A Problem 10 Years in the Making

Prepared for:

Representative Steven Lindberg
District 109 Budget Town Hall

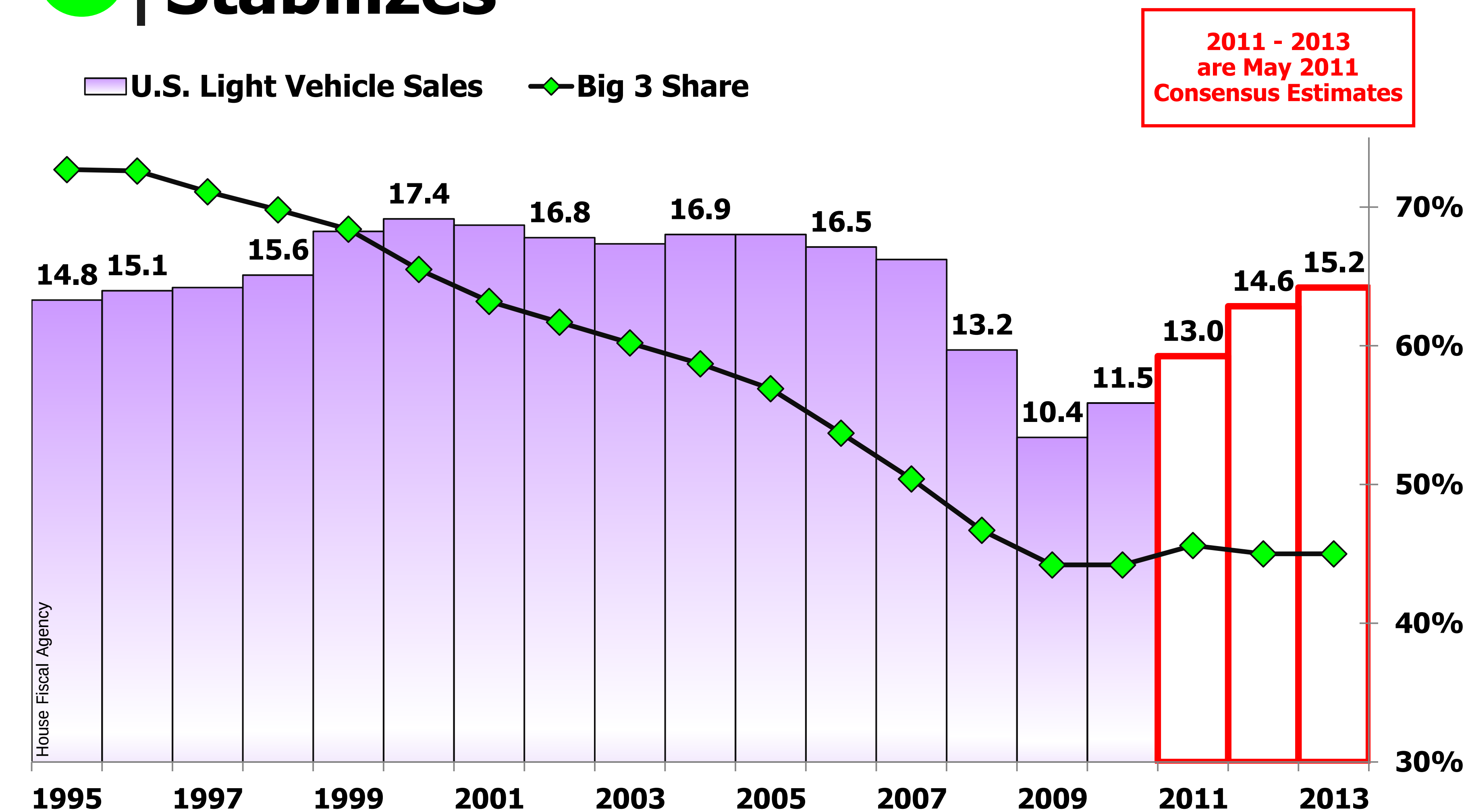
May 20, 2011

HOUSE FISCAL AGENCY
Mitchell E. Bean, Director

State Budget Shortfalls Caused By

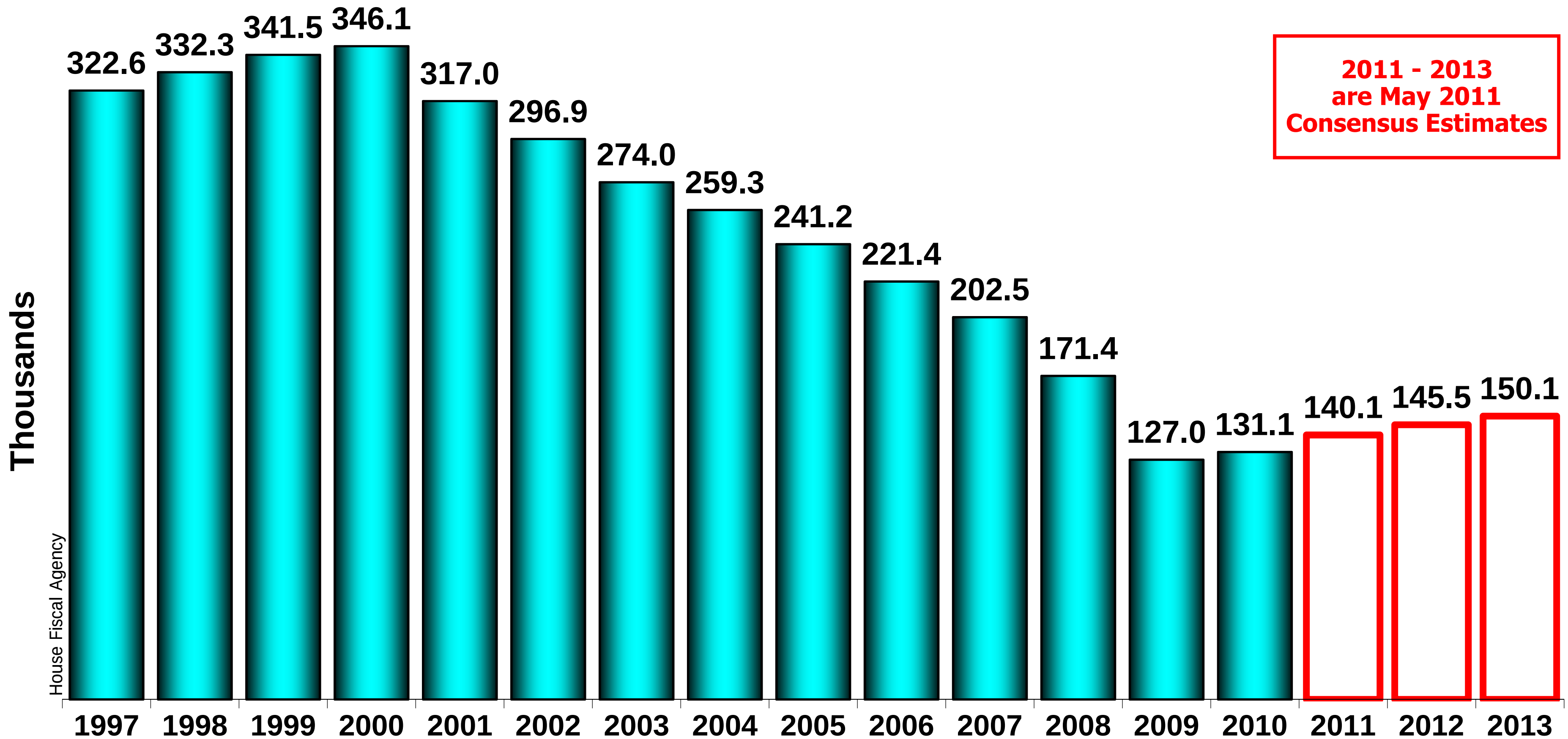
- Severe economic contraction led by domestic auto industry
- State tax policy
- Increasing cost of Medicaid and corrections
- Chronic use of one-time fixes

