



Budget Briefing: FY 2020-21 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 2020-21 is October 1, 2020 through September 30, 2021.

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), the real estate transfer tax (RET), and the Essential Services Assessment (ESA).
- 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 2020-21, \$ in Millions

Tax	GF/GP	SAF	Total
Individual Income Tax	\$6,212	\$2,890	\$9,772
Sales Tax	1,250	5,949	8,159
Use Tax	655	576	1,231
Tobacco Taxes	168	315	847
Business Taxes	649		649
State Education Tax		2,163	2,163
Real Estate Transfer Tax		325	325
TOTAL	\$8,934	\$12,218	\$23,145

Notes

- 1) All economic and revenue estimates in this budget briefing are from the August 2020 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 more than 97% 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 \$4,750 per dependent in tax year (TY) 2020 and \$4,900 in TY 2021.
- 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, quarterly estimated payments, and annual payments.
- Net income tax revenue is gross income tax revenue after refunds have been deducted.

Individual Income Tax Distributions

- 23.8% of gross income tax revenue is earmarked to the School Aid Fund.
- In FY 2020-21 and subsequent years, \$600 million of net income tax revenue is earmarked to the Transportation Fund and \$69 million is earmarked to the Renew Michigan Fund.
- Beginning in TY 2023 (FY 2022-23), if GF/GP revenue increases by more than 1.425 times the rate of inflation relative to FY 2020-21, the income tax rate will automatically be reduced to offset the revenue increase.
- Any remaining net income tax revenue accrues to the General Fund.

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.
- The Department of Treasury issued Revenue Administrative Bulletin 2018-16 on August 1, 2018 to implement essentially the same provisions as South Dakota to require certain out-of-state retailers to remit sales tax revenue. Public Acts 145 and 146 of 2019 codified this treatment.
- Public Acts 143 and 144 of 2019 extended the requirement to collect and remit sales and use tax revenue on remote sales to marketplace facilitators.

Sales Tax Distributions

- 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 from the 4% levy are made to the Comprehensive Transportation Fund and the Michigan Health Initiative.
- Any remaining sales tax revenue accrues to the General Fund.

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 prominent examples of the use tax are auto leases, telecommunications, and 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.
- More than 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 37.2% 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 36.1% 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 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 are expected to reduce GF/GP revenue by almost \$650 million in FY 2020-21.

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.
- All business tax revenue accrues to the General Fund.

State Property Taxes

- The state education tax (SET) 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 (RET) is assessed at 0.75% of the fair market value of real property.
- The essential services assessment (ESA) is levied against business entities that are able to exempt eligible manufacturing personal property. The rate varies based on the age of the exempted personal property.
- All revenue from the SET and RET is earmarked to the School Aid Fund. All ESA revenue accrues to the General Fund.

Recently Enacted Tax Changes

Recreational Marihuana

- Proposal 1, which legalized recreational marihuana in Michigan, was approved by the voters on November 6, 2018. The Michigan Regulation and Taxation of Marihuana Act imposes a 10% excise tax on the purchase of recreational marihuana. Purchases are also subject to Michigan's 6% sales tax.
- For at least two years or until 2022, the first \$20 million of the revenue collected from the 10% excise tax is set aside to fund research into the benefits of marihuana for treating veterans of the U.S. armed services.
- After the \$20 million distribution, 35% of the remaining revenue is earmarked to the School Aid Fund. An additional 35% is earmarked to the Michigan Transportation Fund.
- The remaining 30% is split evenly, with 15% going to counties in which dispensaries are located and the remaining 15% distributed to the cities, villages, or townships in which dispensaries are located.

