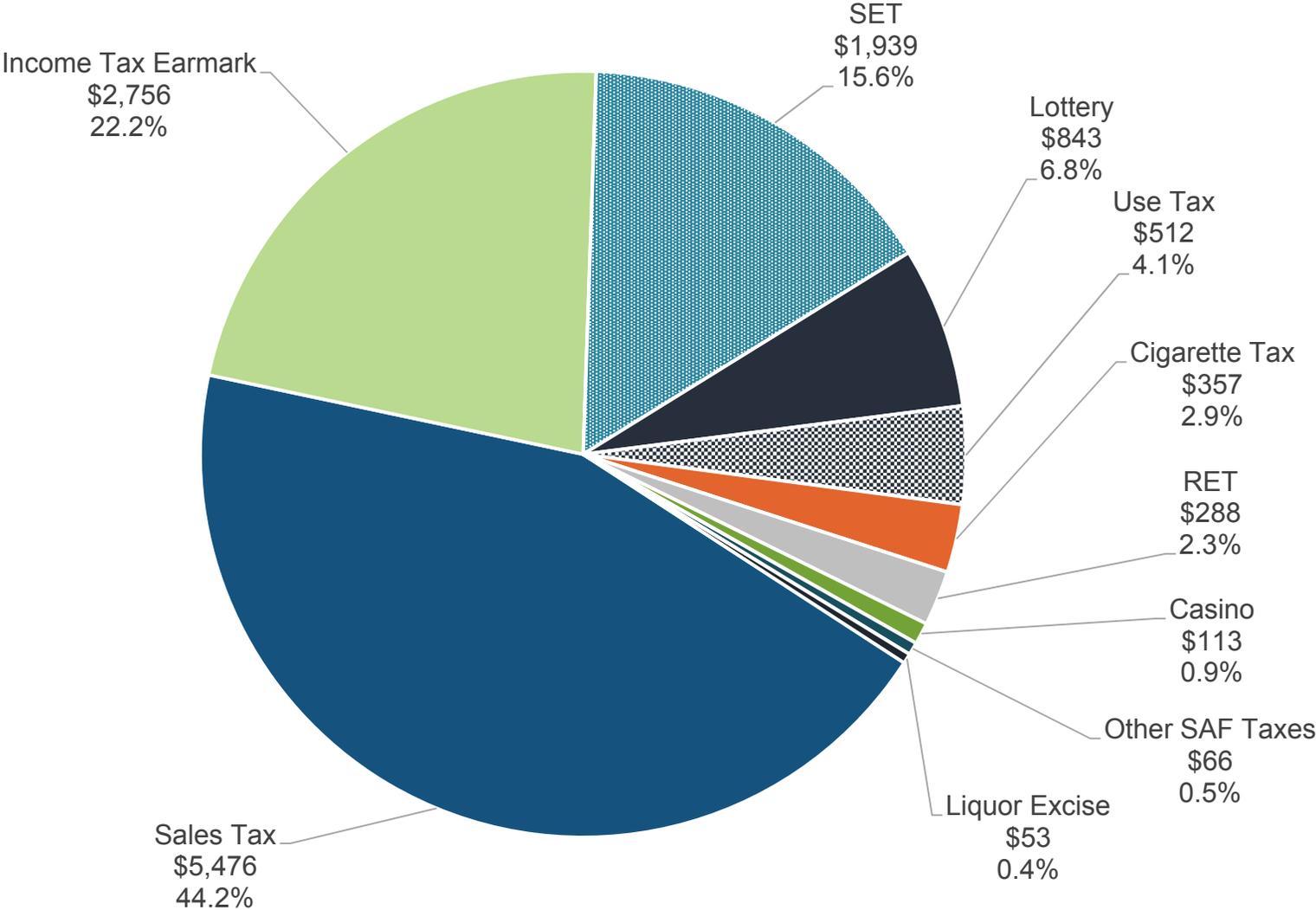
# Major State Funds

# Major State Funds

- The School Aid Fund is used primarily to fund K-12 education, although a portion is also appropriated to community colleges and public universities.
- The major sources of SAF revenue are the earmark from the individual income tax, consumption taxes, the 6-mill state education tax, the real estate transfer tax, casino gaming revenue, and net lottery proceeds.
- Unless otherwise specified, most remaining revenue becomes General Fund/General Purpose revenue.
- GF/GP revenue can be appropriated to any specific budget and/or program.
- Major sources of GF/GP tax revenue include the individual income tax, consumption taxes, and business taxes.

