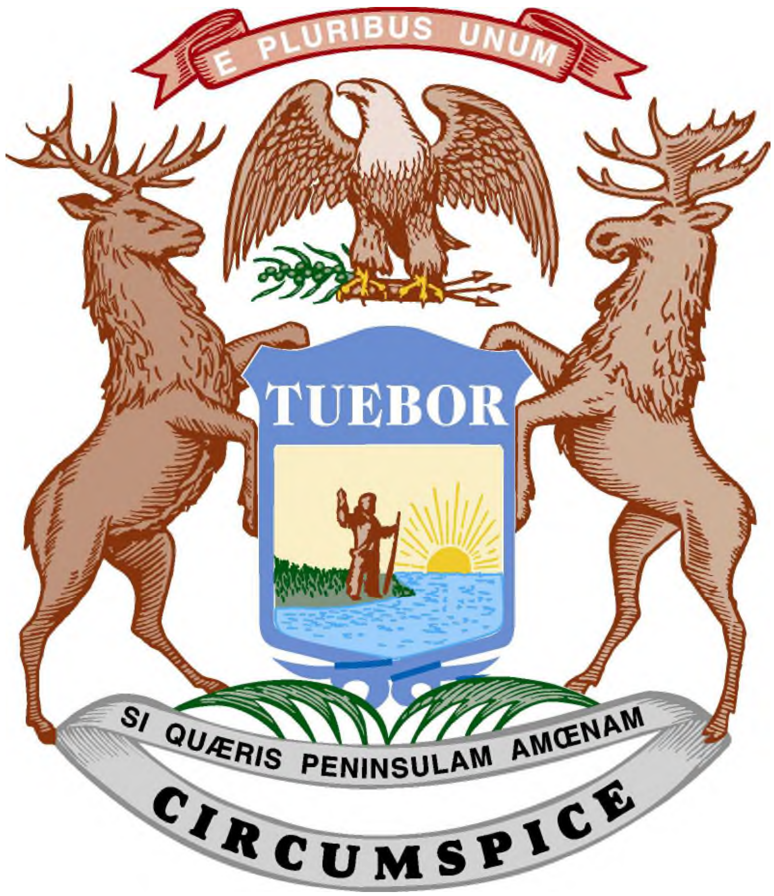
MICHIGAN'S INDIVIDUAL INCOME TAX 2018



Tax Analysis Division
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III. HISTORY OF THE MICHIGAN INDIVIDUAL INCOME TAX[1]

The Michigan individual income tax became effective on October 1, 1967, under PA 281. The tax was enacted to help eliminate a state budget deficit. When originally enacted, the state income tax was levied at 2.6 percent and allowed a $1,200 exemption per person. On August 1, 1971, the personal income tax rate was raised to 3.9 percent. In 1973, the personal exemption was raised from $1,200 to $1,500, and the homestead property tax credit was established. The income tax rate rose to 4.6 percent on May 1, 1975, to replace revenue lost from the exemption of food and prescription drugs from the state sales tax. Although scheduled to be rolled back to 4.4 percent on July 1, 1977, the state income tax rate was set at 4.6 percent in 1977.

In response to the early 1980s economic recession that plagued Michigan with budget deficits, the state income tax rate was raised to 5.6 percent between April 1 and September 30, 1982, further increasing to 6.35 percent in 1983. As the Michigan economy improved, the income tax rate was rolled back to 5.85 percent in 1984, 5.33 percent in 1985, and 4.6 percent in 1986. On May 1, 1994, the rate was lowered to 4.4 percent, following the passage of the property tax reform package known as Proposal A. For the 1995 tax year only, the Headlee Amendment Refund reduced the income tax liability of all Michigan taxpayers by 2.0 percent. Legislation passed in 1999 reduced the income tax rate to 4.2 percent effective January 1, 2000, and further reduced the rate by 0.1 percentage point on January 2002, January 2003, and July 2004, bringing the rate to 3.9 percent, where it remained until September 2007. Renewed budgetary pressures led to legislation that increased the income tax rate to 4.35 percent effective October 1, 2007, and provided for a gradual reduction of the rate (0.1 percentage point) on each October 1 beginning in 2011, until the rate reached 3.95 percent, and finally dropped to 3.9 percent on October 1, 2015. However, PA 38 of 2011 and PA 223 of 2012 maintained the 4.35 percent rate through December 2012, and reduced the rate to 4.25 percent beginning October 2012. (See Exhibit 41 on page 60 for a complete list of average Michigan Individual Income tax rates since 1968.)