Sales Up; Big 3 Market Share Stabilizes



Source: _Automotive News_ and May 2011 Consensus Estimates

Michigan Vehicle Employment



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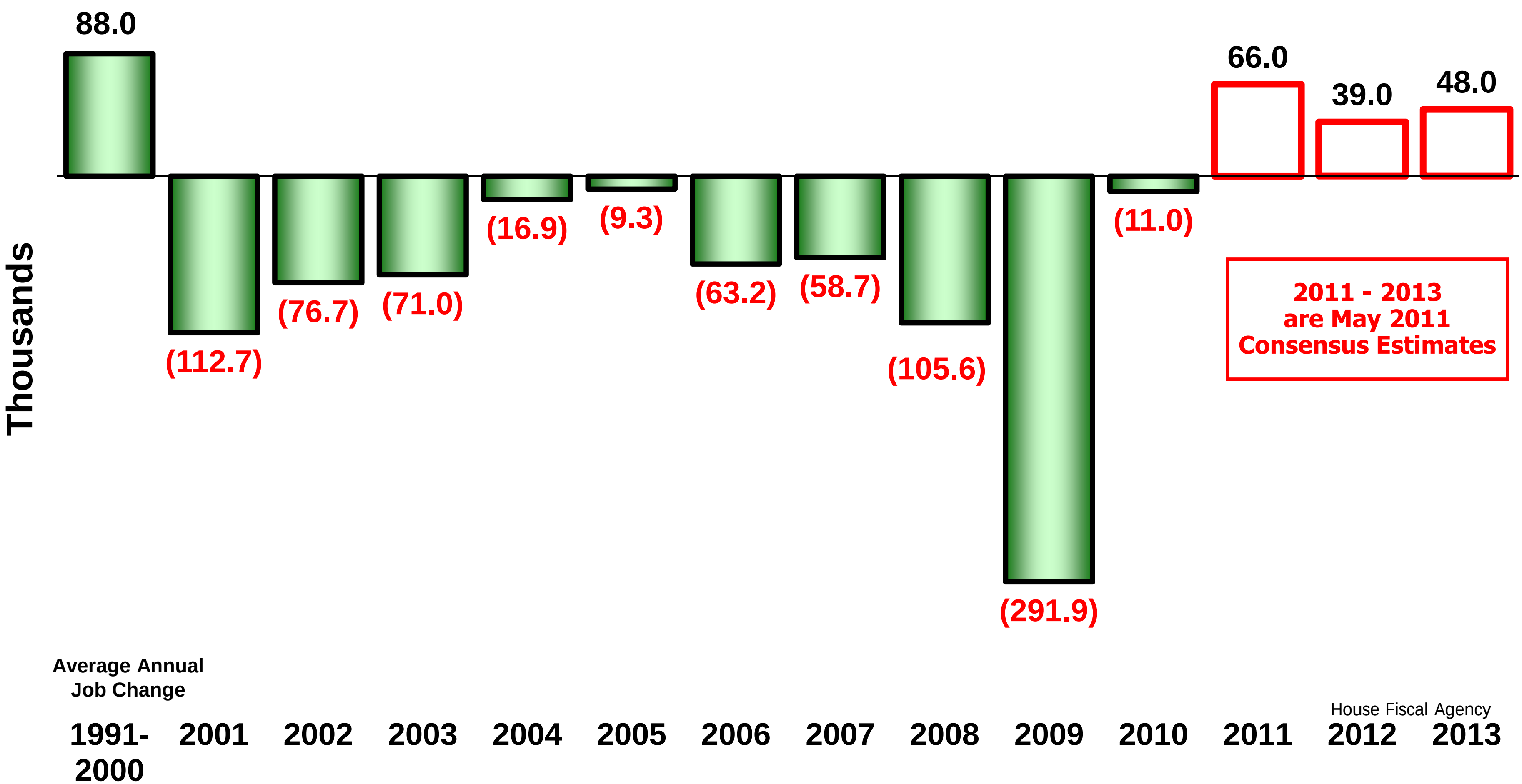
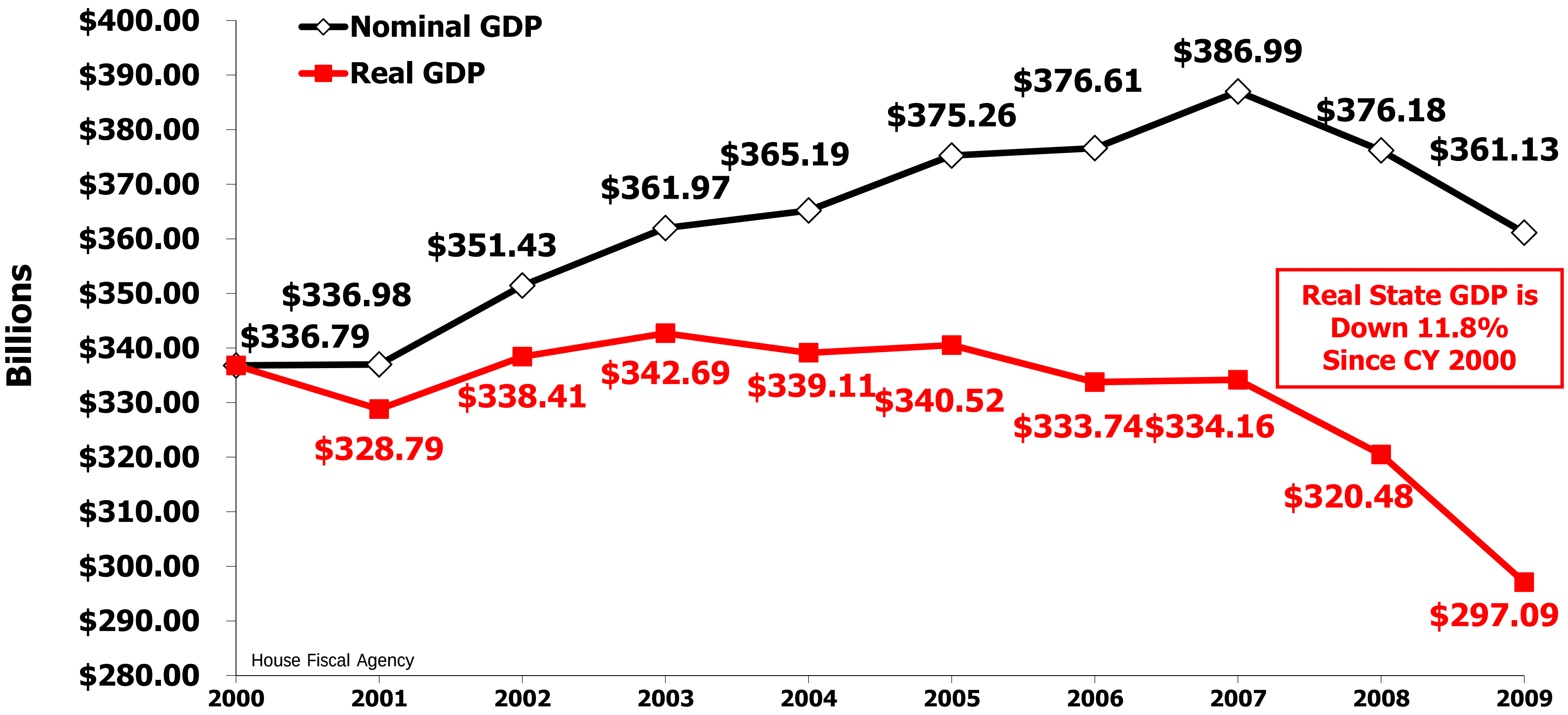
Source: U.S. Bureau of Labor Statistics and May 2011 Consensus Estimates

