Tracking Tax Expenditures in Michigan

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How Tax Expenditures Are Tracked

- ➢ **Executive tracking required by statute: Public Act 72 of 1979**
  - MCL 21.271-296
  - Required to be included with the Governor's Budget Recommendation
  - Focus is on exclusions granted by statute
  - Compiled by Michigan Department of Treasury
- ➢ **Legislative tracking occurs as part of the consensus revenue estimating process**
  - May initially have different estimates
  - Reconciled at consensus time
  - Only tracked as long as not part of the baseline revenue estimates
    - – Reflects legislatively granted tax expenditures only
- ➢ **Tax expenditures resulting from following Federal treatment are much more difficult to track.**

Taxes Tracked for Tax Expenditures

- ➢ **At a minimum, includes tax expenditures under:**
  - Individual and corporate income taxes
  - Earlier primary business taxes, like the Single Business Tax and the Michigan Business Tax
  - The General Property Tax Act and several other property tax authorizations
  - Sales and use taxes
  - Severance taxes
  - Real estate transfer taxes
  - Motor fuel taxes, aviation fuel taxes, and motor carrier taxes
  - Local taxes such as the city income tax
  - Accommodations taxes
  - Insurance taxes
  - Cigarette taxes, alcoholic beverage taxes, etc.
  - Also included intangibles taxes, estate taxes, inheritance taxes, and a number of other smaller taxes that have been either been repealed or are otherwise no longer effective.

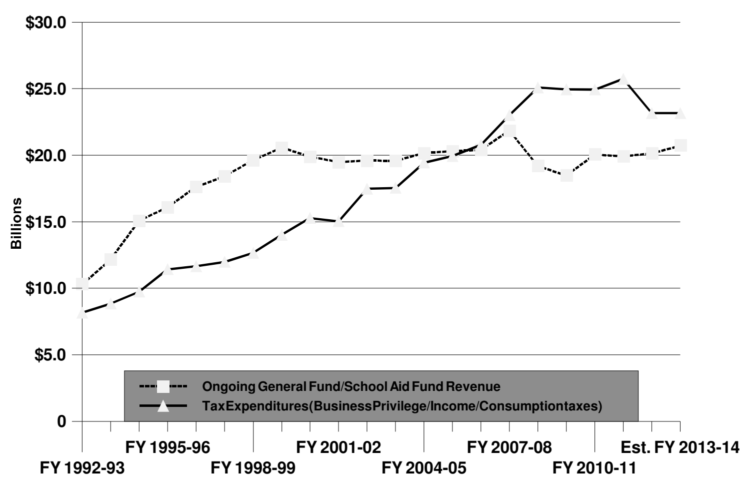
Challenges: Reliability

- **Tax expenditure report assigns three levels of reliability:**
  - **High**
    - Estimates derived from actual recent tax return data.
    - Estimates include earned income tax credit and the homestead property tax credit
  - **Average**
    - Estimates derived from tax return data that required additional simplifying assumptions to develop the estimate.
    - Examples include personal exemption on city income taxes and most business tax provisions under the Michigan Business Tax
  - **Low**
    - Often based on national data or other highly aggregated data
    - Often requires restrictive assumptions or non-tax data sources
    - Examples include impact of sales tax exemptions and flow-through of federal tax expenditures

Challenges: Data

- **Data tracking**
  - Electronic filing has improved access to data.
  - Electronic scanning of paper returns has also helped.
- **Data availability**
  - Filing thresholds omit a substantial number of taxpayers
  - Consumption taxes do not track value of exemptions
  - Limited connectivity to local government
  - Federal data issues
- **Aggregate data**
  - How to apportion Federal data
  - How to apportion other national data
  - Fine enough detail not available
- **Computation/liability**
  - Provisions that interact
  - Changes that occur in isolation vs. together

Tax Breaks Growing Faster Than Revenue



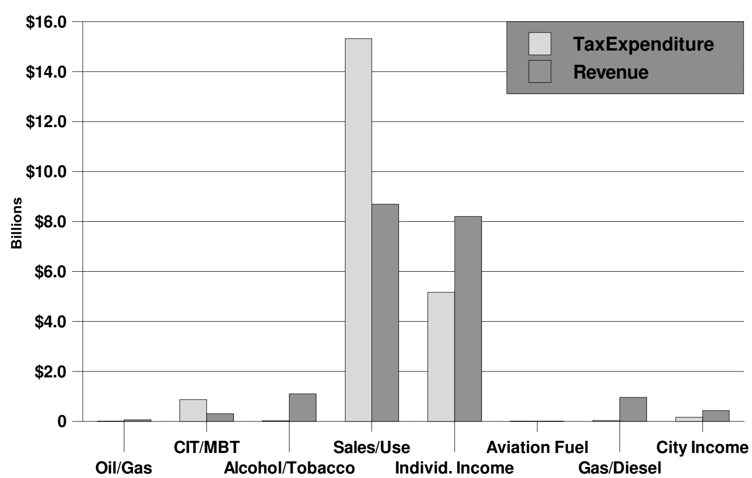
2011 Tax Reform: Businesses

- Replace a combination modified gross receipts/income tax with a corporate income tax
- Eliminate all credits other than prior "certificated" credits and the alternate tax/small business credit
  - Certificated credits expected to reduce revenue by $500.0 million in FY 2012-13 and $623.0 million in FY 2013-14
- Narrow tax base to only corporations
- Change filing threshold from gross receipts to liability
- Initial estimate placed net business tax reduction at $1.7 billion in first full year
- Current estimate is $1.7 billion reduction in business taxes
  - Changed base of tax expenditures: smaller base
  - New tax expenditures are $1.8 billion less than under prior tax

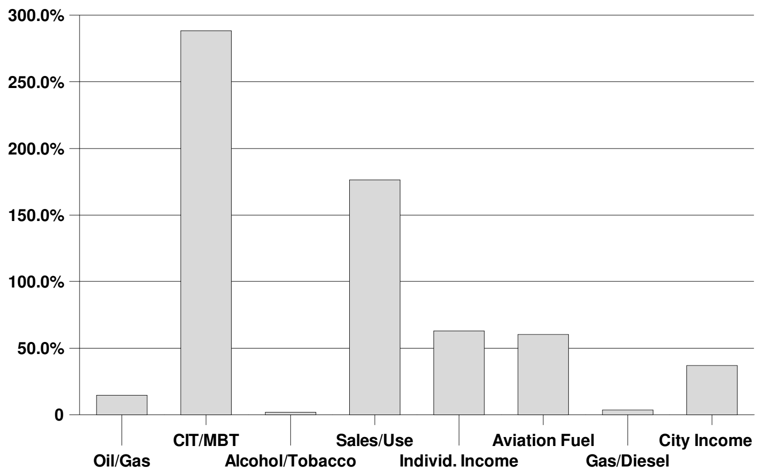
2011 Tax Reform: Individuals

- Eliminate special exemptions for seniors and those receiving unemployment compensation
- Eliminate many subtractions from income, including:
  - pension income
  - interest/dividend exclusion for seniors
  - political contributions
  - pension/retirement plan distributions donated to charitable organizations or used for higher education expenses
- Eliminate nonrefundable credits other than credit for taxes paid to other states
- Reduce refundable Homestead Property Tax Credit and refundable Earned Income Tax Credit
- Eliminate all other refundable credits
- Initial estimate placed net tax increase at $1.7 billion in first full year. Current estimate is $1.4 billion.
  - Reduced tax expenditures by $990.0 million

Tax Expenditures Vs. Revenue



Tax Expenditures as a Percent of Revenue



Tax Expenditures Vs. Appropriated Expenditures