The starting point of the Michigan individual income tax is federal AGI. Therefore, changes in federal tax law can affect Michigan income tax collections. For example, the broad changes in AGI effected by the Tax Reform Act of 1986 significantly increased the Michigan income tax base. In response, the personal exemption was gradually increased from $1,500 in 1986 to $2,100 in 1990, a 40 percent overall increase. Under PAs 2 and 3 of 1995, the personal exemption increased to $2,400 for tax years 1995 and 1996, and to $2,500 in 1997, and the amount was indexed to inflation, where the inflation adjustments would be rounded to the nearest $100 after tax year 1997. For tax years 1998 through 2013, the inflation adjusted personal exemption is further increased by an additional $200 under PA 86 of 1997. PA 224 of 2012 provided that the personal exemption would increase to the greatest of the indexed value or a base ($3,950 for October 1, 2012 through December 2013, and $4,000 for tax years 2014 and after). In December 2017, the Tax Cuts and Jobs Act became law, providing the largest federal tax overhaul since 1986. To offset the revenue gains resulting from the federal changes on individual taxes, the Michigan personal exemption was increased to $4,050 in 2018, up to $4,900 in 2021. A table with chronological changes to the

[1] For a complete Michigan personal income tax legislative history through 2017, see Appendix A, page 66.

Michigan Income Tax (filing requirements, average rates, maximum limits of deductions and credits, and others) can be found in Appendix A on page 95.

For 2018, the following exemptions were available for taxpayers: $4,050 personal exemption, $2,700 special exemption for filers with certain disabilities, $400 exemption for disabled veterans, and $1,500 exemption for taxpayers claimed as dependent by another taxpayer. Effective in tax year 2012, PA 38 of 2011 eliminated exemptions for seniors, filers receiving at least 50 percent of their AGI from unemployment compensation, and children aged 18 years and under (for all changes resulting from that legislation, see page 88). Exhibit 1 depicts the average annual Michigan individual income tax rate and allowed exemptions since 2010.

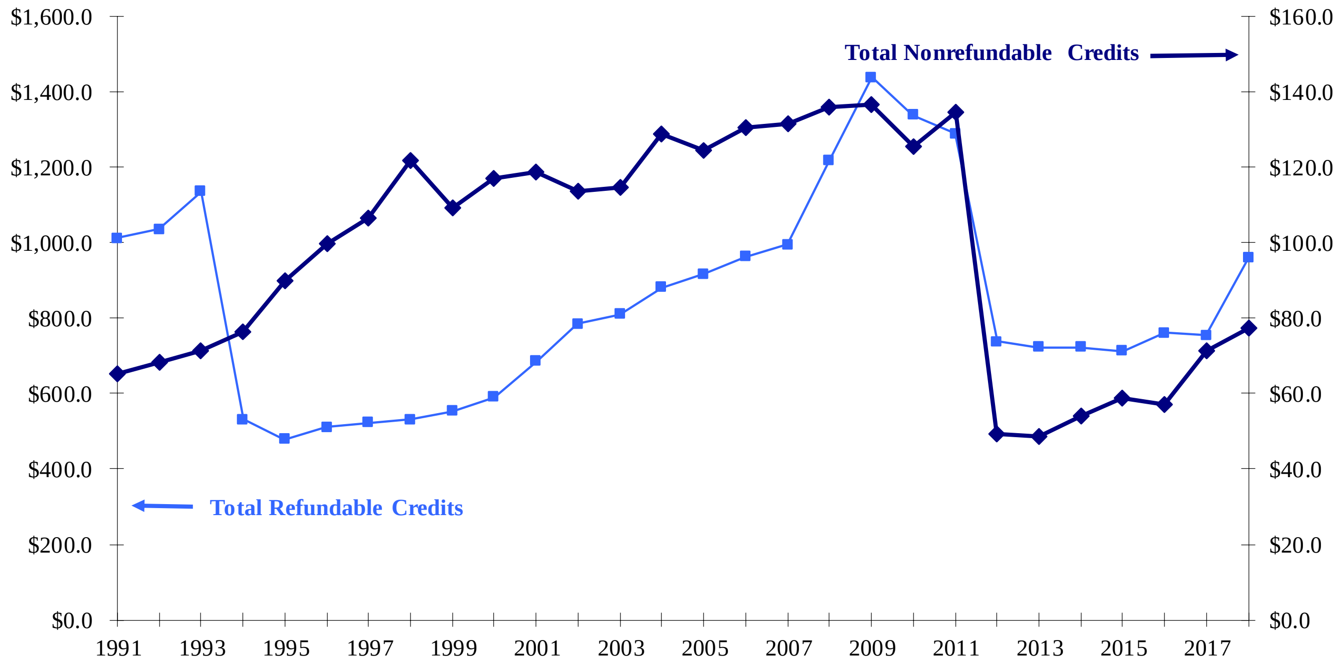
Exhibit 1
Michigan Individual Income Tax Exemption Allowances