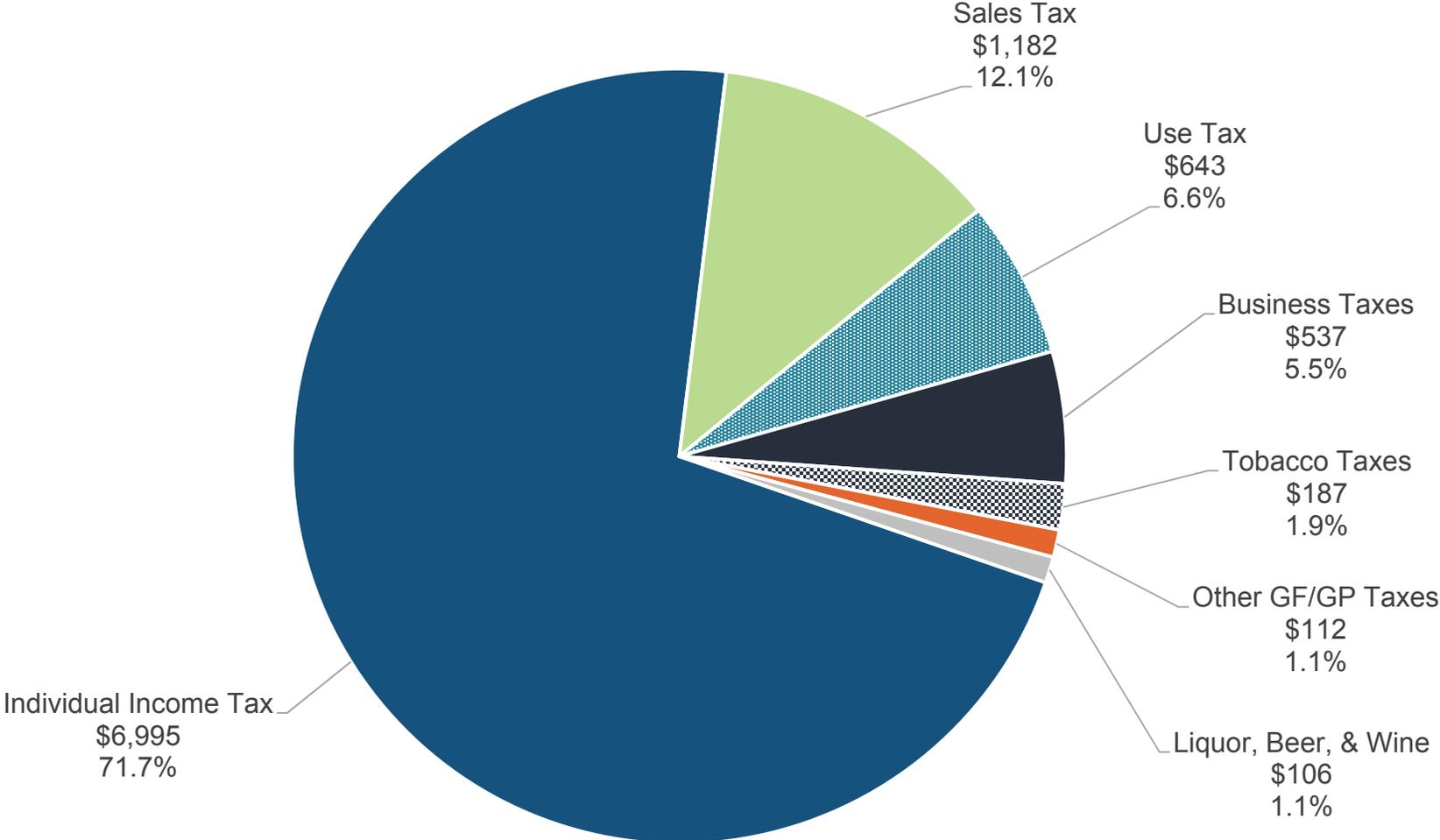
# FY 2016-17 SAF Tax and Lottery Revenue

The School Aid Fund is projected to total almost \$12.5 billion in FY 2016-17. Dollar amounts below are in millions.