Job Change in Michigan

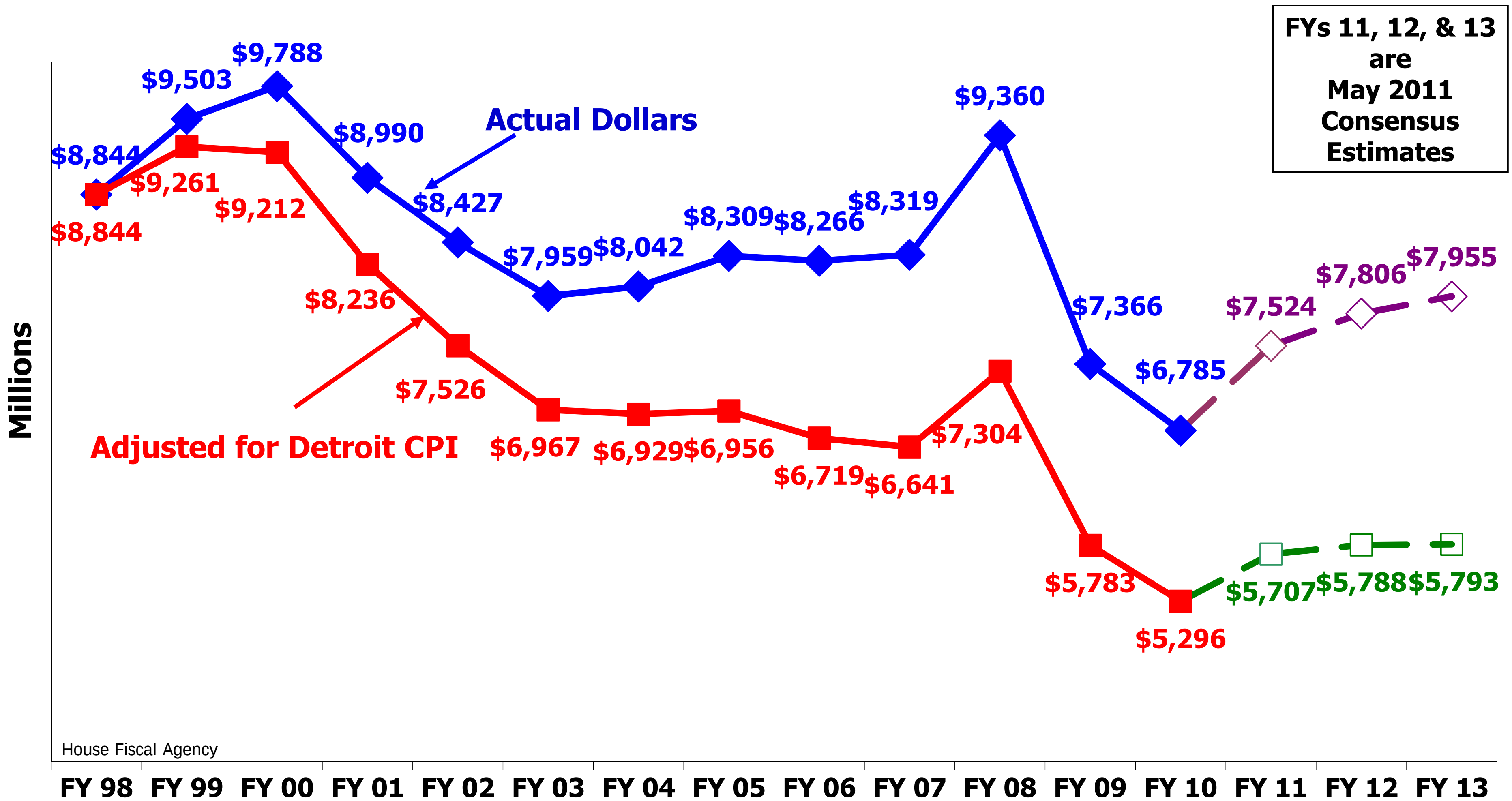


Source: U.S. Bureau of Labor Statistics and May 2011 Consensus Estimates

Real and Nominal State GDP

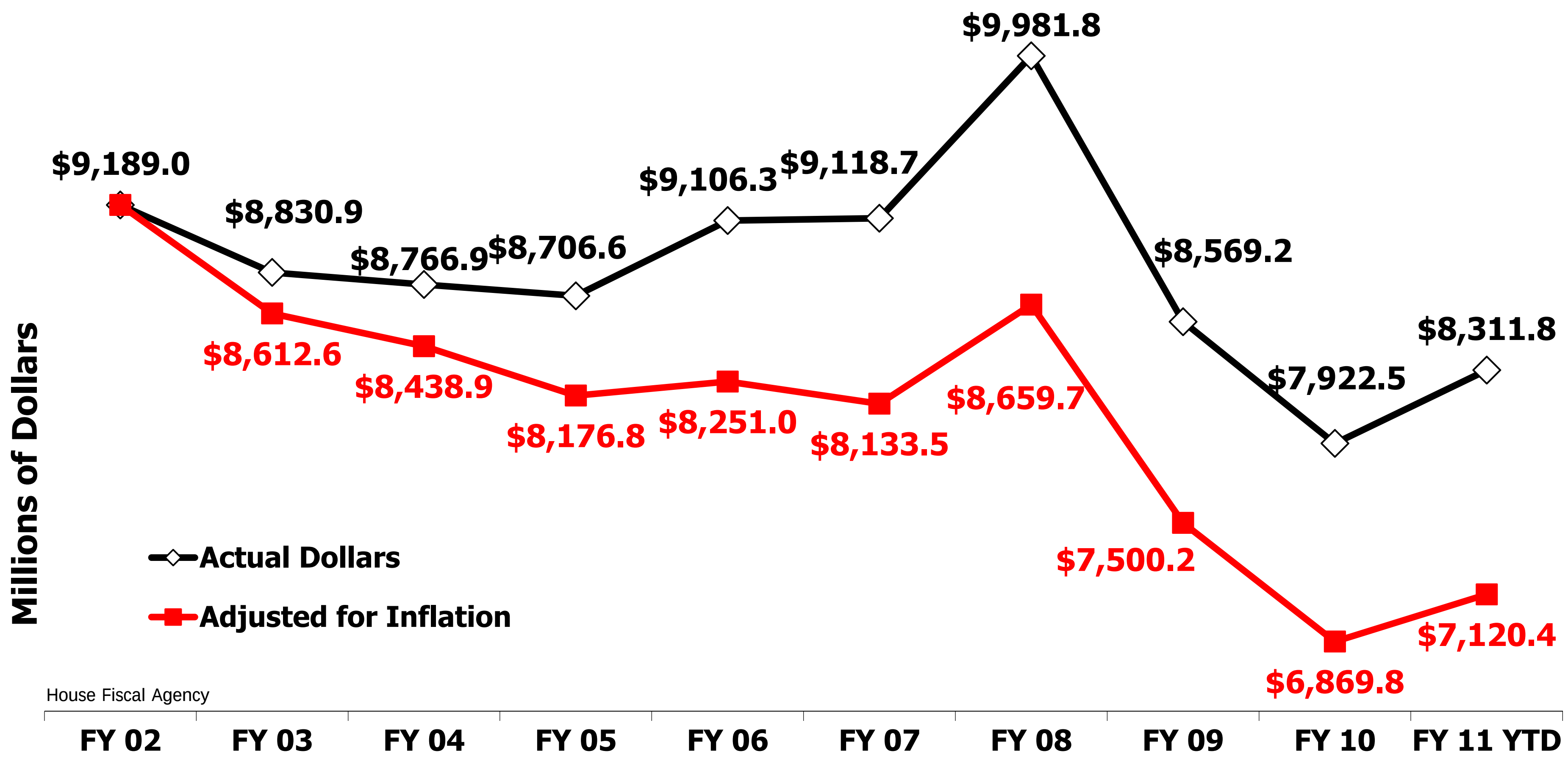


Inflation Adjusted GF/GP Revenue Down 40% Since FY 2000

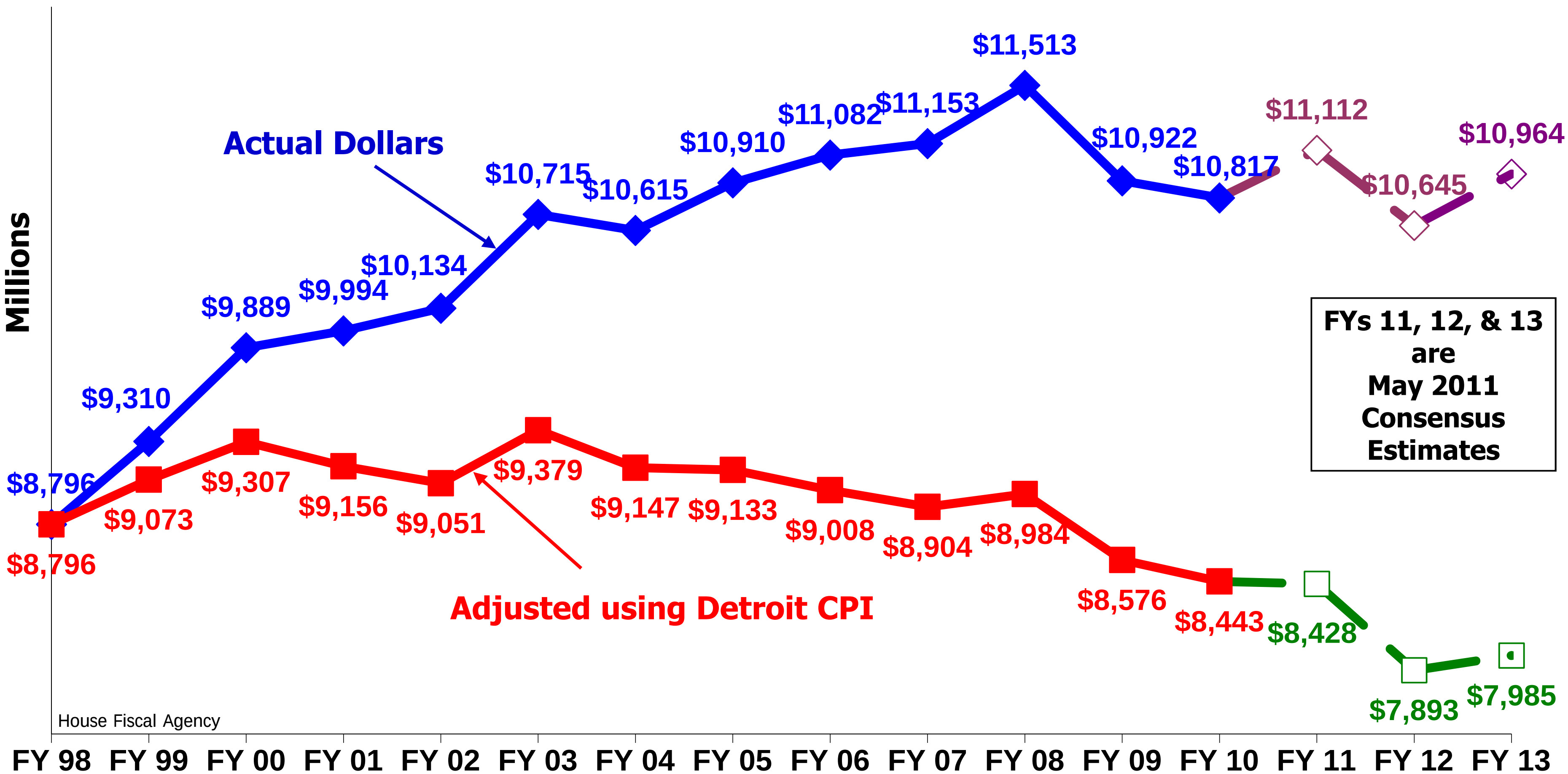


Note: Consensus estimates adjusted to include the tax plan.