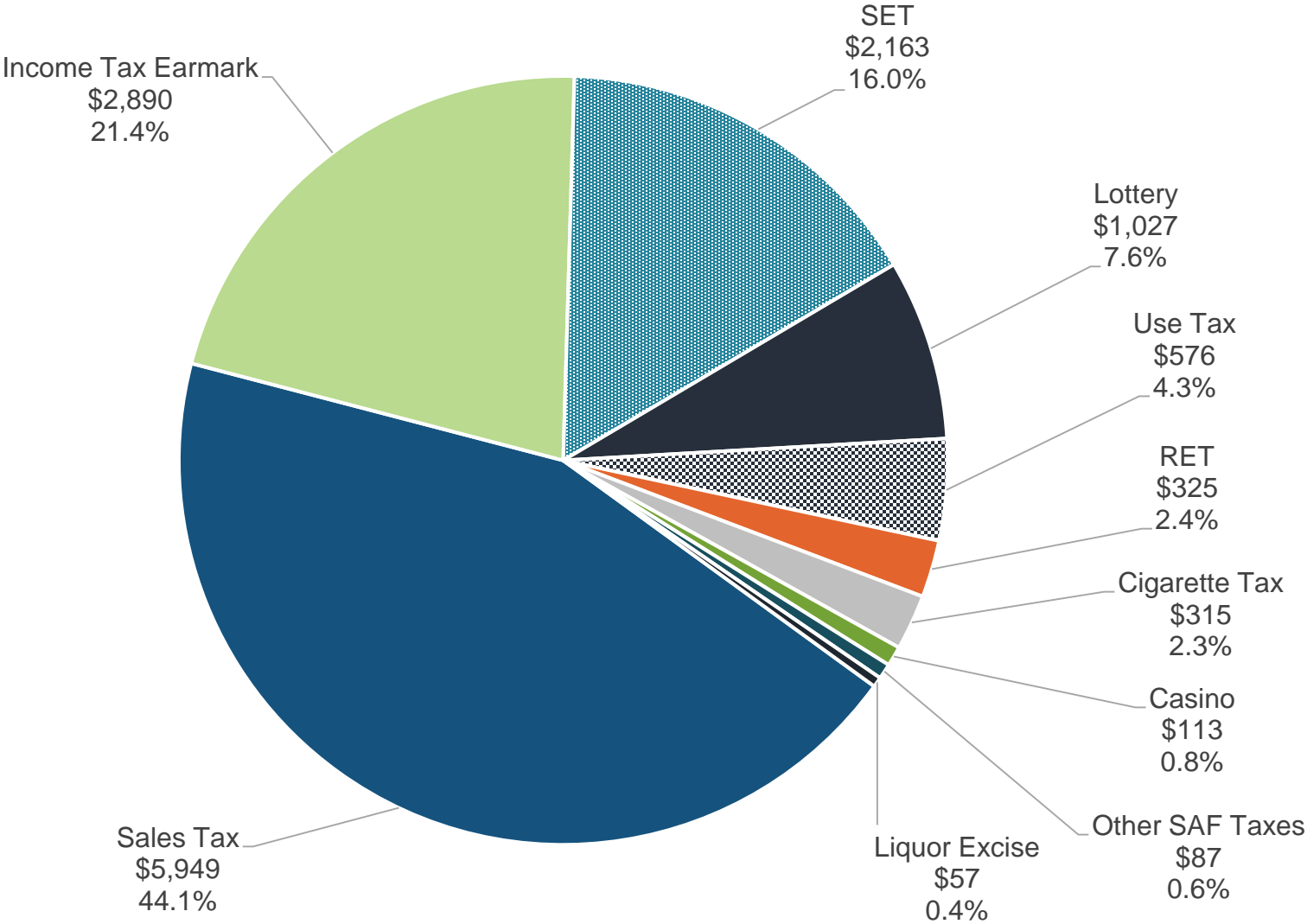
Major State Funds

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.