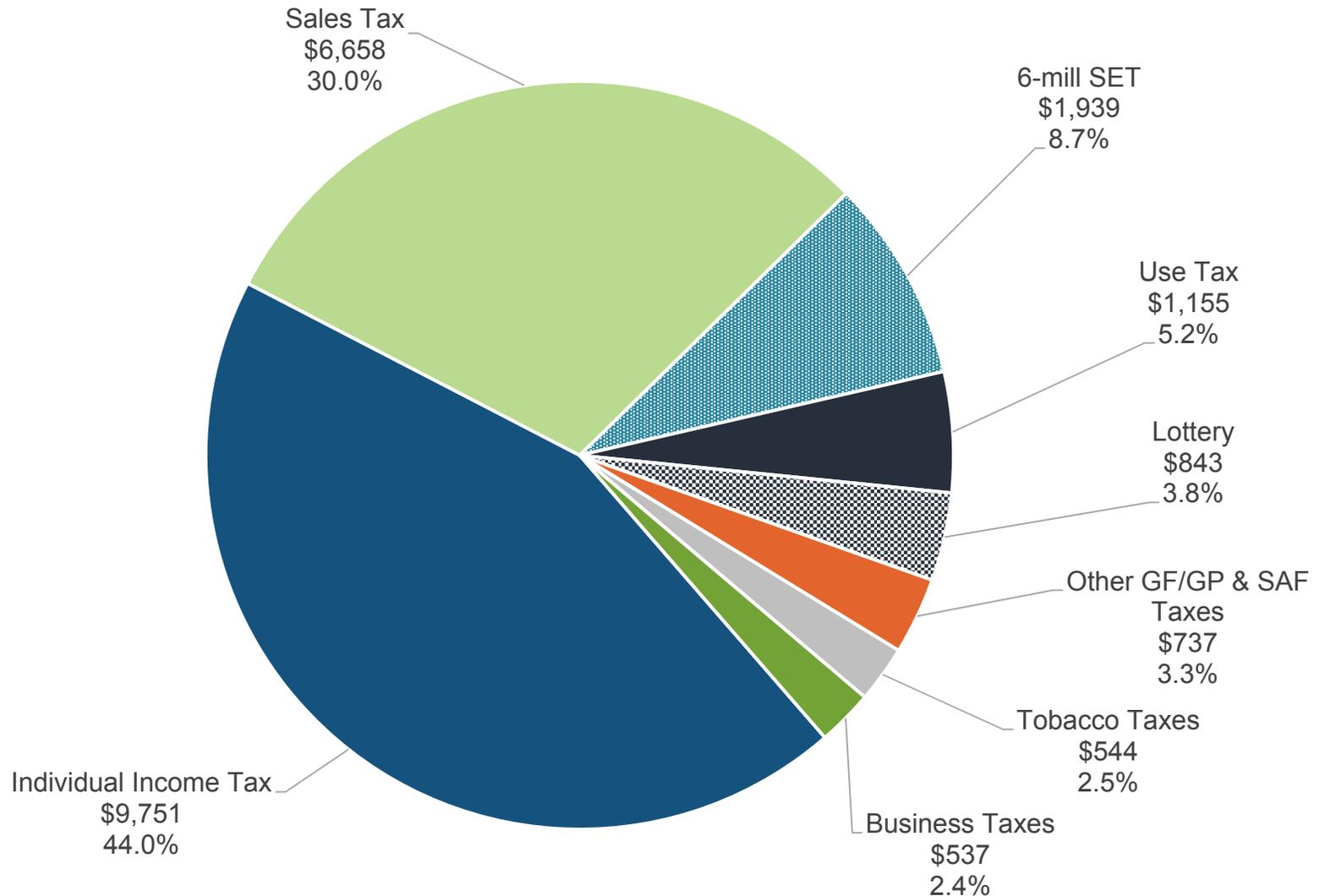
# FY 2016-17 GF/GP Tax Revenue

The General Fund/General Purpose tax revenue is projected to total almost \$9.8 billion in FY 2016-17. Dollar amounts below are in millions.