GF/GP Appropriations

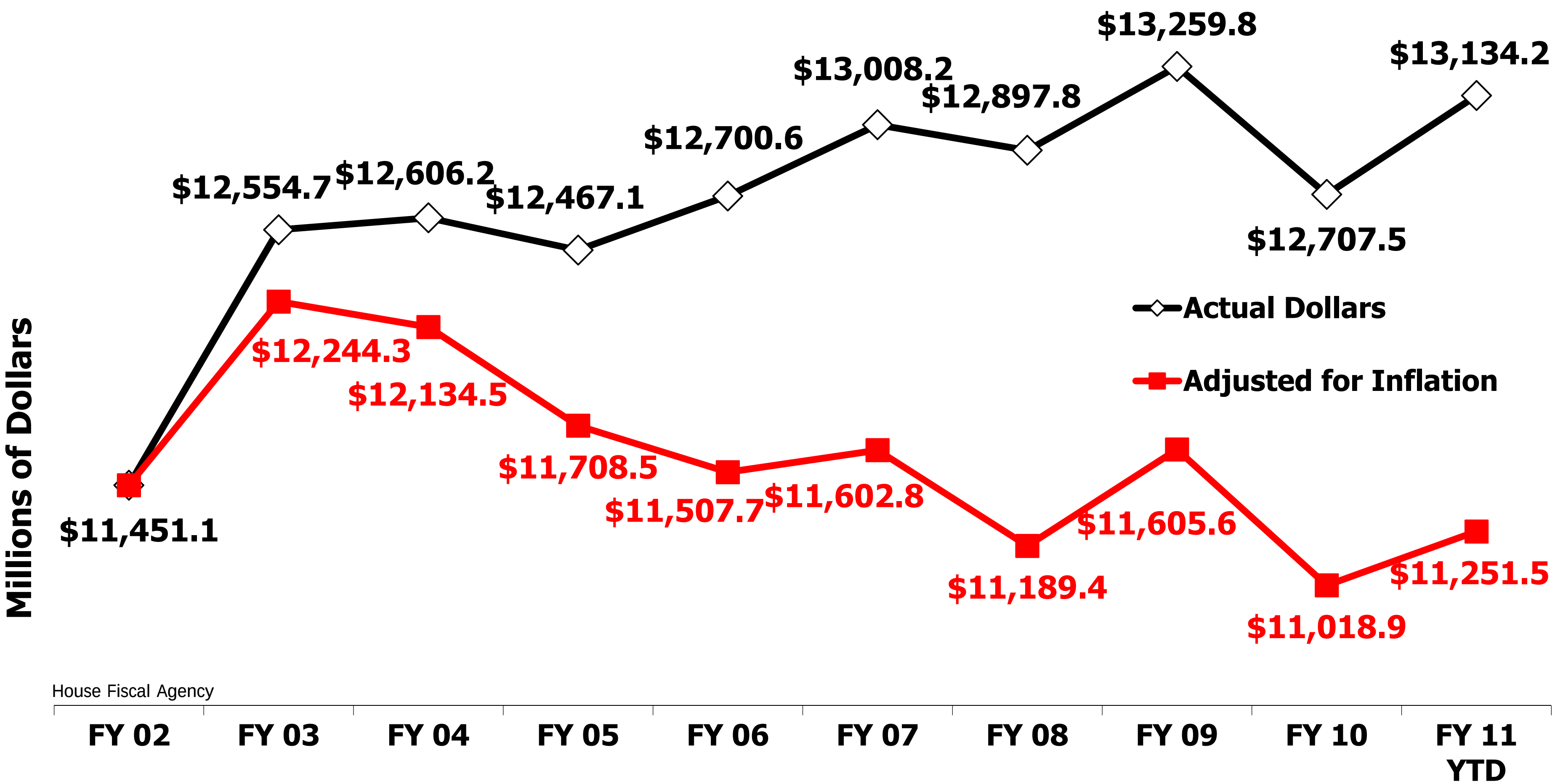


Inflation Adjusted SAF Net Revenue Down 8.7% Since FY 2000

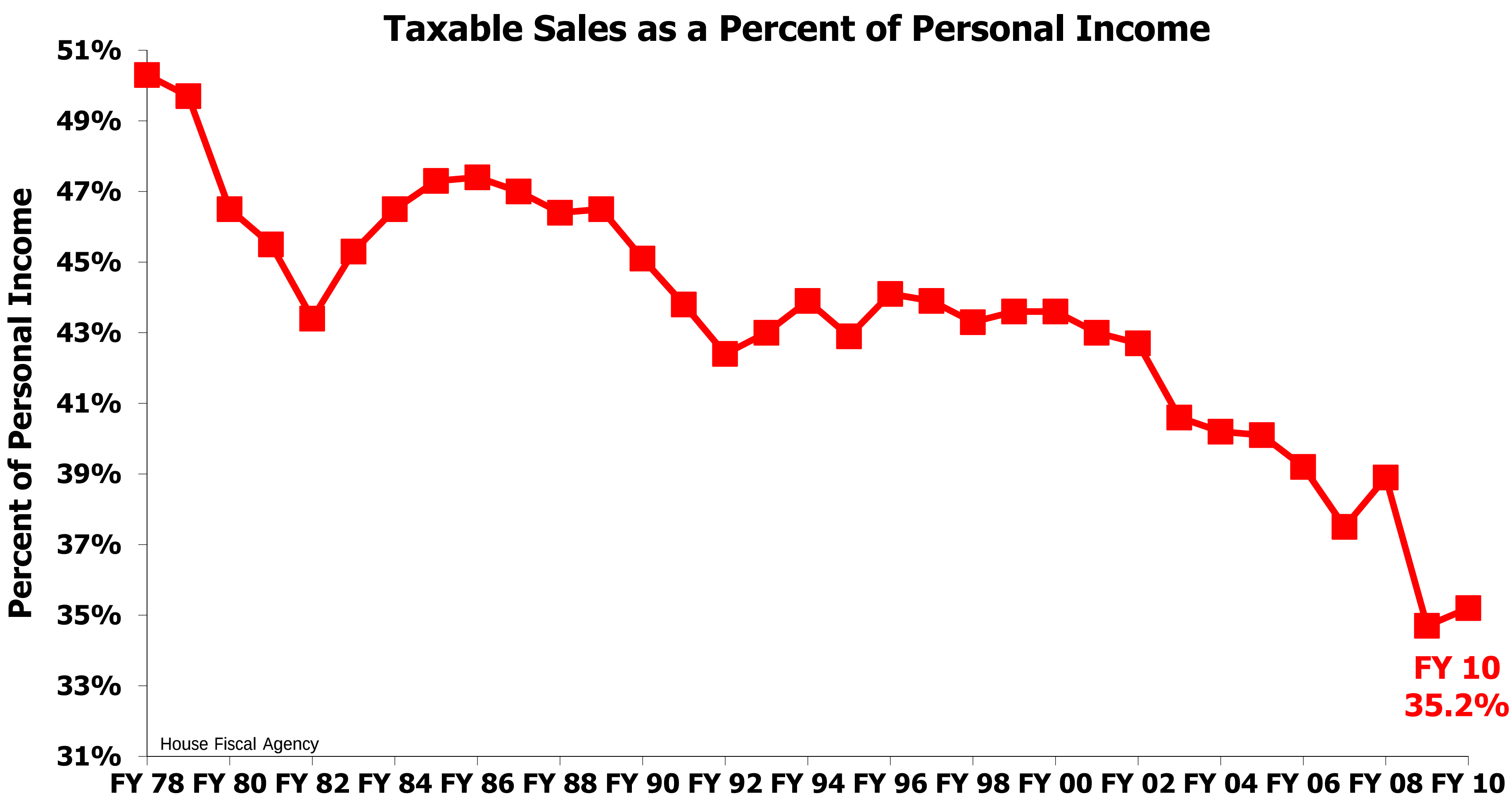


Note: Consensus estimates adjusted to include the tax plan.

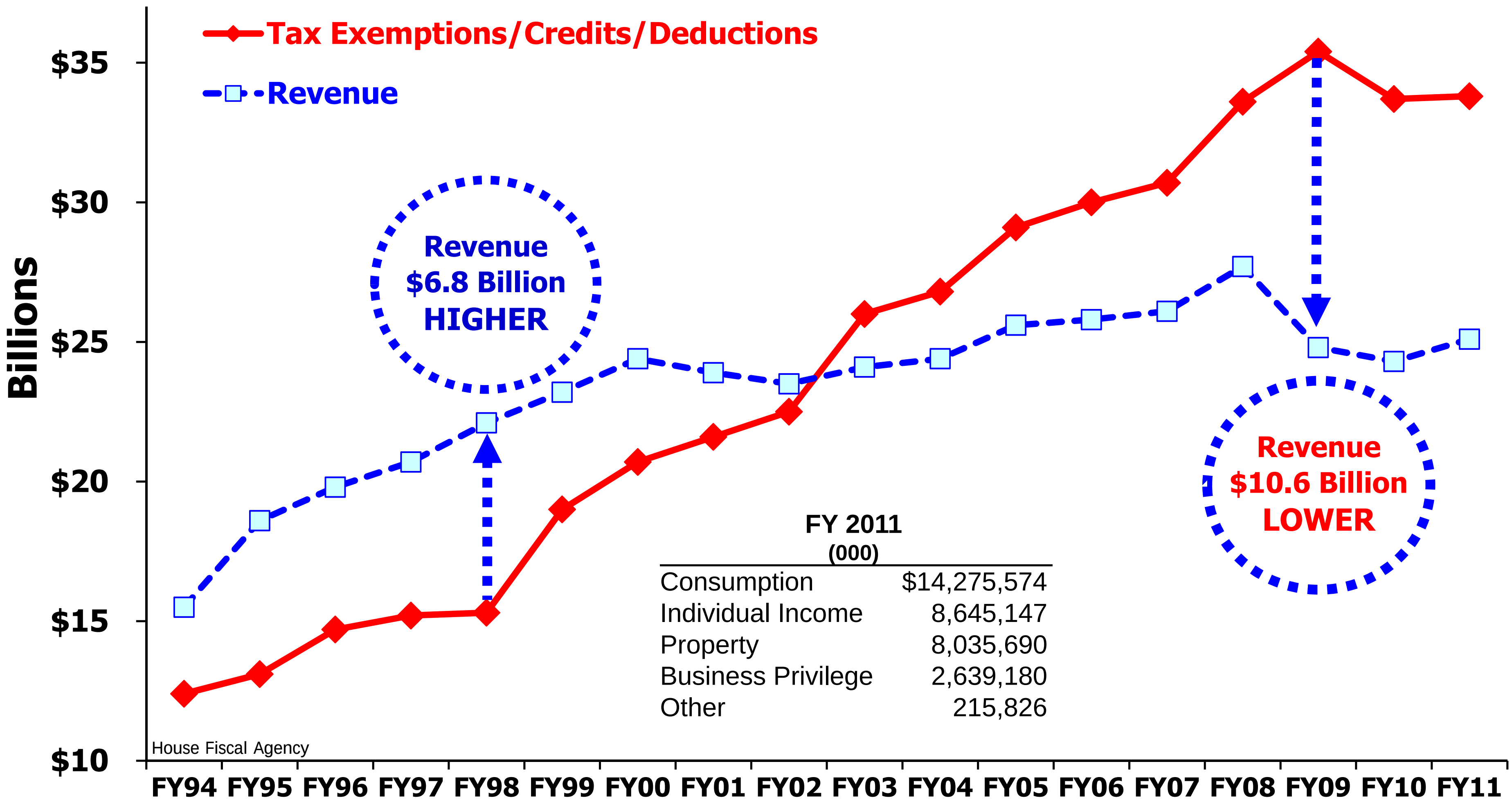
School Aid Budget
Adjusted Gross Appropriations



Sales/Use Tax Share Declining



Impact of Tax Exemptions/Credits/Deductions



FY 2011
(000)

Consumption	$14,275,574
Individual Income	8,645,147
Property	8,035,690
Business Privilege	2,639,180
Other	215,826

Why Consider Tax Expenditures?

- Tax expenditures are an alternative to direct spending.
- They can be used to effectively continue to spend tax dollars on policy initiatives while the budget is being reduced.
- They're "off-budget" for all practical purposes.
- Transparency and government accountability demand they be reported and evaluated.

Impact of Recent Tax Cuts on Future Revenues

	FY 2009	FY 2010	FY 2011	FY 2012	FY 2013	FY 2014
Reducing Michigan Income Tax Rate	$0.0	$0.0	$0.0	($161.8)	($342.2)	($543.5)
Alternative Energy Credits - Income Tax	($16.0)	($22.6)	($24.2)	($18.9)	$0.0	$0.0
Michigan EITC	($140.0)	($341.0)	($357.0)	($378.0)	($400.7)	($424.8)
Eliminating MBT Surcharge			Eliminated in Tax Year 2017			
MBT Battery Credits (Assumes Maximum Used)	$0.0	$0.0	$0.0	($40.0)	($268.0)	($278.0)
MBT Film Production Credit	($37.5)	($61.9)	($105.0)	($140.0)	($140.0)	($140.0)
Photovoltaic Technology - Facility & Manufacturing	$0.0	$0.0	($1.5)	($7.5)	($7.5)	($10.0)
Polycrystalline Manufacturing Credit	$0.0	$0.0	$0.0	$0.0	($20.0)	($25.0)
MBT Gross Receipt Changes	($115.8)	($80.5)	($93.4)	($117.8)	($129.9)	($132.7)
Decouple Bonus Depreciation/Production Activities	$172.5	$23.4	$19.2	$45.3	$52.3	$60.0
Historic Preservation Credits	$0.0	$0.0	($5.0)	($8.6)	($9.6)	($10.6)
Use Tax Bad Debt Deduction Change (Court Case)	($2.0)	($25.5)	($16.6)	($17.1)	($17.7)	($18.4)
Angel Credit	$0.0	$0.0	($3.4)	($9.0)	($9.0)	($9.0)
Exempt Supplies for Cobo Center	$0.0	$0.0	($2.5)	($2.5)	($3.5)	($1.5)
Totals in Millions	**($138.8)**	**($508.1)**	**($589.4)**	**($855.9)**	**($1,295.8)**	**($1,533.5)**

Fewer People Pay Income Tax

All Filers	2000	2008
Tax Liability < $0	19.5%	25.6%
Tax Liability = $0	8.0%	8.0%
Tax Liability Between $0 and $100	6.1%	5.0%
Tax Liability < $100	33.6%	38.6%

Refundable Credits on the Michigan Income Tax

- **Homestead Property Tax Credit ($1,006.6 million in FY 2010-11)**
- **Earned Income Tax Credit ($353.8 million in FY 2010-11)**
- **Alternative Energy/Qualified Home Improvement Credit ($23.6 million in FY 2010-11) – sunsets in 2012**
- **Adoption Credit ($0.8 million in FY 2010-11)**
- **Stillbirth Credit ($39,000 in FY 2010-11)**

Indexed Provisions of the Michigan Income Tax

- Personal Exemption
- Special Exemptions for Seniors and/or Disabled Individuals
- Special Exemption for Qualified Disabled Veterans
- Income Threshold for Pension Income Deduction
- Income Threshold for Deduction of Interest and Capital Gains Earned by Seniors
- Home Heating Credit
- Stillbirth Credit

Impact of Shrinking Tax Base

	Income Tax Rate	Collections as Percent of State Personal Income
FY 2000	**4.0%**	**2.6%**
FY 2010	**4.35%**	**1.5%**
Revenue Impact of Declining Base (In Millions of Dollars)		**$3,653.50**

	Sales and Use Tax Rate	Collections as Percent of State Personal Income
FY 2000	**6.0%**	**2.8%**
FY 2010	**6.0%**	**2.1%**
Revenue Impact of Declining Base (In Millions of Dollars)		**$2,511.60**