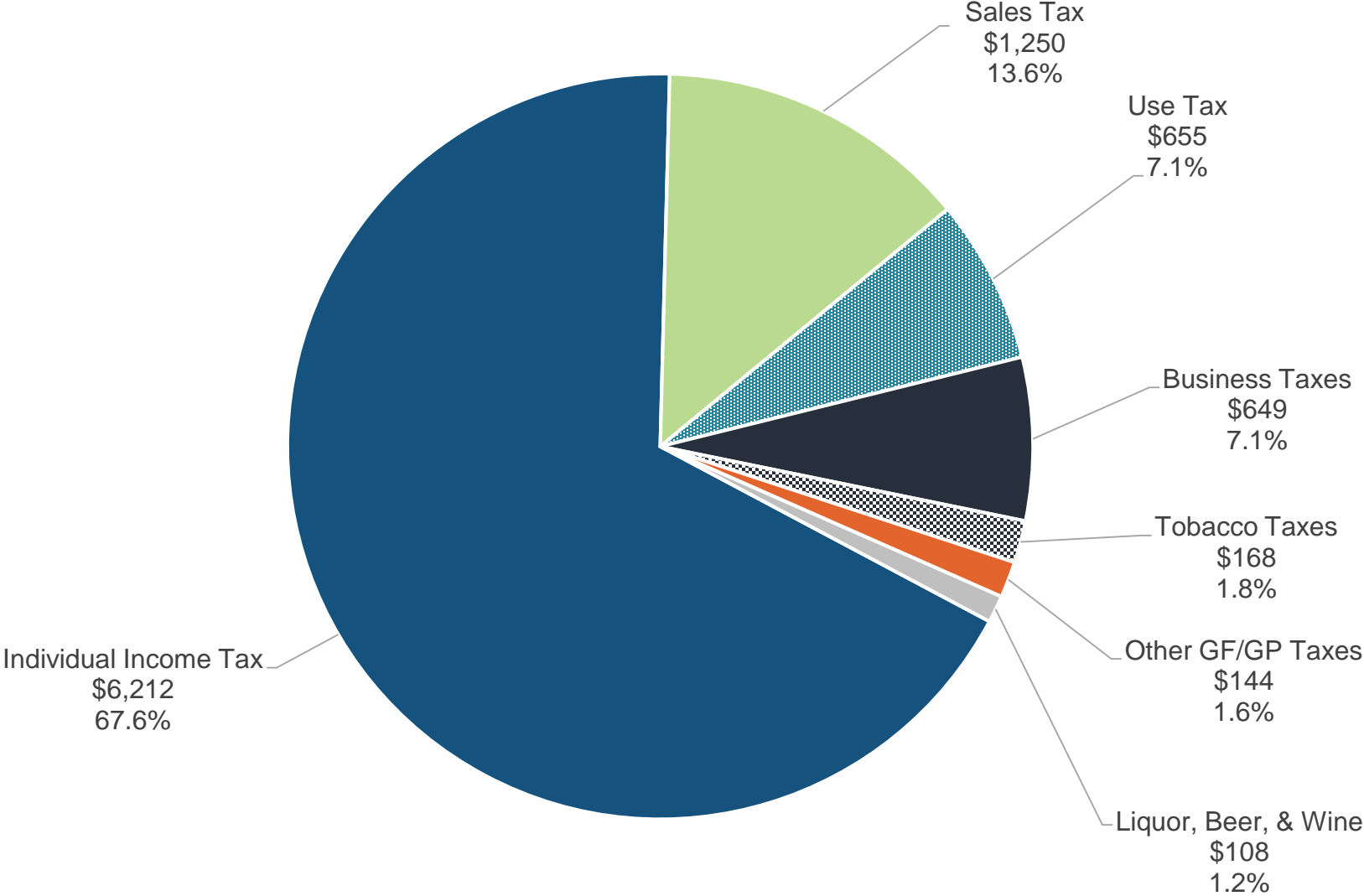
FY 2020-21 SAF Tax and Lottery Revenue

The School Aid Fund is projected to total over \$13.5 billion in FY 2020-21. Dollar amounts below are in millions.



