



Budget Briefing: FY 2018-19 State Tax Revenue Overview

Jim Stansell, Senior Economist

January 2019

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 2018-19 is October 1, 2018 through September 30, 2019.

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 a taxpayer's 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 earmarks to specific funds, such as the School Aid Fund (SAF) or the Comprehensive Transportation Fund (CTF). In general, any revenue not otherwise earmarked becomes General Fund/General Purpose (GF/GP) revenue.
- This overview does not include gasoline and diesel taxes because they are earmarked to the Michigan Transportation Fund, and are discussed as part of the Transportation budget briefing.

Major State Taxes

Estimated FY 2018-19, \$ in Millions

Tax	GF/GP	SAF	Total
Individual Income Tax	\$7,040	\$2,813	\$10,186
Sales Tax	1,343	6,202	8,517
Use Tax	689	573	1,262
Tobacco Taxes	182	346	919
Business Taxes	866		866
State Education Tax		2,085	2,085
Real Estate Transfer Tax		353	353
TOTAL	\$10,119	\$12,372	\$24,188

Notes

- 1) All economic and revenue estimates in this budget briefing are from the January 2019 Consensus Revenue Estimating Conference.
- 2) 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.
- 3) Business Taxes are comprised of the single business tax, the Michigan business tax, the corporate income tax, and insurance company taxes.
- 4) These taxes account for almost 98% of combined 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.
- The tax rate is 4.25% and taxpayers receive a personal exemption of \$4,400 per dependent in TY 2019.
- Retirement income for most taxpayers born after 1946 is taxable.
- Both the Homestead Property Tax Credit (HPTC) and the Earned Income Tax Credit (EITC) are refundable.
- Gross income tax revenue is the sum of withholding from wages and salaries, estimated quarterly payments, and annual payments.
- Net income tax revenue is gross income tax revenue less refunds.
- Effective December 1, 2018, 22.4% of gross income tax revenue is earmarked to the School Aid Fund.
- Beginning in FY 2018-19, a portion of net income tax revenue is earmarked to the Transportation Fund. The dollar amounts are \$264 million in FY 2018-19, \$468 million in FY 2019-20, and \$600 million in FY 2020-21 and subsequent years.

Sales Tax

- The sales tax is imposed on retailers' gross taxable sales of tangible personal property not exempt by law.
- The maximum rate as set forth in the Constitution 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.
- Almost 40% 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 37.7% of all tobacco tax revenue.
- Approximately 19.2% of cigarette tax revenue is earmarked to the General Fund. The GF receives about 19.8% of all tobacco tax revenue.
- Approximately 31.4% of cigarette tax revenue and 35.7% 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 subsequently 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 February 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 more than \$600 million in FY 2018-19.

Business Taxes

- The Corporate income tax replaced the MBT effective February 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 February 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 February 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 amounts authorized by statute beginning with FY 2015-16.
- The LCSA uses this revenue to reimburse local taxing authorities for the loss of property tax revenue resulting from the personal property tax exemptions.
- In addition, effective February 1, 2016, the state began levying 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 \$327.7 million in FY 2017-18, \$341.0 million in FY 2018-19, and \$362.9 million in FY 2019-20.
- When fully implemented, the net revenue loss to the state will be approximately \$500.0 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.
- Per gallon tax rates of \$0.19 for gasoline and \$0.15 for diesel increased to \$0.263 on January 1, 2017, and are adjusted annually for inflation with a maximum annual increase of 5%.
- Registration fees increased by about 20% on January 1, 2017. Electric and hybrid vehicles are subject to an additional surcharge.
- A portion of GF/GP individual income tax revenue is 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.

Income Tax and Sales Tax Changes

- Public Act 588 of 2018 reduced the percentage of gross income tax revenue accruing to the SAF from approximately 23.8% to about 22.4%. This reduces the amount of income tax revenue earmarked to the school aid fund by about \$150 million in FY 2018-19 and \$180 million in subsequent years.
- While not a legislative change, as a result of the June 2018 U.S. Supreme Court decision (*South Dakota v. Wayfair*), many business with no physical nexus in Michigan will now be required to collect and remit sales tax revenue attributable to online purchases. Because roughly 73.3% of sales tax revenue is constitutionally earmarked to the SAF, this additional revenue roughly offsets the reduction in the income tax earmark.
- Public Act 38 of 2018 increased the personal exemption on the Michigan income tax to \$4,050 for TY 2018, \$4,400 for TY 2019, \$4,750 for TY 2020, and \$4,900 for TY 2021. In subsequent years an inflationary adjustment will apply.