Structural Problems Began in Earnest in 2001

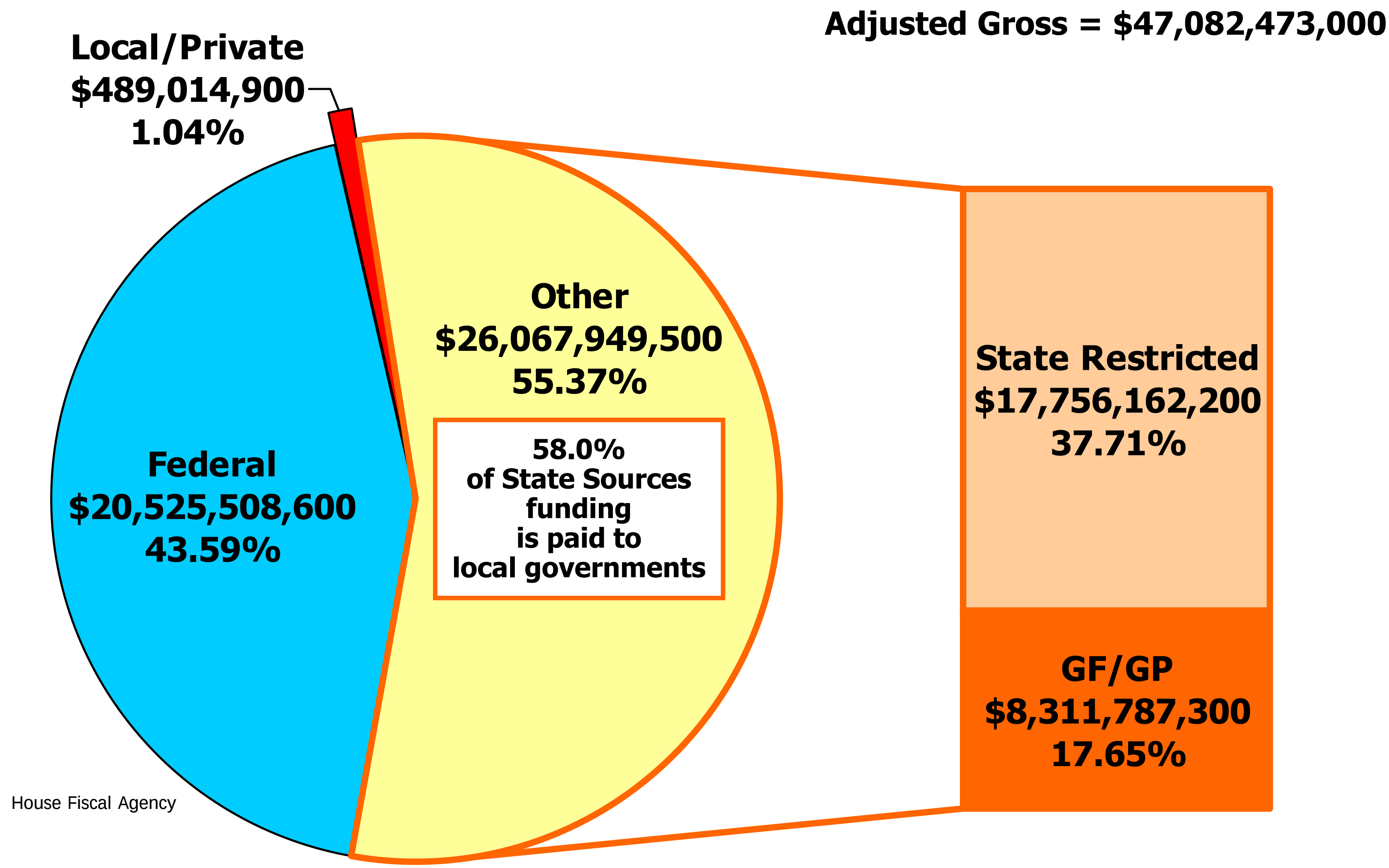
Funding Source	$ Amount in Millions
Withdrawn from the BSF	$1,264.0
SAF surplus	$870.0
One-time revenue from changing SET collection dates	$454.0
Other one-time revenue from various fund shifts and property sales	$689.0
Total One-Time Revenue June 2001 to December 2002	**$3,277.0**

Structural Problems Continue in FY 2011

Funding Source	$ Amount in Millions
Federal Funds	$976.5
Tax Amnesty ($88.8M in FY11 plus assumed $20.5M loss in FY12)	$109.3
Unclaimed Property (difference between FY11 and FY12)	$107.0
Debt Service Restructuring (difference between FY11 and FY12)	$162.2
Early Retirement (one-time replacement savings minus 3% phase-in)	$24.0
County Revenue Sharing: Projected FY 2011-12 Increase	$40.0
Total One-Time Funding Sources	**$1,419.0**