# FY 2016-17 Combined GF/GP and SAF Tax and Lottery Revenue

Combined GF/GP and SAF tax and lottery revenue is projected to total almost \$22.2 billion in FY 2016-17. Dollar amounts below are in millions.



# Revenue Trends

# Revenue Trends of Major Taxes

- Between FY 2000 and FY 2015, personal income in Michigan grew at an average annual rate of 2.3%. However, since FY 2000, revenue generated from Michigan's major taxes as a percent of personal income has generally declined .
- Sales tax revenue has grown since FY 2000, albeit at a slower rate than for personal income. Over time, the base has eroded due to increased remote sales and a shift towards purchasing more services. Tobacco taxes are decreasing as tobacco use becomes less prevalent.
- The individual income tax has shown the most volatility, partially because of fluctuations in capital gain realizations. Revenue increases since FY 2012 can be partially attributed to the taxation of retirement income.
- As previously noted, business taxes have declined in absolute terms since FY 2012 because of existing certificated MEGA credits as well as the replacement of the MBT with the CIT.
- Despite the sharp decline in property values beginning in FY 2008, statewide property taxes as a percent of personal income have remained relatively stable.

# Major State Taxes as a Percentage of Michigan Personal Income

Recent growth in state revenue has been driven by the income tax. Other major state taxes have declined as a percentage of state personal income as a result of economic trends or tax policy decisions.