				Special Exemptions				
Tax Year	**Average Rate**	**Personal Exemption**	**Claimed as Dependent Exemption**	**Blind, Deaf, or Disabled**	**Disabled Veteran**	**Senior**	**Unemployment Compensation**	**Child Age 18 and Under Exemption**
2010	4.35%	$3,600	$1,500	$2,300	$300	$2,300	$2,300	$600
2011	4.35%	3,700	1,500	2,400	300	2,400	2,400	600
2012	4.33% (a)	3,763 (b)	1,500	2,400	300	n.a.	n.a.	n.a.
2013	4.25%	3,950	1,500	2,500	300	n.a.	n.a.	n.a.
2014	4.25%	4,000	1,500	2,500	400	n.a.	n.a.	n.a.
2015	4.25%	4,000	1,500	2,600	400	n.a.	n.a.	n.a.
2016	4.25%	4,000	1,500	2,600	400	n.a.	n.a.	n.a.
2017	4.25%	4,000	1,500	2,600	400	n.a.	n.a.	n.a.
2018	4.25%	4,050 (c)	1,500	2,700	400	n.a.	n.a.	n.a.
2019	4.25%	4,400 (d)	1,500	2,700	400	n.a.	n.a.	n.a.
2020	4.25%	4,400	1,500	2,700	400	n.a.	n.a.	n.a.

(a) Tax rate equals 4.35% through September 2012, then it decreases to 4.25% thereafter.
(b) Exemption equals $3,700 through September 2012, then it increases to $3,950 thereafter.
(c) Effective February 2018.
(d) Starting TY 2019, an additional personal exemption is allowed for a stillbirth certificate.

The Michigan individual income tax is a flat rate tax. The Michigan Constitution prohibits graduated income tax rates. Proposals to allow graduated rates were defeated by voters in 1968, 1972, and 1976. However, a degree of progressivity is achieved with exemptions and credits, such as the homestead property tax credit, the home heating credits, and the Michigan Earned Income Tax credit (EITC). These provisions help to make the tax less burdensome on low income taxpayers. Exhibit 2 provides information on the total amount of refundable and nonrefundable credits paid since 1991. Refundable and nonrefundable credits paid and claimed have gradually increased over the years, except in 1994 (when property tax reductions enacted as a part of school finance reform led to reduced property tax credits); in 2010 and 2011 (when falling property values depressed property tax credits), and in 2012 (when several nonrefundable credits were eliminated, and the EITC and homestead property tax credit were reduced). For tax year 2018, $960.0 million was paid in refundable credits, and an additional $77.4 million was paid in nonrefundable credits. For a complete list of credits available in tax year 2018 see Chapter V on page 20.

Exhibit 2
Individual Income Tax Credits
(millions)



Starting in fiscal year 1995, a portion of income tax revenues is earmarked to the School Aid Fund (SAF) with the remainder distributed as General Fund/General Purpose (GF/GP) revenues. In fiscal year (FY) 1995, 14 percent of gross income tax collections was statutorily allocated to the SAF with the remainder of net income tax revenue allocated to GF/GP. For fiscal year 1997 through tax year 1999, the SAF allocated percentage increased to 23 percent. Starting in tax year 2000, the percentage of gross income tax collections earmarked to the SAF changed to 1.012 percent divided by the income tax rate. The inverse relationship between the income tax rate and the percentage allocated to the SAF prevents the reduction of funds to the SAF when the income tax rate decreases. PA 588 of 2018[2], under specific conditions, reduced the SAF earmark percentage to 0.954 percent divided by the income tax rate, starting in December 2018, and each fiscal year thereafter. Using