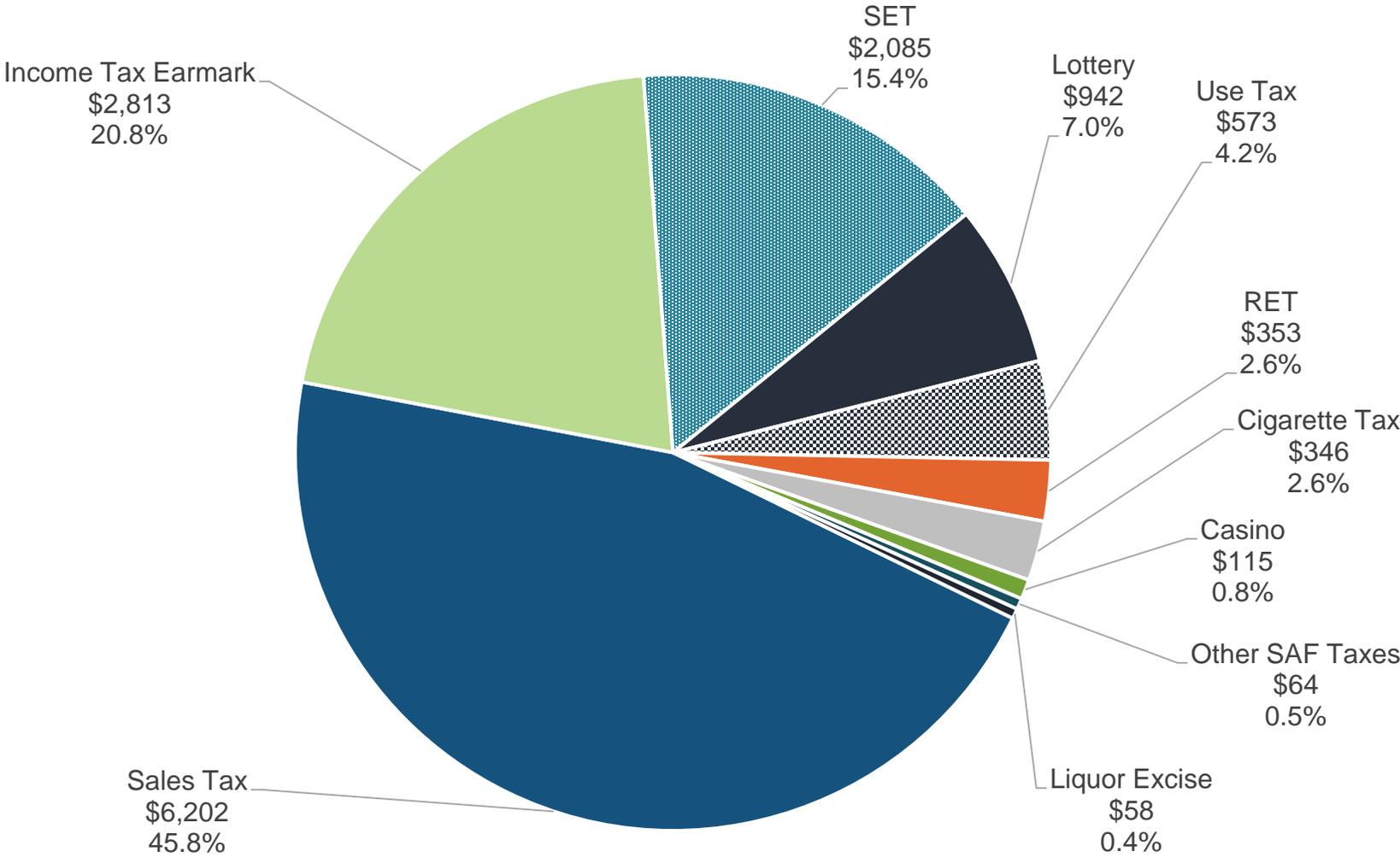
Major State Funds

Major State Funds

- The School Aid Fund is used primarily to fund K-12 education, although a portion is also appropriated to community colleges.
- 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.