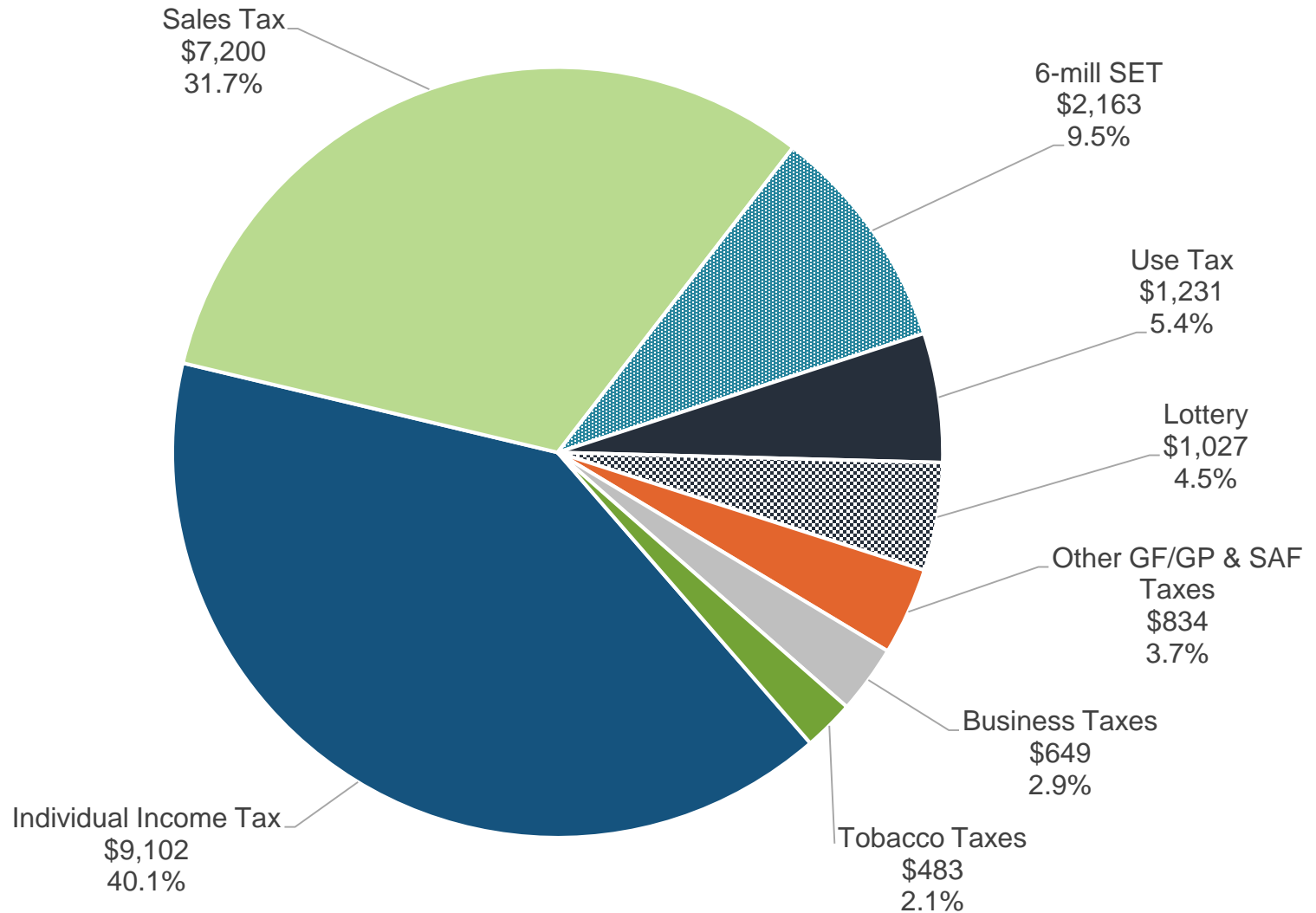
FY 2020-21 GF/GP Tax Revenue

The General Fund/General Purpose tax revenue is projected to total slightly less than \$9.2 billion in FY 2020-21. Dollar amounts below are in millions.



FY 2020-21 Combined GF/GP and SAF Tax and Lottery Revenue

Combined GF/GP and SAF tax and lottery revenue is projected to total more than \$22.6 billion in FY 2020-21. Dollar amounts below are in millions.