[2] The reduction in the SAF earmark results in more revenue going into the GF/GP annually. PA 588 of 2018 provides that such increase is to be divided between $69 million earmarked to the Renew Michigan fund, and increased distributions to the Michigan Transportation Fund (MTF) in FY 2019 (from $150 million to $264 million), FY 2020 (from $325 million to $468 million), while distributions for FY 2021 and after remain the same at $600 million annually. The Act provides that if in any fiscal year from 2019 to 2022 the minimum foundation allowance falls below the established FY 2018 minimum foundation allowance ($7,631 per pupil) then for that fiscal year no money shall be deposited into the Renew Michigan fund, and the distributions to the MTF revert to the limit established prior to the Act.

the new and reduced earmark percentage, the earmarked percentage beginning December 2018 is reduced to 22.45. Exhibit 3 summarizes the income tax revenue earmarking to the SAF and GF/GP since 1995.

Exhibit 3
Earmarking of Income Tax Gross Collections

Tax Years	Average Tax Rate	Earmarking Percentages		Tax Years	Average Tax Rate	Earmarking Percentages	
		SAF	GF/GP			SAF	GF/GP
1995	4.40 %	14.00 %	86.00 %	2007	4.01 %	25.24 %	74.76 %
1996 - 1999	4.40	23.00	77.00	2008 - 2011	4.35	25.24	74.76
2000 - 2001	4.10	24.68	75.32	2012	4.33	23.40	76.60
2002	3.95	25.62	74.38	2013 - 2015	4.25	23.81	76.19
2003	4.00	25.30	74.70	2016 - 2018	4.25	23.81	up to 76.19 (a)
2004	3.95	25.62	74.38	2019	4.25	22.45 (b)	up to 77.55 (c)
2005 - 2006	3.90	25.95	74.05	2020 - 2022	4.25	23.81 (b)	up to 76.19 (c)

(a) Starting on October 2016, GF/GP revenues refer to the remainder of IIT revenues after SAF and Agricultural Preservation Fund (APF) distributions based on amount of farmland credit claimed in the prior three fiscal years (2016 PA 266).
Starting on fiscal year 2017, besides the SAF and the APF, distributions are also provided to the Brownfield Redevelopment Fund (BDF) and the Good Jobs for Michigan Fund (GJMF) for eligible projects. The BDF refers to transformational Brownfield projects, while the GJMF refers to qualified withholding tax attributable to certified new jobs resulting from the Good Jobs for Michigan program (PAs 47 and 110 of 2017).
No distributions to these two funds have yet been made since 2016.

(b) New SAF earmark begins on December 2018 through September 2019 (2018 PA 588, and 2020 PA 75).

(c) New GF/GP earmark begins on December 2018, and equals the remainder of IIT revenues after all of the following annual distributions: SAF, APF, BDF, GJMF, Michigan Transportation Fund (MTF) and Renew Michigan Fund (RMF). The MTF and RMF distributions are statutorily set at $264 million in FY 2019, $468 million in FY 2020, and $600 million thereafter for the MTF, and $69 million annually for the RMF.
If in any fiscal year from 2019 to 2022 the minimum foundation allowance amount falls below the established FY 2018 amount ($7,631 per pupil), then for that fiscal year no money shall be deposited into the RMF, and the distribution to the MTF decreases to $150 million in FY 2019, and $325 million in FY 2020.

USE TAX PAYMENTS

Taxpayers owe use tax when they purchase tangible personal property, either for use, consumption, or storage in Michigan, from companies that do not collect Michigan sales or use tax. This includes mail order and Internet purchases, as well as purchases made while traveling in other states or foreign countries. In those cases, compliant Michigan taxpayers must submit a use tax form, remitting the use tax owed on the total price (including shipping and handling charges) of all taxable items purchased from the out-of-state retailer who does not collect Michigan tax. Prior to PA 553 of 2014, out-of-state businesses that did not have a store, warehouse, or employees in Michigan did not have to register and collect Michigan use tax, even though many of those businesses voluntarily collected use tax for their customers[3]. Since then, more and more out-of-state sellers (e.g. on-line sellers) are collecting sale taxes for their customers.

In order to simplify the use tax compliance process for the taxpayers, starting in tax year 1999, Michigan taxpayers were able to remit use tax payments while filing their income tax return, instead of filing separate use tax forms. For tax year 2018, 85,590 taxpayers remitted $4.7 million in use tax (see Exhibit 4).