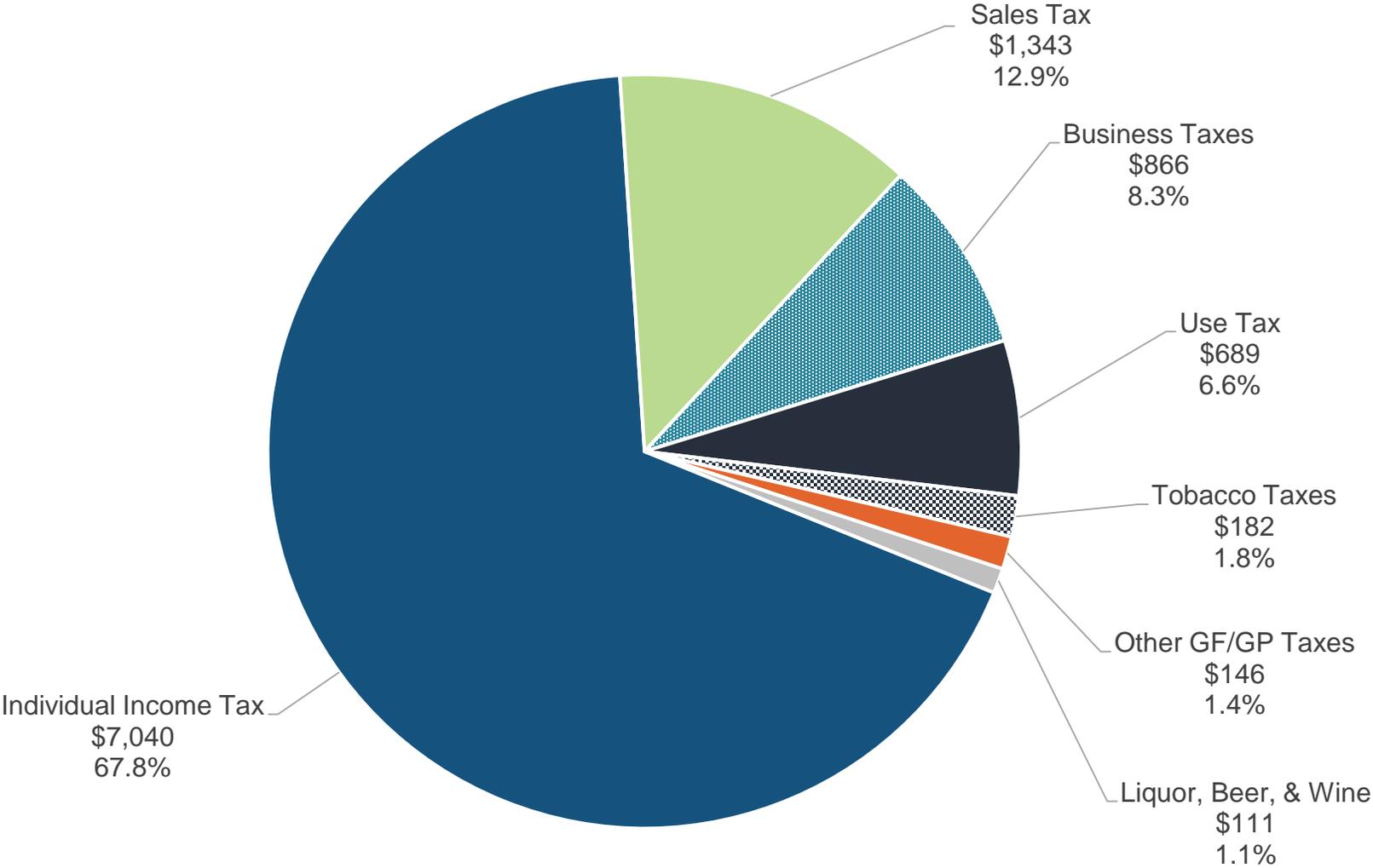
FY 2018-19 SAF Tax and Lottery Revenue

The School Aid Fund is projected to total almost \$13.6 billion in FY 2018-19. Dollar amounts below are in millions.