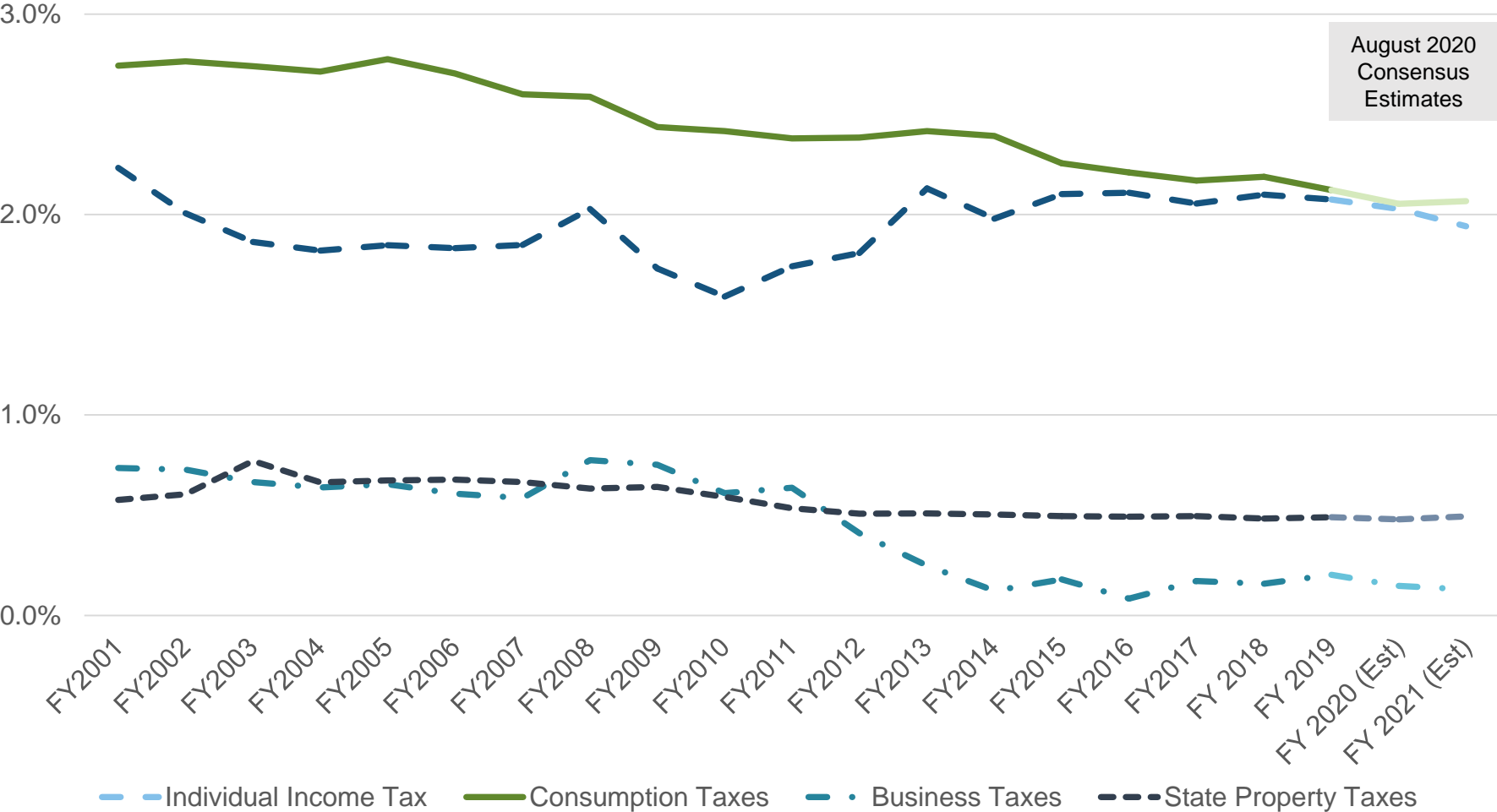
Revenue Trends

Revenue Trends of Major Taxes

- Between CY 2000 and CY 2019, personal income in Michigan grew at an average annual rate of 2.7%. 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 1999-00, albeit at a slower rate than for personal income. Over time, the base has eroded due to 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 2011-12 can be partially attributed to the taxation of most retirement income.
- As previously noted, business taxes have declined in absolute terms since FY 2011-12 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 2007-08, 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.