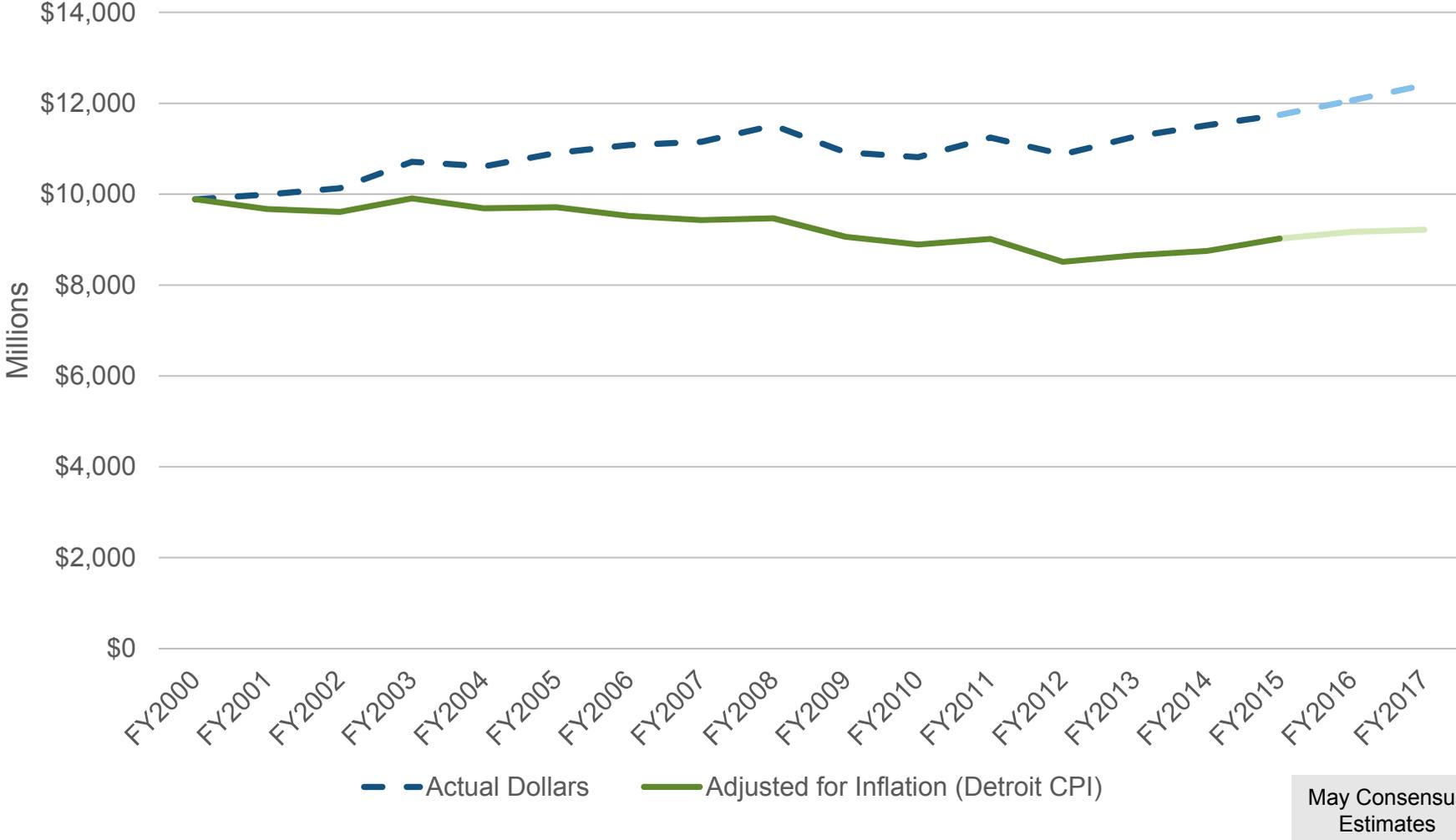


# Revenue Trends of Major Funds

- Between FY 2000 and FY 2015, School Aid Fund revenue grew at an annual average rate of 1.2%.
- When adjusted for inflation using the Detroit CPI, SAF revenue declined at an average annual rate of 0.6% between FY 2000 and FY 2015.
- SAF revenue, which was 3.3% of personal income in FY 2000, is estimated to decline to 2.7% of personal income in FY 2017.
- Between FY 2000 and FY 2015, General Fund/General Purpose revenue declined at an annual average rate of 0.4%.
- When adjusted for inflation using the Detroit CPI, GF/GP revenue declined at an average annual rate of 2.2% between FY 2000 and FY 2015.
- GF/GP revenue, which was 3.6% of personal income in FY 2000, is estimated to decline to 2.2% of personal income in FY 2017.
- Both personal property tax reform and the transportation package will continue to reduce GF/GP revenue going forward.