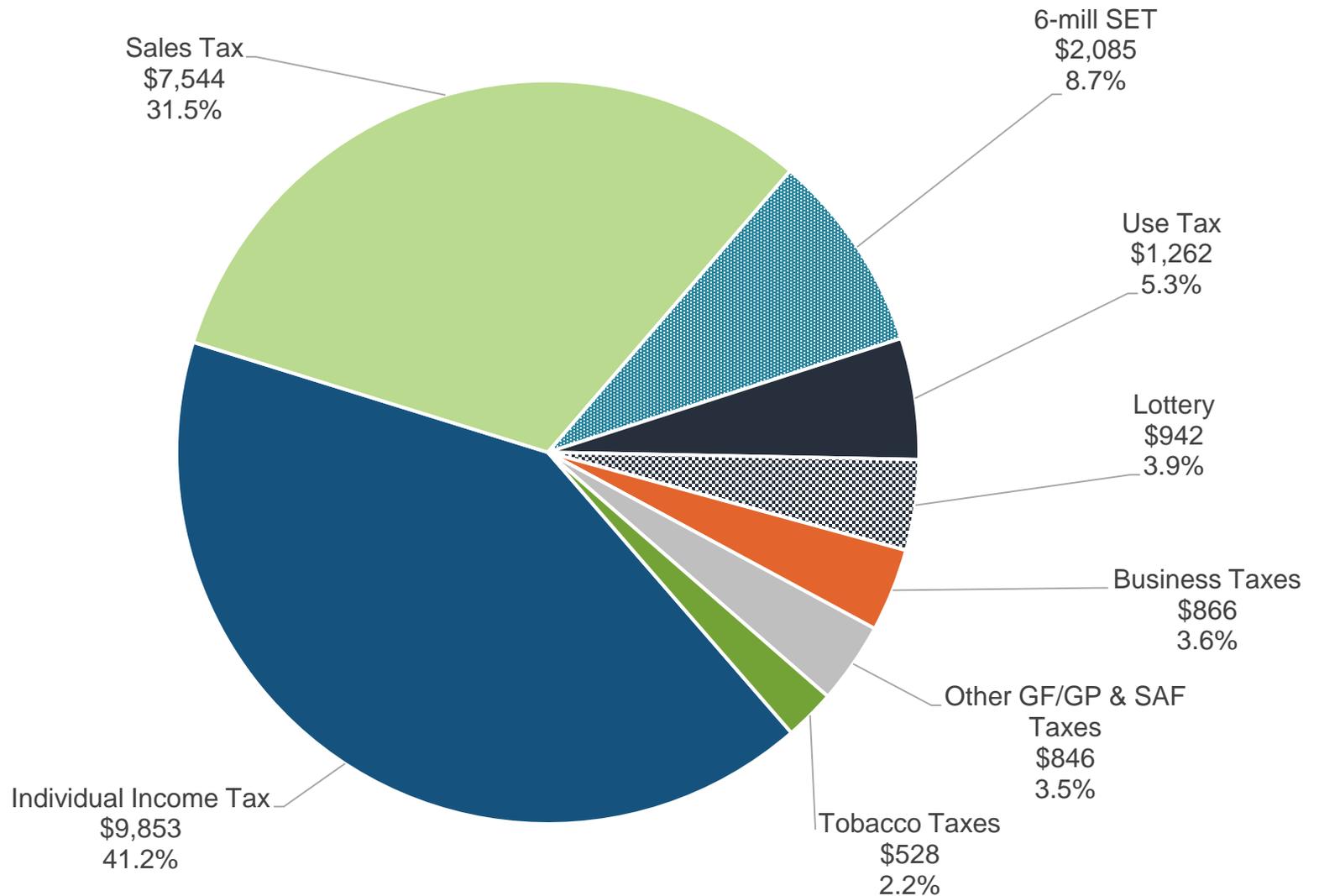
FY 2018-19 GF/GP Tax Revenue

The General Fund/General Purpose tax revenue is projected to total slightly more than \$10.4 billion in FY 2018-19. Dollar amounts below are in millions.



FY 2018-19 Combined GF/GP and SAF Tax and Lottery Revenue

Combined GF/GP and SAF tax and lottery revenue is projected to total more than \$23.9 billion in FY 2018-19. Dollar amounts below are in millions.