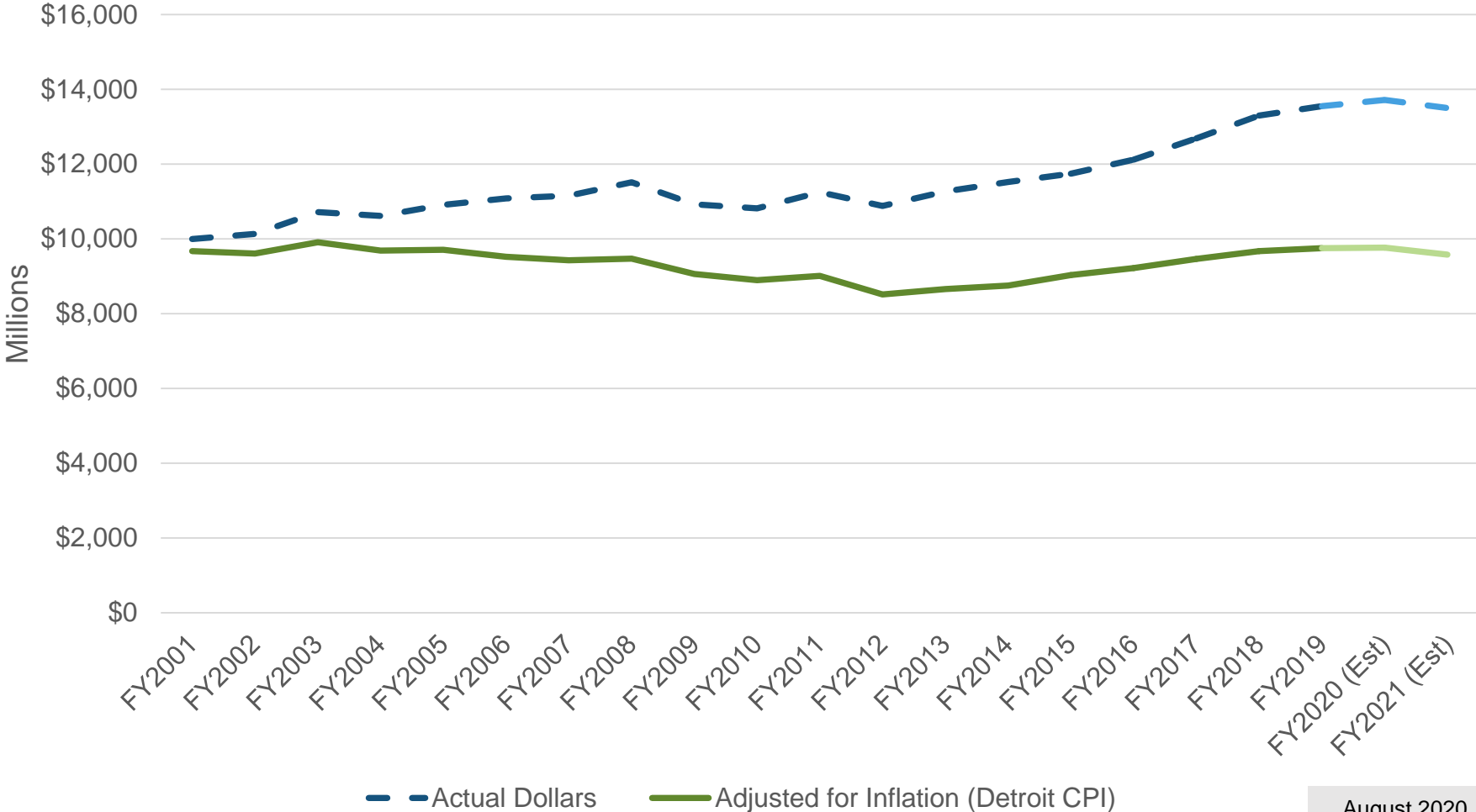


Revenue Trends of Major Funds

- Between FY 1999-00 and FY 2018-19, School Aid Fund revenue grew at an annual average rate of 1.7%.
- When adjusted for inflation using the Detroit CPI, SAF revenue declined at an average annual rate of 0.1% between FY 1999-00 and FY 2018-19.
- SAF revenue, which was 3.3% of personal income in FY 1999-00, is estimated to decline to 2.7% of personal income in FY 2020-21.
- Between FY 1999-00 and FY 2018-19, General Fund/General Purpose revenue increased at an annual average rate of 0.2%.
- When adjusted for inflation using the Detroit CPI, GF/GP revenue declined at an average annual rate of 1.5% between FY 1999-00 and FY 2018-19.
- GF/GP revenue, which was 3.5% of personal income in FY 1999-00, is estimated to decline to 2.0% of personal income in FY 2020-21.
- Diversion of GF/GP revenue for both personal property tax reform and transportation funding along with the income tax trigger will continue to limit GF/GP revenue going forward.