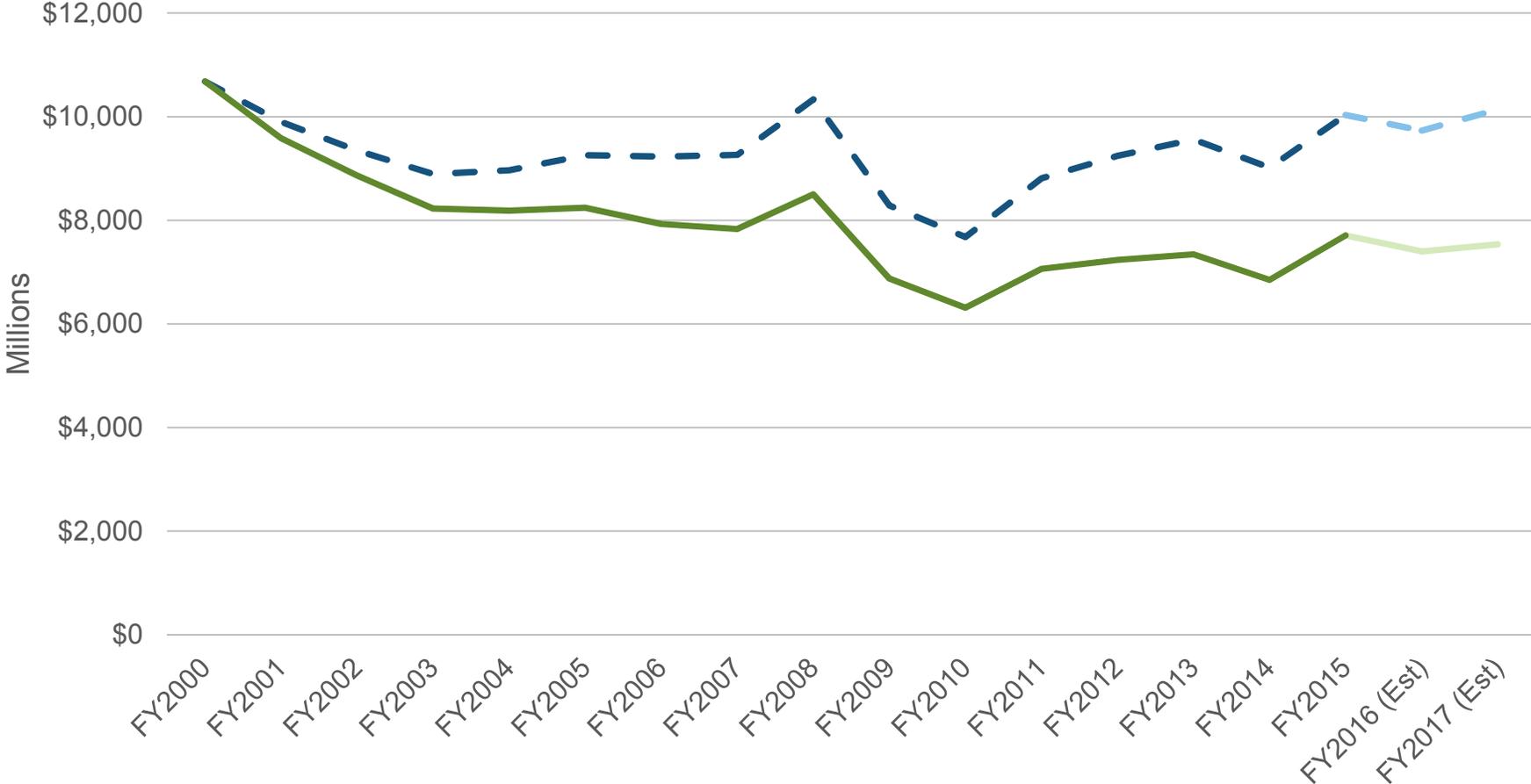
# School Aid Fund Revenue

Nominal SAF revenue has grown steadily since FY 2011-12. In inflation-adjusted terms, however, FY 2016-17 revenue is estimated to be 6.8% below the FY 1999-00 level.



# GF/GP Revenue

Nominal GF/GP revenue is expected to exceed \$10 billion in FY 2016-17. When adjusted for inflation, however, GF/GP revenue is estimated to be 29.4% below the FY 1999-00 level.