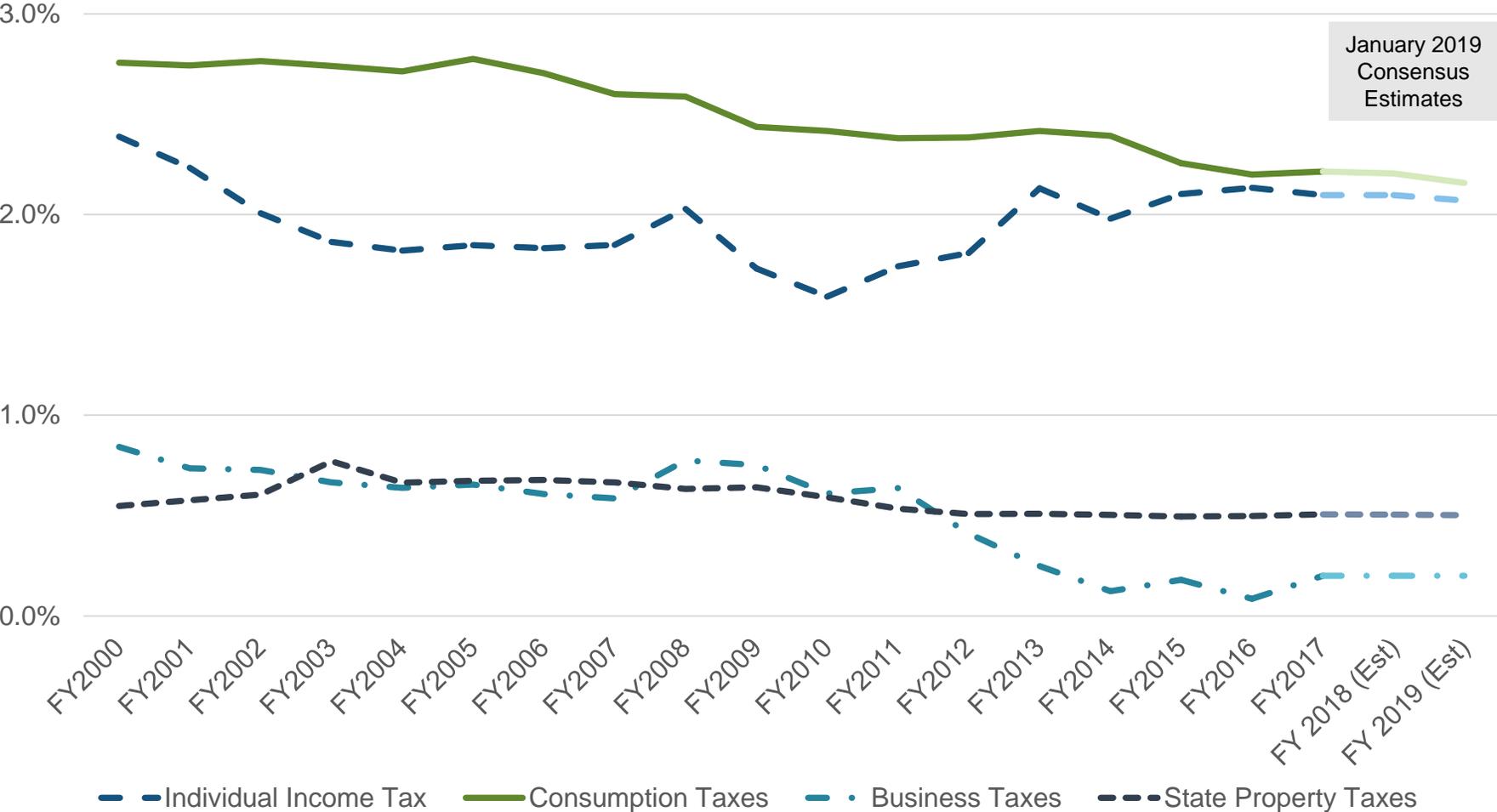
Revenue Trends

Revenue Trends of Major Taxes

- Between CY 2000 and CY 2017, personal income in Michigan grew at an average annual rate of 2.5%. However, since CY 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 revenue has shown the most volatility, partially because of fluctuations in withholding and estimated payments. 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.