School Aid Fund Revenue

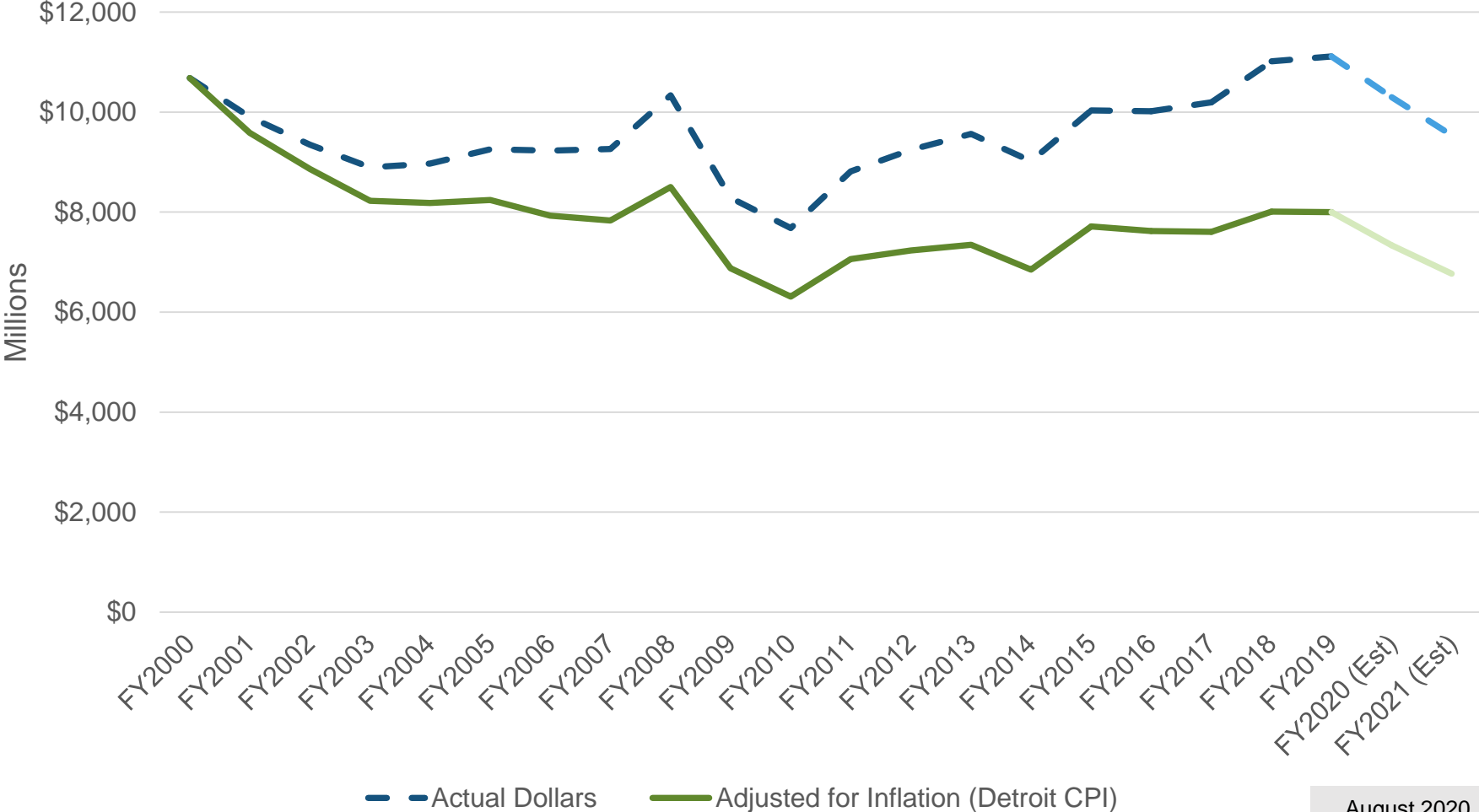
Nominal SAF revenue has grown steadily since FY 2011-12. In inflation-adjusted terms, however, FY 2020-21 revenue is estimated to be 3.1% below the FY 1999-00 level.