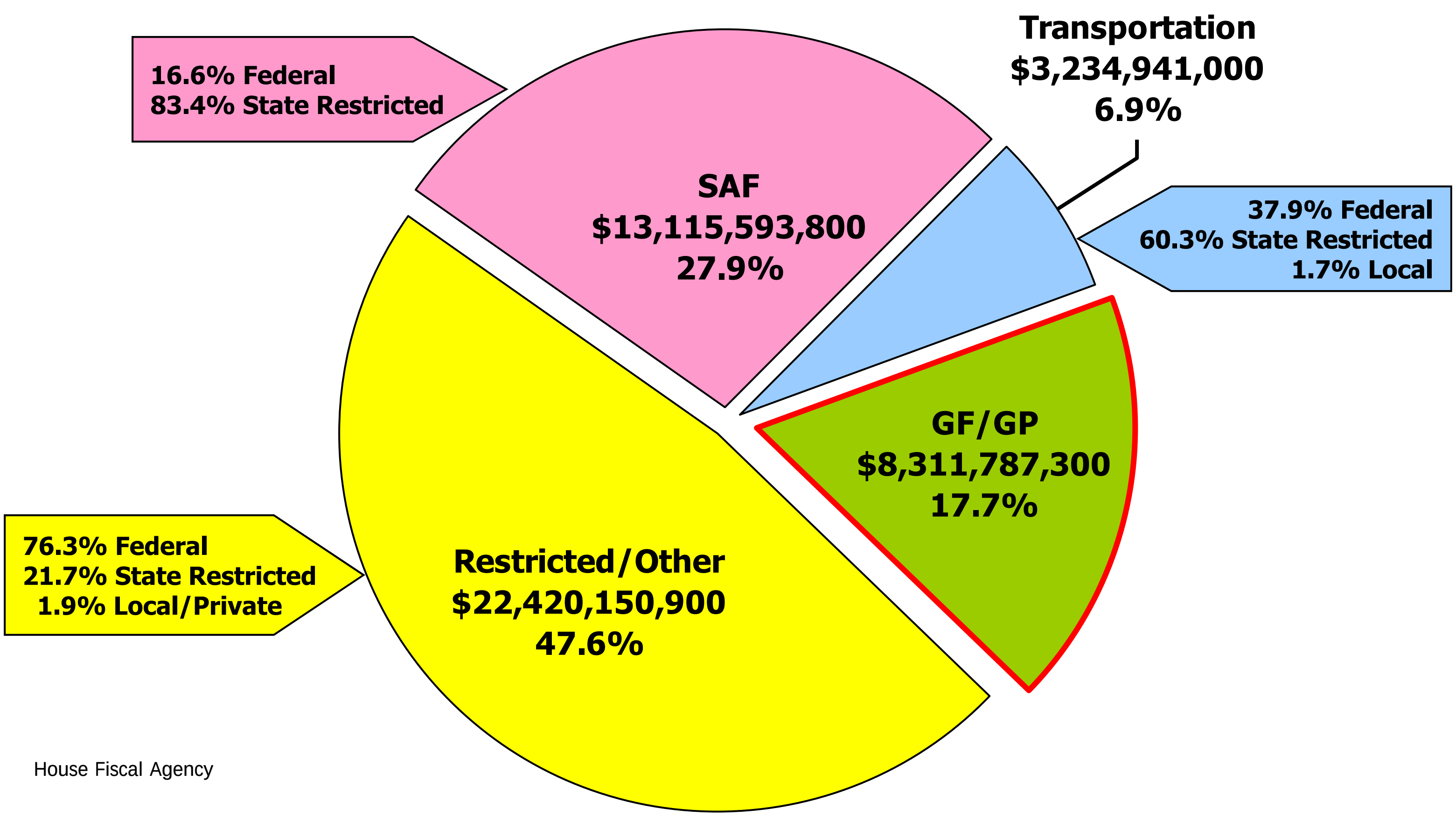
MICHIGAN'S CURRENT BUDGET

FY 2010-11 Budget
Adjusted Gross Funding Sources



FY 2010-11 Appropriations Funding

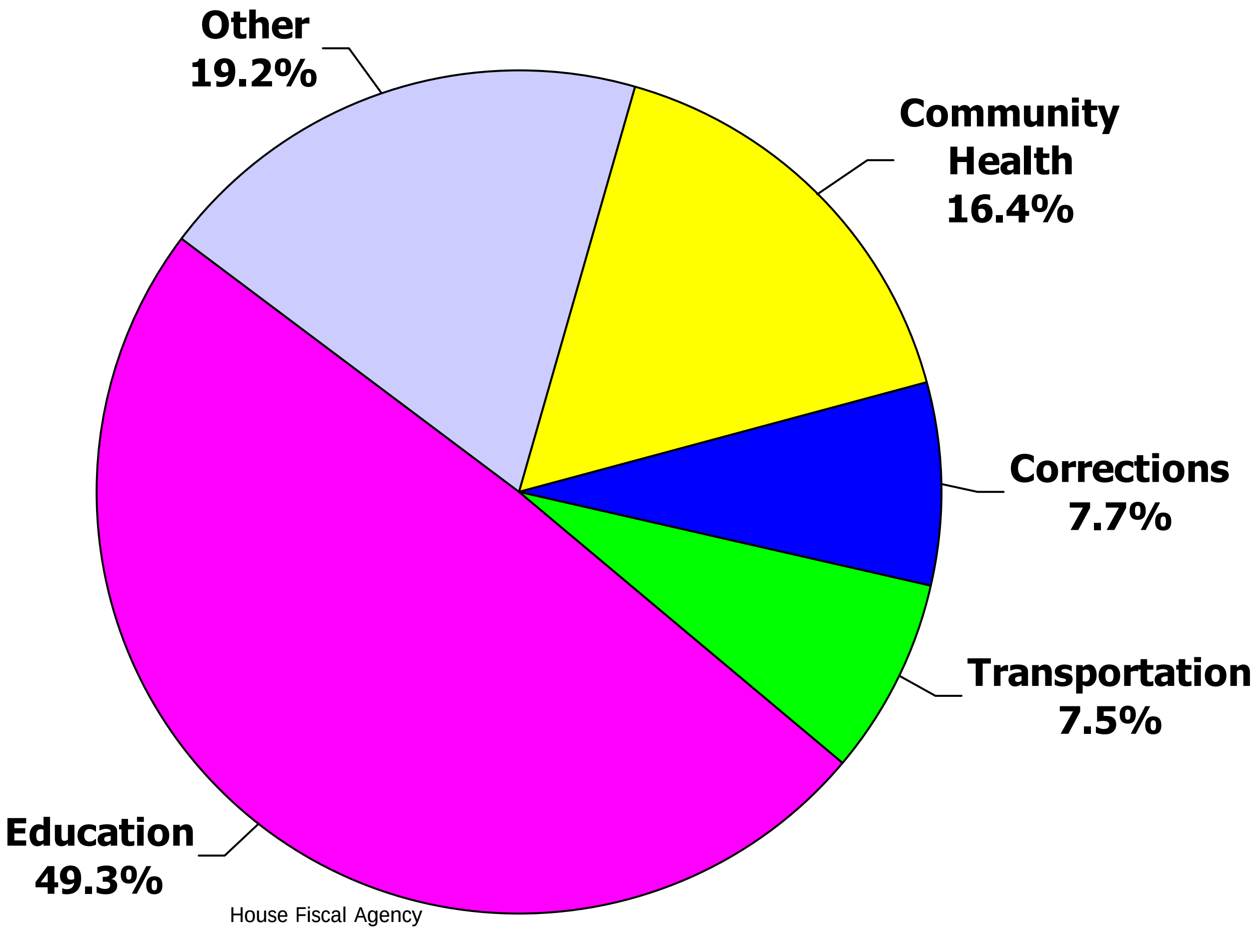
Adjusted Gross = $ 47,082,473,000



House Fiscal Agency

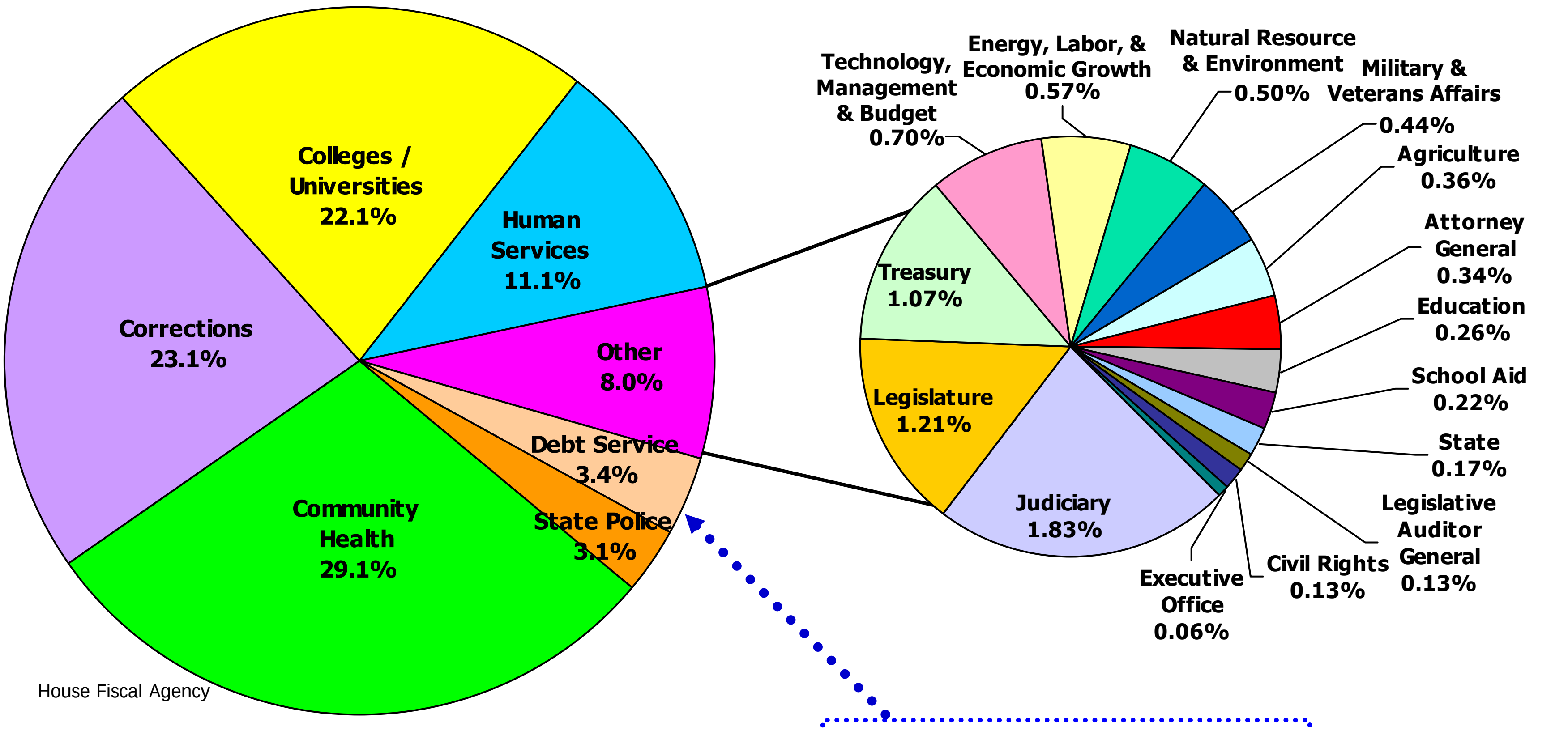
State Tax and Fee Revenue FY 2010-11

FY 2010-11 Total = $26,067,949,500



FY 2010-11 GF/GP

FY 2010-11 Total = $8,311,787,300



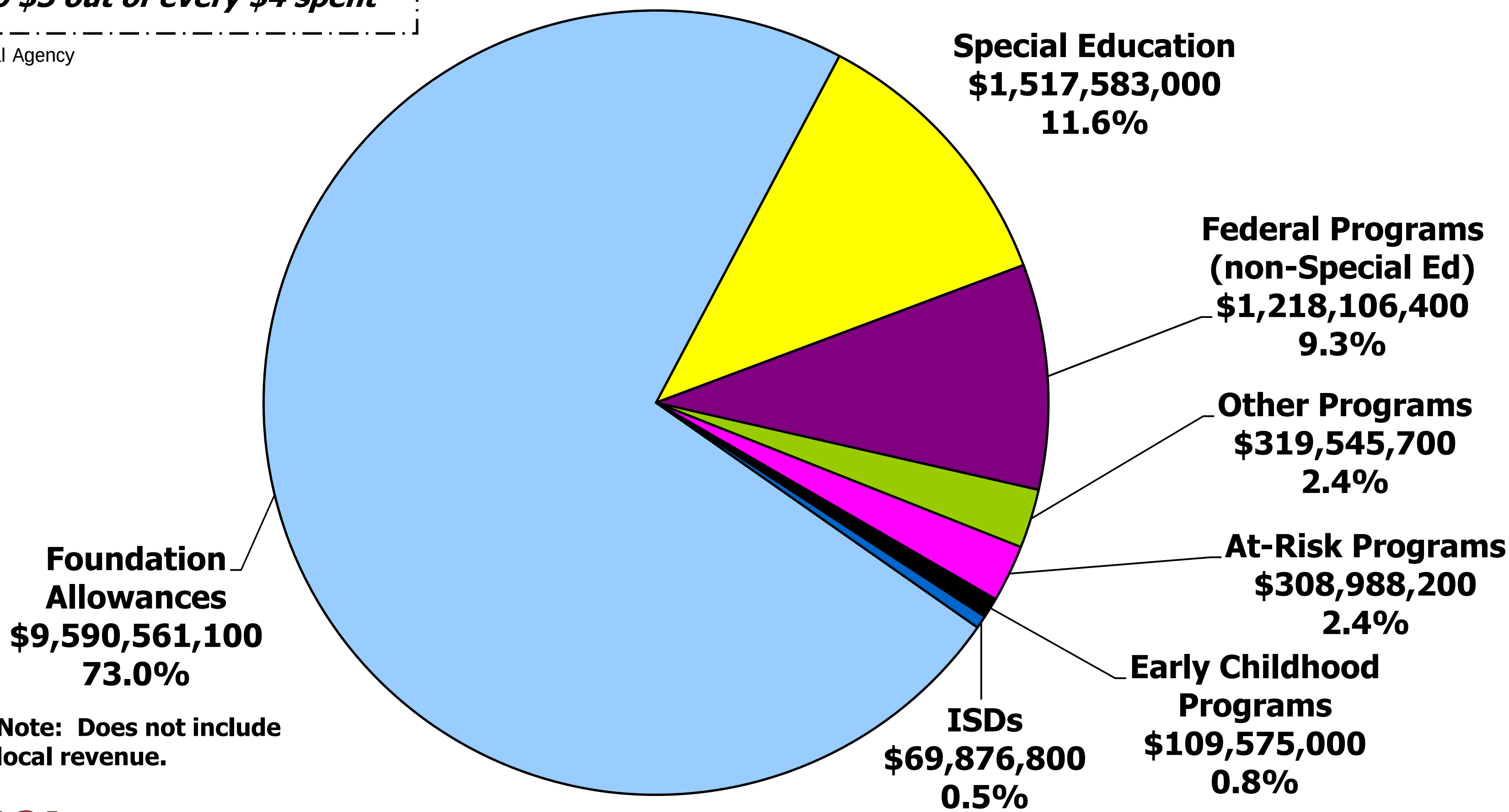
3.4%
$284 million
Debt Service and SBA Rent

School Aid
Major Spending Categories

FY 2010-11 Total = $13,134,236,200

Foundation allowances (used for school operations) absorb $3 out of every $4 spent