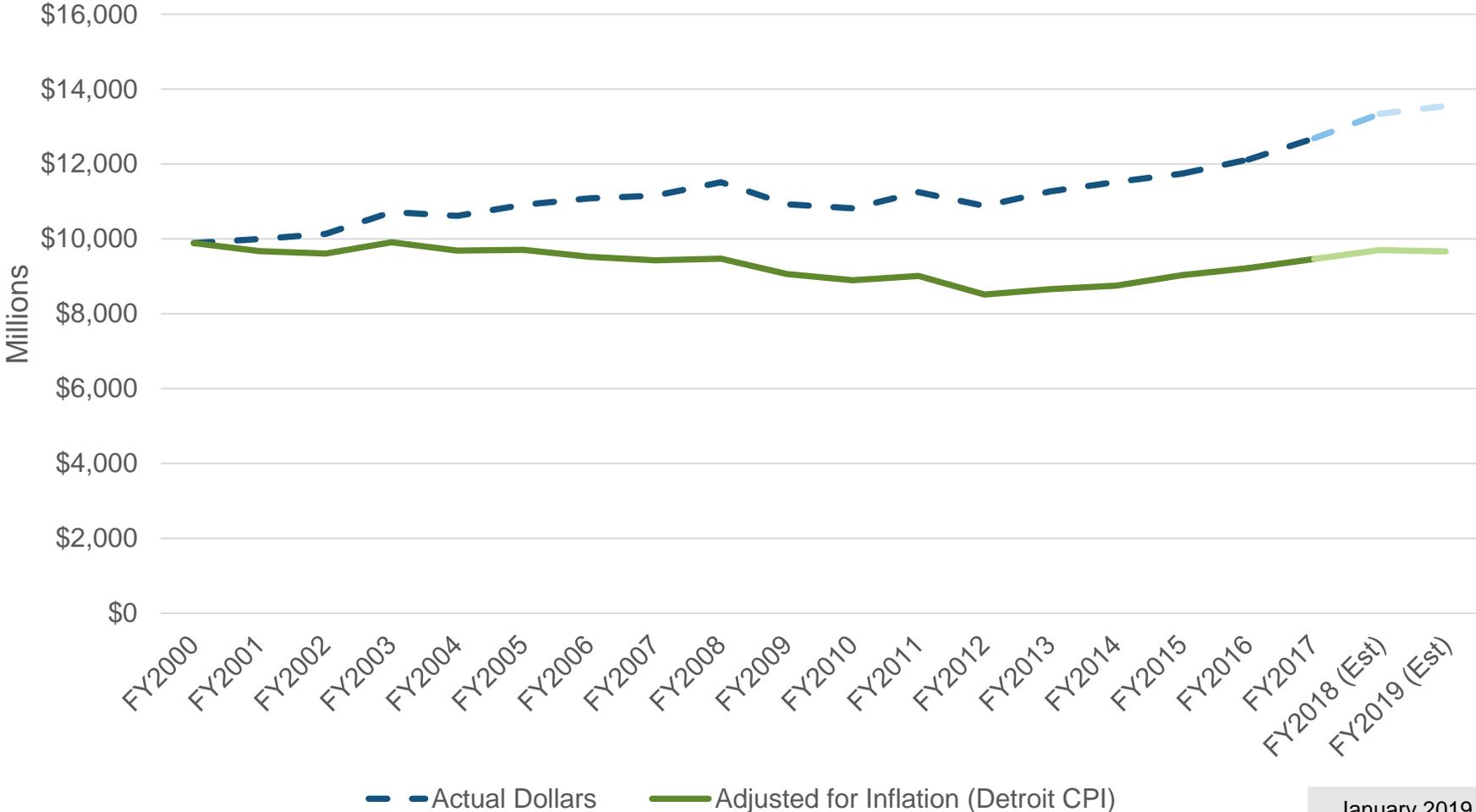


Revenue Trends of Major Funds

- Between FY 2000 and FY 2018, School Aid Fund revenue grew at an annual average rate of 1.8%.
- When adjusted for inflation using the Detroit CPI, SAF revenue declined at an average annual rate of 0.1% between FY 2000 and FY 2018.
- SAF revenue, which was 3.3% of personal income in FY 2000, is estimated to decline to 2.9% of personal income in FY 2019.
- Between FY 2000 and FY 2018, General Fund/General Purpose revenue increased at an annual average rate of 0.1%.
- When adjusted for inflation using the Detroit CPI, GF/GP revenue declined at an average annual rate of 1.6% between FY 2000 and FY 2018.
- 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 2019.
- Both personal property tax reform and the transfers to transportation funding will continue to limit GF/GP revenue going forward.