August 2020
Consensus
Estimates

GF/GP Revenue

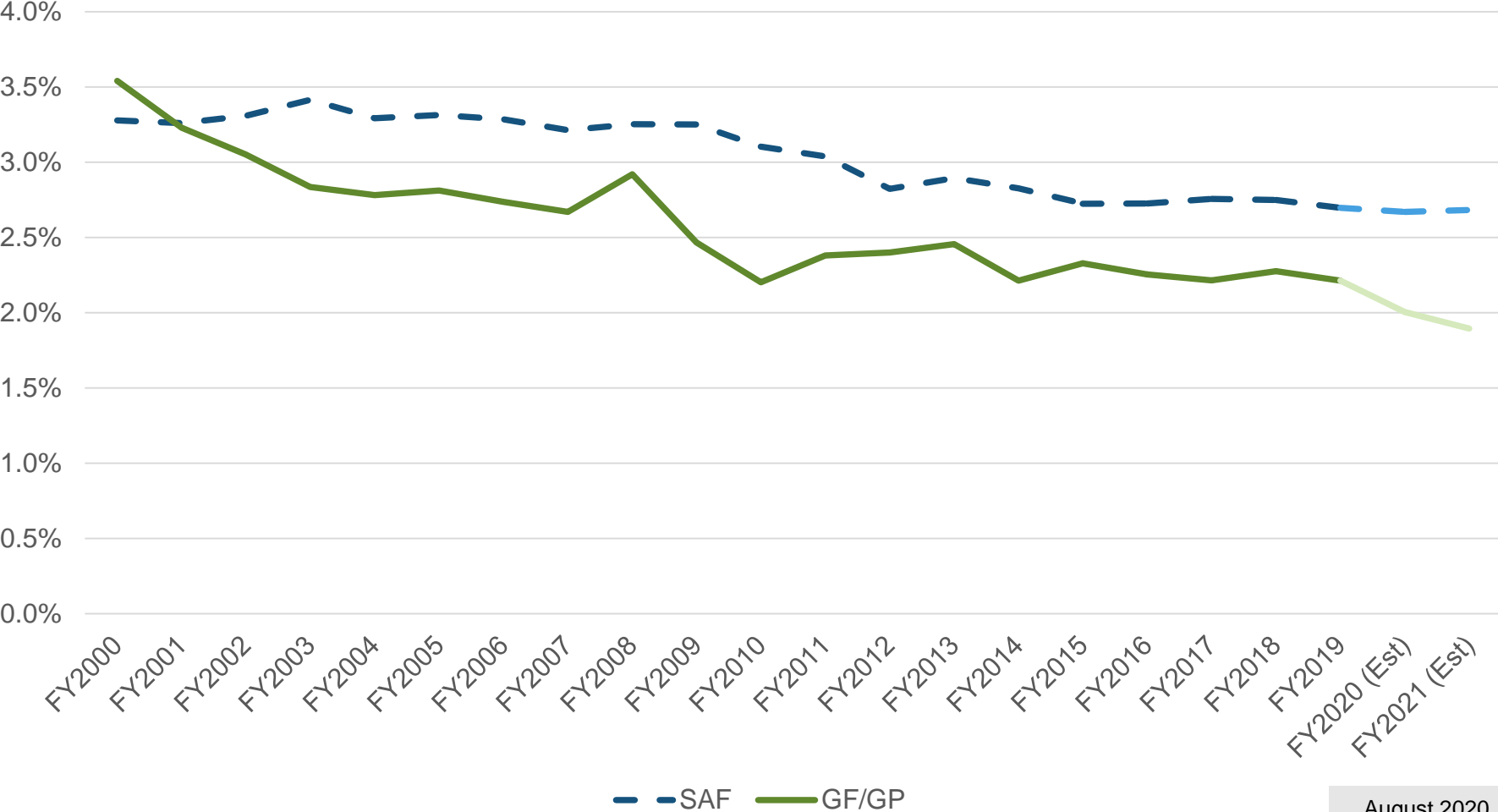
Nominal GF/GP revenue is expected to exceed \$9.5 billion in FY 2020-21. When adjusted for inflation, however, GF/GP revenue is estimated to be 36.6% below the FY 1999-00 level.



August 2020
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.



August 2020
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/>

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