House Fiscal Agency

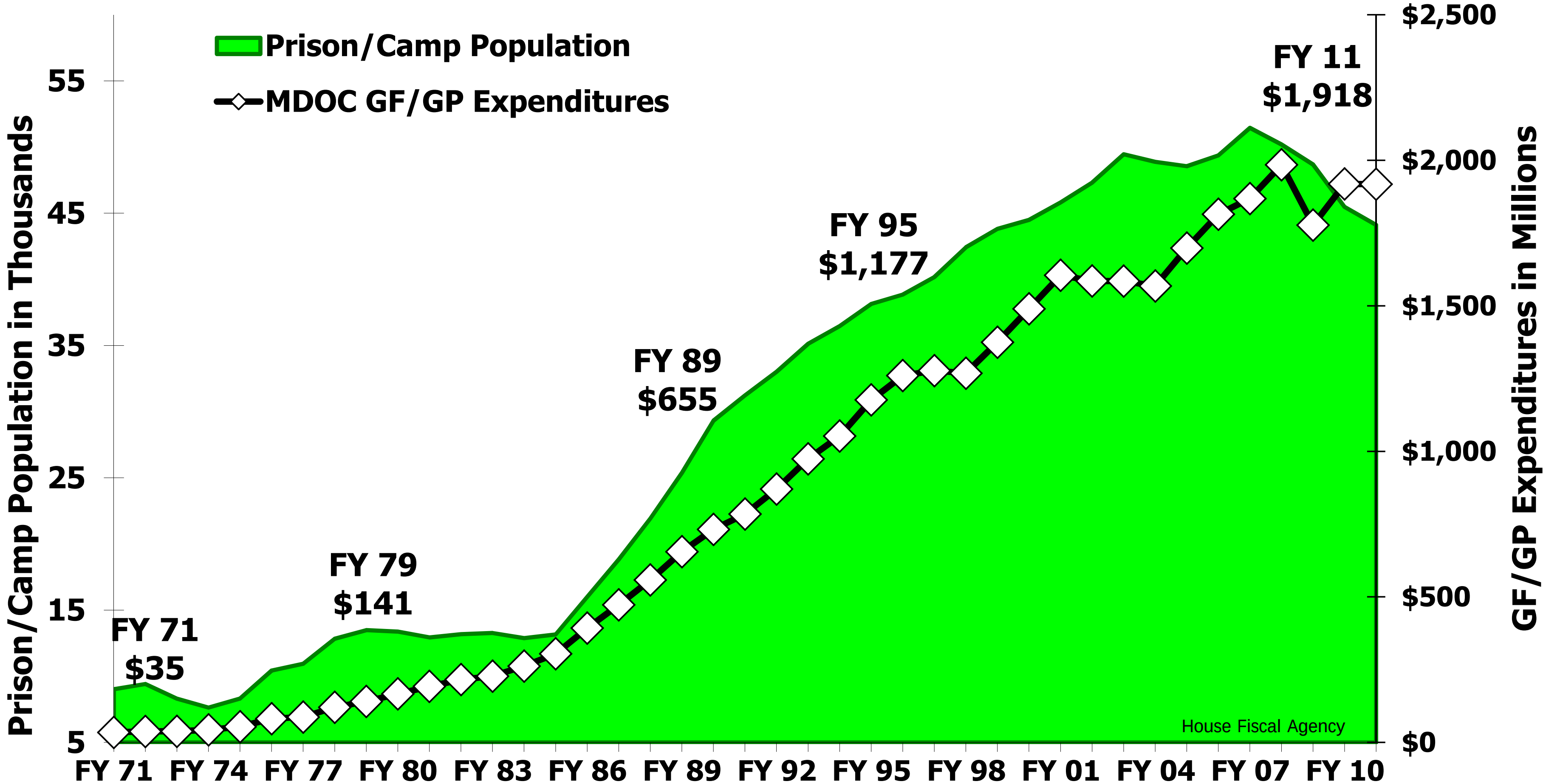


Note: Does not include local revenue.

Medicaid Impact on Michigan Budget

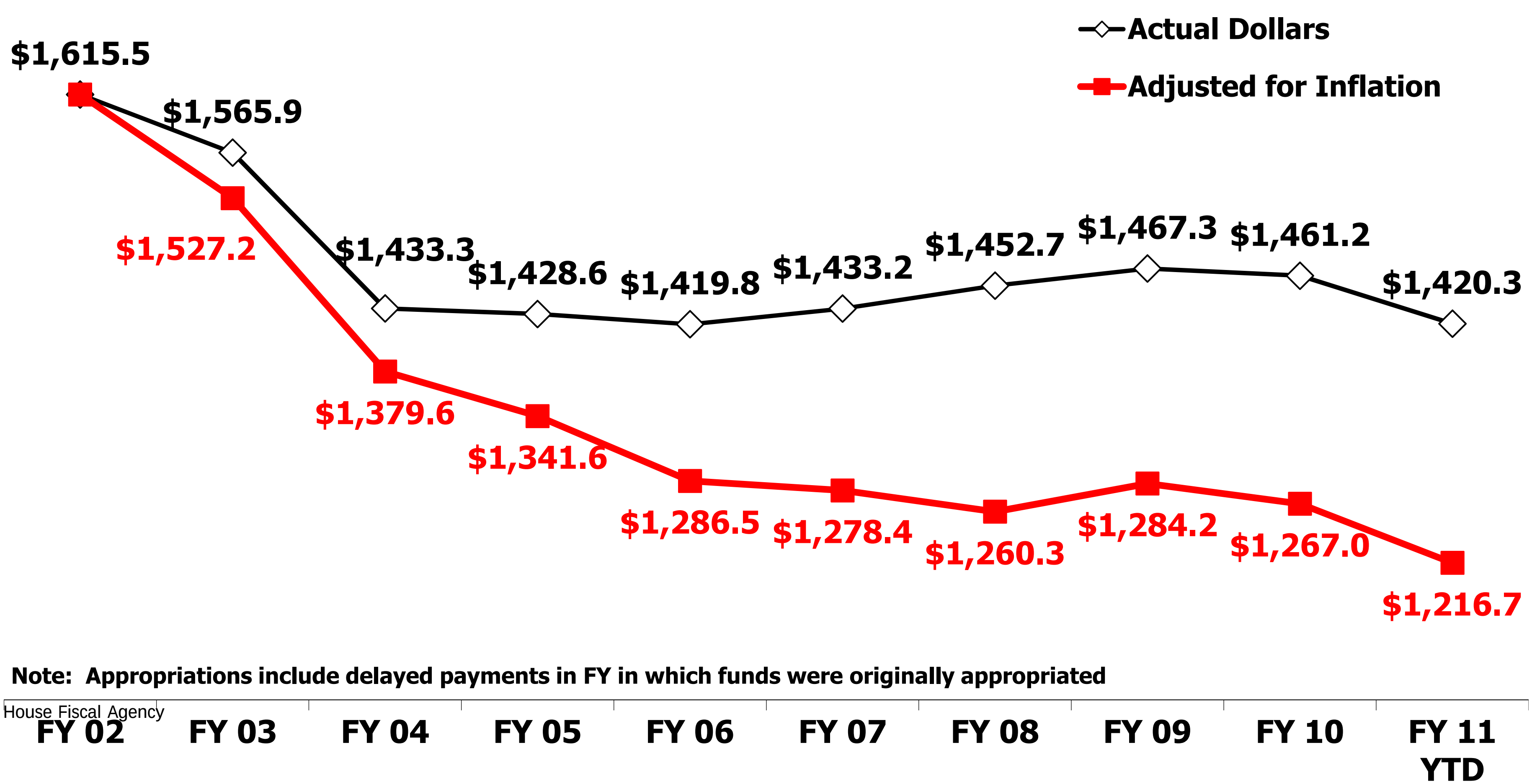
- For FY 11, approximately 19.1% of Michigan GF/GP revenue is appropriated for Medicaid
- 1 of 6 Michigan residents were eligible for Medicaid in April 2009
- 42% of births and 70% of nursing home expenditures in Michigan are financed through Medicaid
- Total state and federal Medicaid appropriation is over $11.5 billion in FY 11
- Since FY 1999-2000
  - 126.5% increase in Medicaid funding
  - 71.5% growth in Medicaid caseload (759,800 cases)

Corrections Budget Increases

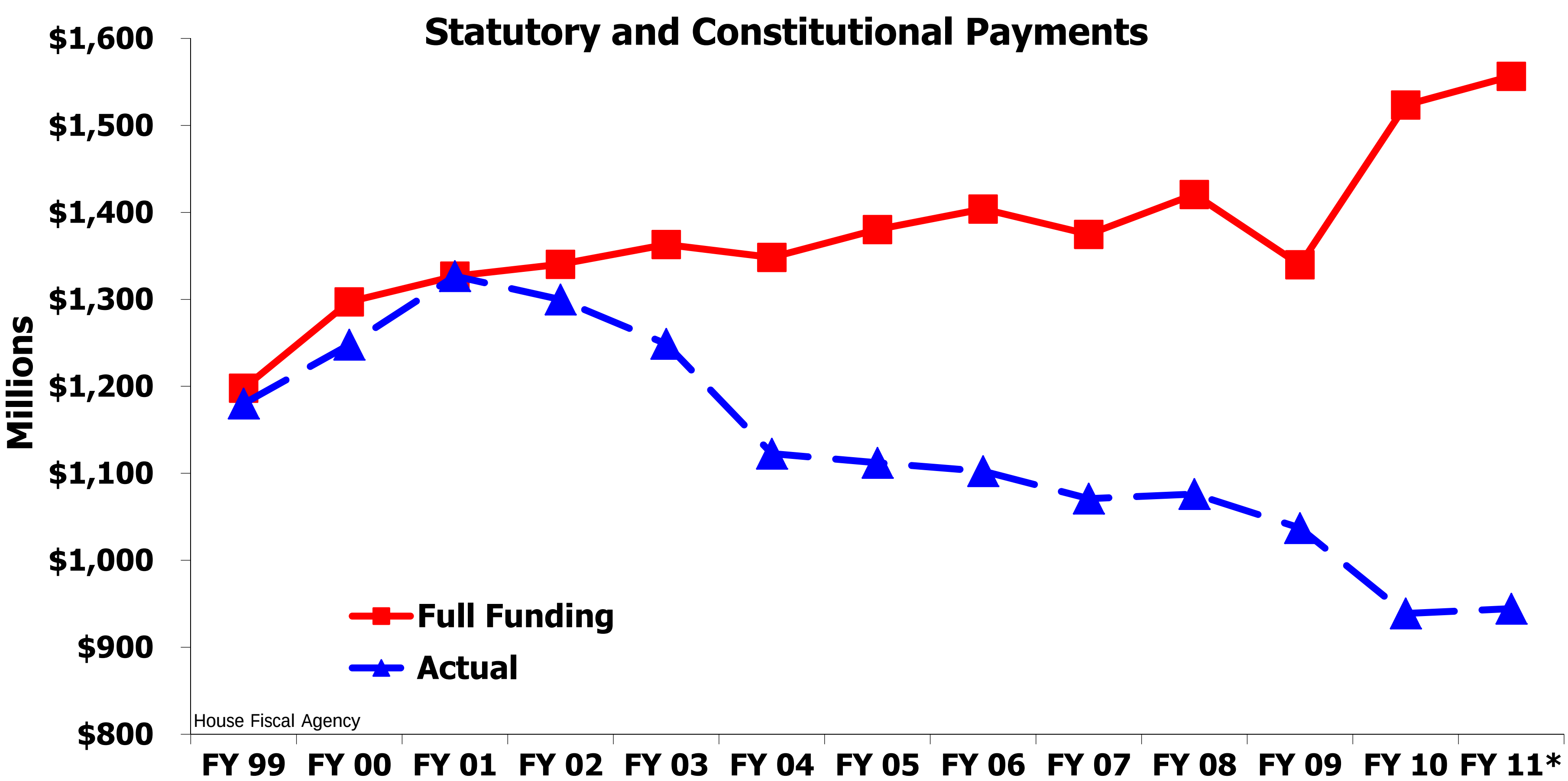


Fiscal Year 2008-09 includes GF/GP reductions due to appropriation of federal ARRA funds.