School Aid Fund Revenue

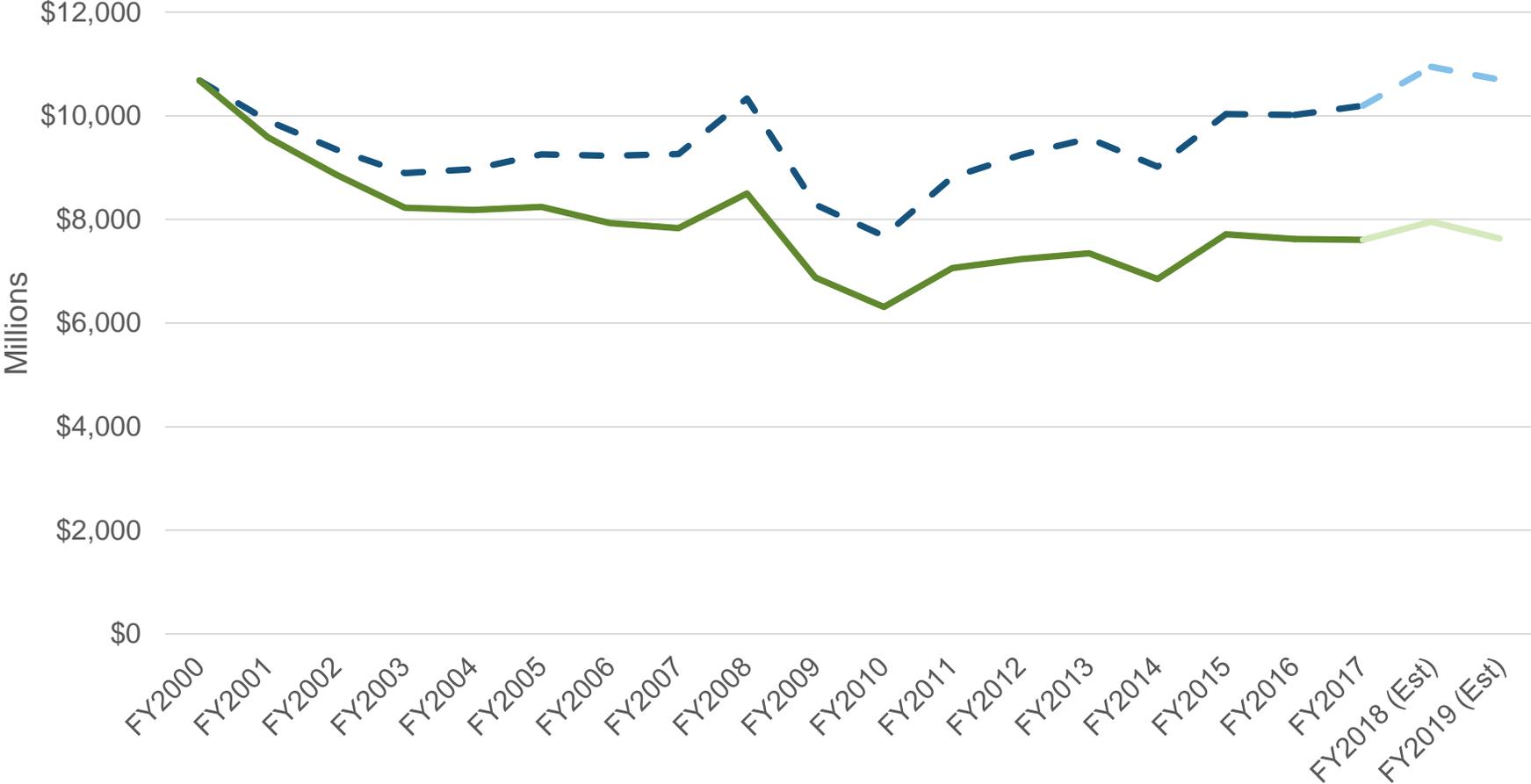
Nominal SAF revenue has grown steadily since FY 2011-12. In inflation-adjusted terms, however, FY 2018-19 revenue is estimated to be 1.7% below the FY 1999-00 level.



January 2019
Consensus
Estimates

GF/GP Revenue

Nominal GF/GP revenue is expected to exceed \$10.7 billion in FY 2018-19. When adjusted for inflation, however, GF/GP revenue is estimated to be 29.9% below the FY 1999-00 level.