Beginning October 2, 2018, Treasury requires remote sellers with sales exceeding $100,000 to, or 200 or more transactions with, Michigan purchasers in the previous calendar year to remit sales tax. This change was made following the decision of the U.S. Supreme Court in South Dakota v. Wayfair. This requirement will reinforce to the trend of declining use tax payments with income tax return filing.

Beginning January 1, 2020, marketplace facilitators that meet the thresholds above for facilitated sales to Michigan purchasers are required to remit Michigan sales or use tax. As more sales are subject to tax at the point of sale fewer transactions will be reported on the income tax return.

Exhibit 4
Use Tax Liability Reported on Income Tax Returns

Tax Year	Number Of Returns	Use Tax Amount	Average Per Return	Tax Year	Number Of Returns	Use Tax Amount	Average Per Return
1999	64,650	$2,895,475	$44.79	2009	100,779	$4,984,597	$49.46
2000	79,627	2,976,223	37.38	2010	104,707	5,232,886	49.98
2001	72,913	2,877,459	39.46	2011	106,850	5,680,746	53.17
2002	70,619	2,872,252	40.67	2012	110,597	5,825,409	52.67
2003	79,684	3,302,217	41.44	2013	113,684	6,195,577	54.50
2004	86,774	4,041,439	46.57	2014	115,568	6,669,182	57.71
2005	82,691	3,409,451	41.23	2015	105,435	6,089,413	57.76
2006	81,360	3,346,874	41.14	2016	92,336	5,389,889	58.37
2007	104,836	4,086,157	38.98	2017	93,793	5,618,420	59.90
2008	103,637	$4,056,857	39.14	2018	85,590	4,697,093	54.88

Source: Office of Revenue and Tax Analysis, Michigan Department of Treasury

[3] Effective October 2015, PA 553 of 2014 provides additional presumptions to when an out-of-state company is engaged in the business of making sales at retail in the state, and therefore should register and collect sales taxes on those sales, lessening the burden of consumers to remit use taxes on such transactions.

eligibility for the credit. Business losses no longer offset other income for purpose of calculating total household resources, unlike the calculation of household income[14].

PA 38 reduces the deduction for pension and retirement benefits by limiting the deduction for taxpayers born between 1946 and 1952 to $20,000 on a single return and $40,000 on a joint return, and eliminating the deduction for taxpayers born after 1952[15].

The new 6 percent corporate income tax was enacted to replace the Michigan business tax (MBT) that was eliminated for most taxpayers by Public Act 39 of 2012. New and updated requirements for flow-through income withholding were also implemented by the new law.

PAs 41 through 45 amended the State Employees' Retirement Act, the Public School Employees Retirement Act, the Michigan Legislative Retirement System Act, Public Act 339 of 1927 (public libraries), and the Judges Retirement Act, respectively, to repeal the full exemption for pension and retirement benefits received from public sources. After repeal of the exemption in each of these acts, any exemption for pension and retirement benefits is now governed by the provisions of the Income Tax Act. Under the Income Tax Act, benefits from public sources will be treated the same as benefits from private sources for taxpayers born after 1945.

PAs 56 and 57 amended the City Income Tax and City Utility Users Tax Acts, respectively, to lower the population thresholds in these Acts that apply to the City of Detroit to 600,000. The previous threshold in each Act was 750,000. The threshold in the City Income Tax Act allows Detroit to have a different tax rate than other cities and, based on population, Detroit is the only city to levy the utility users tax

PAs 172, 174, 177, 178 and 180 clarified portions of the individual income tax and correct certain technical issues that were identified or had arisen since the passage of PA 38. Changes were made to the definition of total household resources, the calculation of the homestead property tax credit, and the effective date of the new apportionment formula to align the statute with the original intent.

PAs 188 and 192 through 194 corrected and clarified the withholding provisions in the Income Tax Act. They amended provisions related to withholding from pension and retirement benefits and income from flow-through entities.

PA 273 allowed taxpayers to exclude the portion of a parcel of real property that is unoccupied and classified as agricultural when calculating the taxable value of property for purposes of eligibility for the homestead property tax credit (effective 2012, credit only applies to homesteads with a taxable value up to $135,000).

[14] A chart with detailed information on differences between AGI, taxable income, total household resources, and household income can be found at https://www.michigan.gov/documents/taxes/CC-41011_608354_7.pdf

[15] A chart with detailed information on Retirement Benefits Changes can be found at http://www.michigan.gov/documents/taxes/Tax_Change_Summaries_-_Retirement_Exemptions_359799_7.pdf