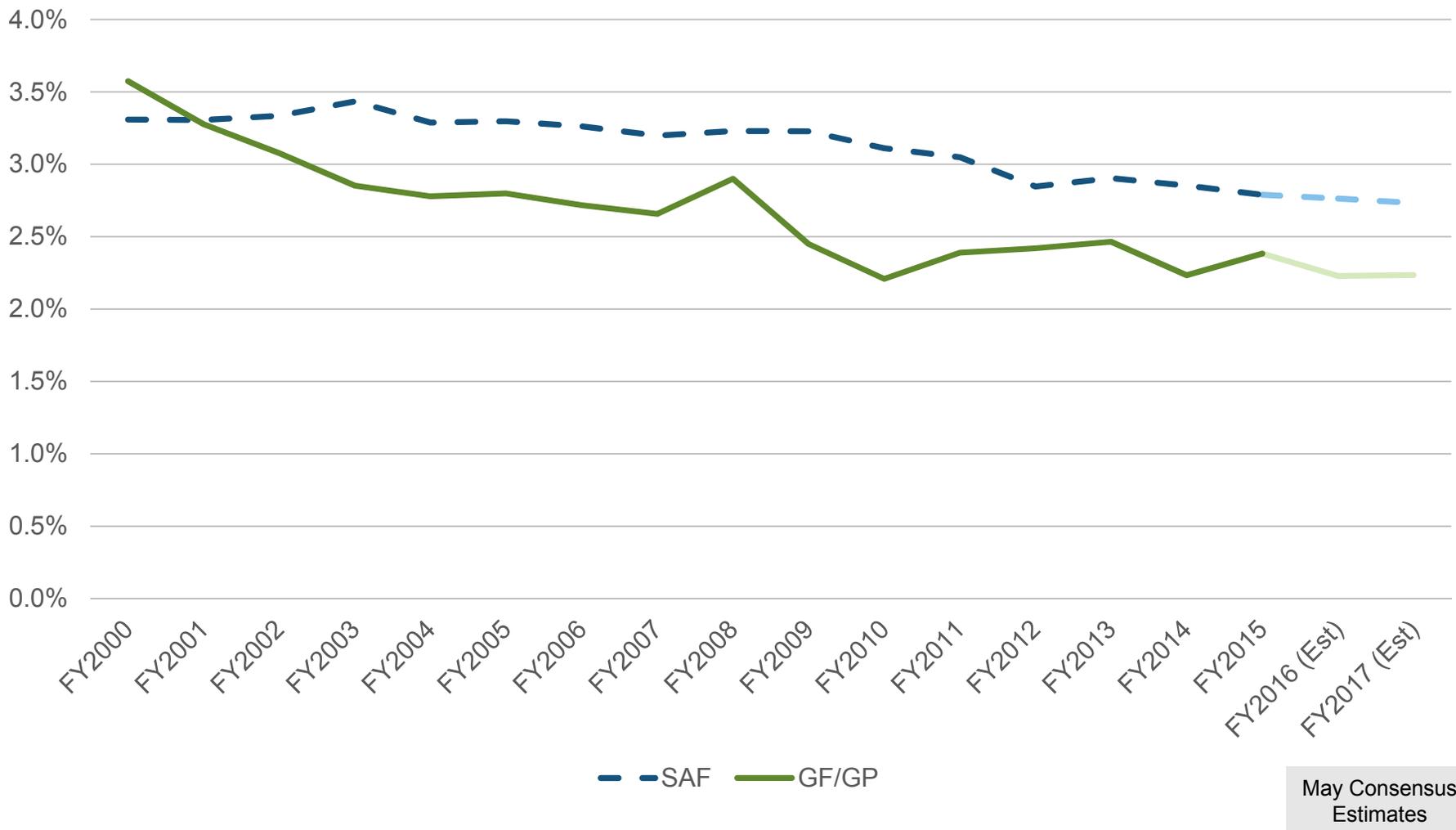


— Actual Dollars      — Adjusted for Inflation (Detroit CPI)

May Consensus Estimates

# SAF and GF/GP Revenue as a Percent of Michigan Personal Income

As a percent of Michigan personal income, both SAF and GF/GP revenue have been generally declining since FY 2000.



# House Fiscal Agency Economics Roles

- **Economic Forecasting and Revenue Estimating**
  - Prepare economic forecasts for both the U.S. and Michigan as well as a detailed revenue forecast for Michigan in preparation for the Consensus Revenue Estimating Conference held in January and May. The HFA forecast is typically published shortly before the conference date.
  - Monitor revenues to ensure that the consensus estimates remain viable. An HFA revenue update is published monthly.
- **Tax and Revenue Analysis**
  - Prepare fiscal analyses of bills with revenue implications which receive hearings in various subcommittees.
- **Legislative Assistance**
  - Provide assistance to members and staff about potential or introduced legislation that might have tax and revenue implications.
  - Assist legislators and staff in addressing constituent questions on tax and revenue related issues.
- **All tasks are completed in compliance with statutory requirements for nonpartisanship and confidentiality.**

# For more information about the state revenue:

## HFA website

<http://www.house.mi.gov/hfa/>

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