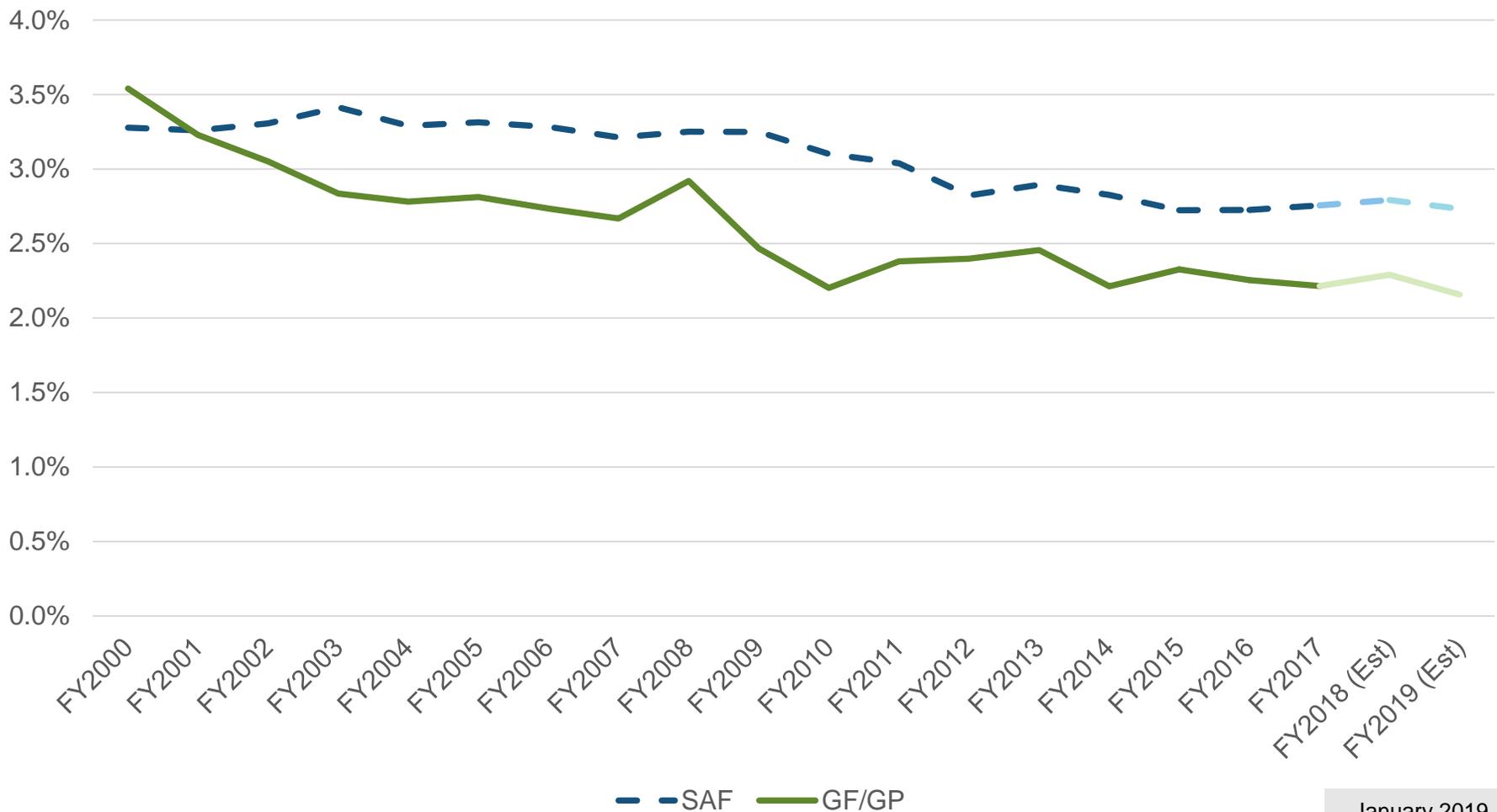


— Actual Dollars — Adjusted for Inflation (Detroit CPI)

January 2019
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.



January 2019
Consensus
Estimates

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 February 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/>

Contact Information

Jim Stansell

Senior Economist and Associate Director

jstanse@house.mi.gov

(517) 373-8080