Total Appropriations for State University Operations



Revenue Sharing Payments to Cities, Villages, and Townships



*FY 11 Amounts are Estimates

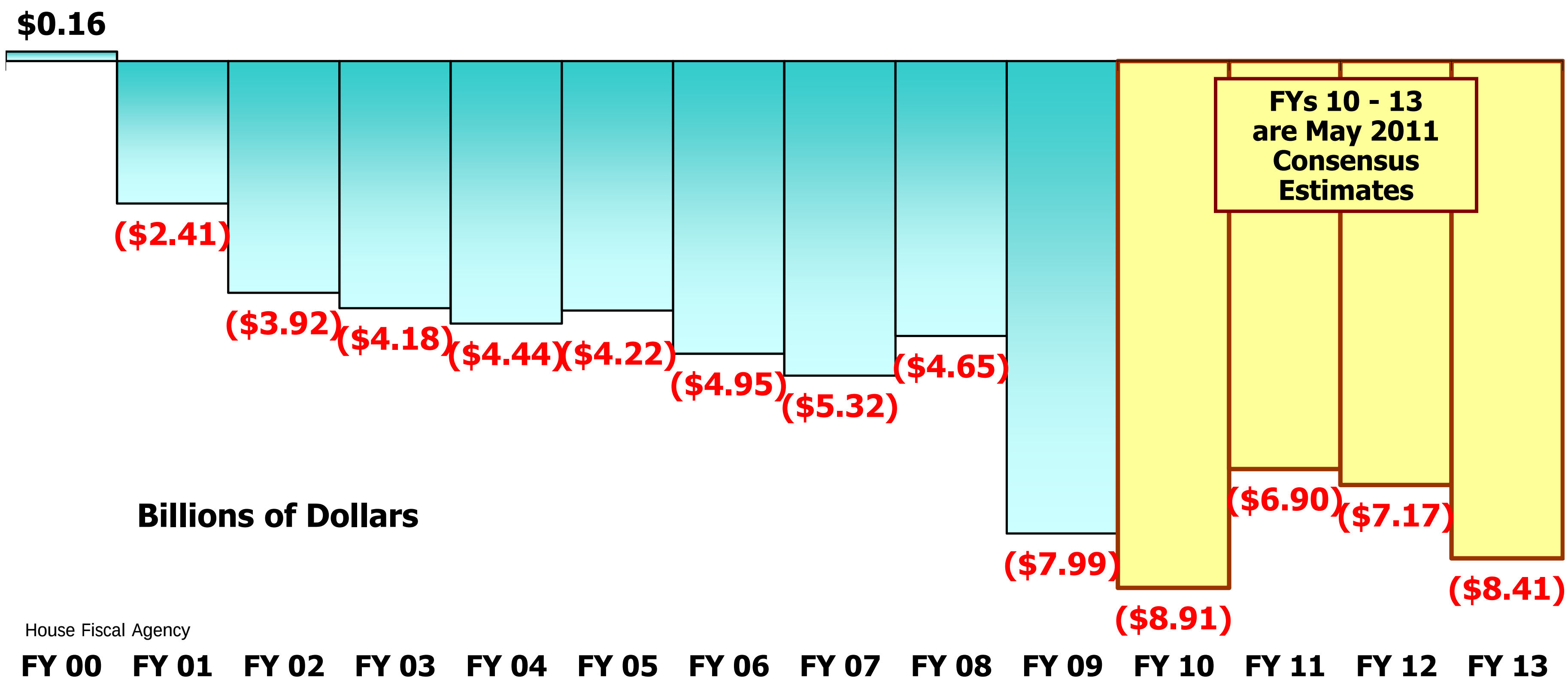
Property Value Growth Slowing

	Yearly Change		
	Inflation Rate Multiplier for Property	Total SEV Growth	Total Taxable Value Growth
1997	2.8 %	8.2 %	5.7 %
1998	2.7 %	9.5 %	6.1 %
1999	1.6 %	9.9 %	6.0 %
2000	1.9 %	9.0 %	5.5 %
2001	3.2 %	10.0 %	7.1 %
2002	3.2 %	9.8 %	6.7 %
2003	1.5 %	7.5 %	4.8 %
2004	2.3 %	6.3 %	5.7 %
2005	2.3 %	5.9 %	5.6 %
2006	3.3 %	5.0 %	5.8 %
2007	3.7 %	3.8 %	5.2 %
2008	2.3 %	−1.1 %	1.4 %
2009	4.4 %	−5.4 %	−0.8 %
2010	−0.3 %	−9.2 %	−6.6 %
2011	2.5 %	N/A	−4.3 %

Constitutional Revenue Limit

Average growth of Michigan personal income = 2.0% per year from 2000 through 2012

Average increase of Michigan revenue = 0.4% per year from 2000 through 2012



EXECUTIVE BUDGET RECOMMENDATION

Total Budget Cuts $1,520.9 Million

- Corrections ($51.2 million)
- Community Health ($212.6 million)
- Human Services ($109.5 million)
- Higher Education ($222.4 million)
- Statutory Revenue Sharing ($143.9 million)
- State employee concessions ($180.0 million)
- Other ($63.2 million)
- School Aid reductions ($538.1 million)

School Aid Cuts

- **Reduces Foundation Allowances by $470 Per Pupil**
  - **Makes the FY 2011 $170 per pupil reductions permanent by rolling the cut into the foundation allowance**
  - **Reduce all foundations by $300 per pupil, for a total foundation allowance reduction of $470 per pupil**
  - **Additional $300 per pupil cut equals a savings of $452.5 million**
- **Certain Categorical Funding programs eliminated – totaling $82.8 million**

School Aid Cuts

- Intermediate School District (ISD) General Operations
  - Reduces payments by 5% or $3.3 million
- School Aid Fund (SAF) Revenue Shifts Totaling $1.1 Billion
  - Tax proposal reduces SAF revenue ($597.1)
  - Budget proposal increases GF/GP transfer to SAF ($393.9)
  - SAF revenue shifted into Community College budget ($195.9) and Higher Education budget ($699.7 million)

Higher Education

- Each university's appropriation is reduced by 15% ($222.4 million GF/GP)
- Tuition restraint incentive funding ($83 million)
  - Funds would be paid only if a university held its FY 2011-12 resident undergraduate tuition/fee increases below the prior-five-year state average
  - Individual incentive amounts (based on average annual tuition/fee rate increase over the last five years) ranging from 5.1% to 9.8% of proposed FY 2012 appropriation amounts

Revenue Sharing Cuts

- **Statutory Revenue Sharing line item for cities, villages, and townships (CVT's) eliminated and replace by Local Government Incentives Program**
  - **Revenue distributed to units that use "Best Practices"**
  - **Net reduction in funding ($107.1 million)**
- **County Revenue Sharing**
  - **Distributed on a pro-rata basis for those who qualify, and is reduced $14.7 million from FY 2011**
  - **Total reduction from current law is $51.7 million**

Local Government Incentives Program

- Total of $200 million: $195 million to CVTs that meet criteria, $5 million to defray consolidation costs

- No amount less than $6,000 distributed. CVTs that receive less are not eligible

- Eligibility to receive distributed based on transparency, consolidation of services, employee compensation

Other Cuts

- Retroactive 48 month lifetime limit for cash assistance recipients (FIP)
  - Will close 12,600 FIP cases generating $77.4 million gross, $65.0 million GF/GP, in savings
  - Graduate Medical Education (GME) reduced 40%, $67.3 million Gross ($22.8 million GF/GP)
- Reduce Fire Protection Grant reduces grant payments to local units with state property ($1.6 million)
- Reduces state aid to libraries by $2.3 million (DOE)
  - Additionally, the School Aid budget eliminates $1.5 million in state aid to libraries

Tax Plan – HB 4361 & HB 4362

- **Net Revenue Reductions**
  - **Reduce total revenue $560.2 million in FY 2011-12 [GF/GP up $129.7 million, SAF down $689.9 million]**
  - **Reduce total revenue $224.0 million in FY 2012-13 [GF/GP up $438.0 million, SAF down $662.1 million]**
- **Cut business taxes $1.64 billion**
- **Increase personal income tax $1.42 billion**

Business Tax Changes

- Cut business taxes $1.64 billion [83% net cut]
- Repeal the Michigan Business Tax
- Institute a 6% tax on business income for C corps only
- Honor existing firm-specific credits including MEGA, film, next energy, battery credits, etc.
- Any additional credits or business benefits will be subjected to appropriation

Personal Income Tax Changes

- Increase personal income tax $1.42 billion [23% net increase 2012]
- Suspend rate reduction from 4.35% to 4.25% until January 1, 2013 (a 15-month delay) [increases FY 13 revenue $223.0 million]
- Reduce private non-military pension exemption [increases revenue $343.4 million]
- Reduces state earned income tax credit, EITC, from 20% of federal to 6% [increases revenue $261.6 million]
- Reduce homestead property tax credits [increases revenue $270.2 million]

Personal Income Tax Changes

- Eliminate special exemptions for seniors and UI and child deductions.
- Eliminate all other major refundable and non-refundable credits except for the homestead property tax credit and the home heating credit.
- The personal exemption will be set to $3,700 and indexed to inflation beginning in 2013. The exemption would be phased out if "total household resources" range between $75,000 – $100,000 for a single filer or between $150,000 – $200,000 for joint filers.

Pension / Retirement Income Tax Changes

- For all taxpayers
  - All military pension/social security remains exempt
  - Distributions from Roth IRAs and 401(k)s attributable to employer contributions or to employee contributions that are matched by the employer remain exempt
  - Retirement/pension exemptions apply based on the oldest spouse for married or joint returns
- Taxpayers > 67
  - No change to retirement /pension income exemptions

Pension / Retirement Income Tax Changes

- **Taxpayers between 60-66**
  - **Receive \$20,000 single / \$40,000 joint exemption against pension and retirement income. When 67, exemption is against all types of income including investment and salary & wages.**
  - **If household resources exceed \$75,000 single / \$150,000 joint, then cannot take \$20,000 single / \$40,000 joint exemption**

Pension / Retirement Income Tax Changes

- **Taxpayers < 60**
  - **No exemption until age 67**
- **When 67**
  - **Receive exemption of either $20,000 single / $40,000 joint against all types of income OR social security and the personal exemption**
  - **If household resources exceed $75,000 single / $150,000 joint, then cannot take $20,000 single / $40,000 joint exemption**

Homestead Property Tax Credit (HPTC) Changes

- HPTC is eliminated for taxpayers with household resources over $50,000 (current upper limit is $82,650) or if taxable value is greater than or equal to $135,000
- For seniors with household resources of $21,000 or less, the credit equals the amount by which 100% of property taxes paid exceeds 3.5% of household, up to $1,200
- For seniors with household resources between $21,000 and $30,000, the property tax factor phases down from 100% to 60%; between $30,000 and $50,000, the property tax factor is 60%
- For non-seniors, the property tax factor is 60% for all household resources levels between $0 and $50,000
- The credit phases out between $41,000 and $50,000

Summary of Executive Recommendation

- Cut services $1.5 billion to address the budget shortfall
- Provide a $1.6 billion [83%] net tax cut for business
- Replace business tax revenue with $1.4 billion [23%] increased income tax revenue by eliminating income tax expenditures

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