



**House
Legislative
Analysis
Section**

House Office Building, 9 South
Lansing, Michigan 48909
Phone: 517/373-6466

TAX BENEFITS FOR UNEMPLOYED

**House Bill 5764 (Substitute H-1)
Sponsor: Rep. Bruce Patterson**

**House Bill 5765 (Substitute H-1)
Sponsor: Rep. Mickey Mortimer**

**House Bill 5766 as introduced
Sponsor: Rep. Gary Woronchak**

**House Bill 5767 as introduced
Sponsor: Rep. Gene DeRossett**

**Committee: Tax Policy
First Analysis (4-23-02)**

THE APPARENT PROBLEM:

The recent downturn in the economy and the accompanying rise in unemployment has prompted legislators to look at ways of improving benefits for unemployed workers. In addition to legislation increasing the weekly unemployment benefit, legislative leadership in the House of Representatives has proposed a package of bills aimed at "providing new tools for unemployed workers to deal with temporary hardship . . . and to help them begin rebuilding their lives". Among the proposals are a series of tax benefits that would be available primarily to unemployed workers.

THE CONTENT OF THE BILLS:

Each of the bills in the package would, generally speaking, provide special tax treatment for taxpayers who had been unemployed during the tax year.

House Bill 5764 would create the Worker Financial Security Account Act, under which a state resident could establish a special tax-free savings or investment account individually or jointly with a spouse, with total cumulative contributions not to exceed \$125,000. Funds in the account would be used solely for the purpose of paying eligible expenses during periods of unemployment or at retirement.

House Bill 5765 would amend the Income Tax Act (MCL 206.30) to provide a deduction from taxable income for 1) contributions made in a tax year to a worker financial security account, with the deduction not to exceed \$5,000 for a single return and \$10,000

for a joint return; 2) interest earned in the tax year on an account; and 3) distributions that were qualified withdrawals from an account. Any withdrawal that was not a qualified withdrawal would be added to taxable income (and could be subject to penalty, as described later). House Bills 5764 and 5765 are tied to one another and both would apply to tax years beginning after December 31, 2001..

House Bill 5766 would amend the Revenue Act (MCL 205.24) to waive penalty and interest on income taxes due from an "unemployed individual" for six months past the date the return was due. An "unemployed individual" would be defined to mean a person who 1) received unemployment benefits under the Michigan Employment Security Act; 2) received unemployment benefits for a period of time prior to the tax year in which tax-deductible withdrawals were made from a financial security account, and who had been continuously unemployed after receiving the maximum benefits available; or 3) was 65 years of age and retired (meaning not employed or employed for 10 hours or less per week).

House Bill 5767 would amend the Income Tax Act (MCL 206.30) to allow a taxpayer who had received unemployment benefits during the tax year to deduct from taxable income up to \$2,500 per year in (in-state) tuition paid to an institution of higher education on behalf of a qualified student (meaning a child, stepchild, or adopted child of the taxpayer). An institution of higher education would include a state college or university; a community college or junior college; or a postsecondary vocational, technical, or

House Bills 5764-5767 (4-23-02)

proprietary school licensed in the state. The maximum deduction available would be based on the percentage of months in the year during which the taxpayer received unemployment benefits. The deduction could only be taken for tuition not already deducted (on the federal return) in determining adjusted gross income. The bill would apply to tax years beginning after December 31, 2001.

Worker Financial Security Accounts. Under House Bill 5764, for tax years after December 31, 2001, a resident individual could establish a worker financial security account with an account administrator for himself or herself or for a spouse. Contributions to the account could only be made in cash, by check, by money order, by credit or debit card, electronic fund transfer, or payroll deduction. The total cumulative contributions to an account could not exceed \$125,000. Any amount in excess of \$125,000 would have to be promptly returned to the account holder. An account administrator would administer the worker financial security account from which payments were made and would have a fiduciary duty to the person for whose benefit the administrator administered the account.

The account administrator could use the fund solely for the purpose of paying the "eligible expenses" of the person on whose behalf the account had been established. The term "eligible expenses" refers to the reasonable living expenses of an individual who 1) received unemployment benefits under the Michigan Employment Security Act; 2) received unemployment benefits for a period of time prior to the tax year in which tax-deductible withdrawals were made from a financial security account, and who had been continuously unemployed after receiving the maximum benefits available; or 3) was 65 years of age and retired (meaning not employed or employed for 10 hours or less per week). The Department of Treasury would have to determine what constituted reasonable living expenses. The account administrator would pay the reasonable living expenses based on bills or other evidence of a debt or account due or would reimburse the account holder based on submitted documentation.

If an account holder withdrew money for any other purpose, the administrator of the account would be required to withhold ten percent of the withdrawal and pay it to the Department of Treasury as a penalty. (The disbursement of assets due to a bankruptcy filing by the account holder or the account holder's spouse would not be considered subject to penalty.) Upon the death of an account holder, the administrator would distribute the principal and

accumulated interest to the estate of the account holder.

The bill would define "account administrator" to mean a state chartered bank, savings and loan association, credit union, or trust company authorized to act as a fiduciary and operating under the supervision of the financial institutions bureau of the Office of Financial and Insurance Services; a national banking association, savings and loan association, or credit union authorized to act as a fiduciary in the state; a broker-dealer, commodity issuer, or investment advisor registered under the state's Uniform Securities Act or a federal investment company registered under the federal Investment Company Act of 1940; a certified public accountant licensed to practice in the state; or a life insurance company.

FISCAL IMPLICATIONS:

The House Fiscal Agency has reported that, given the available information, it is not possible to determine an accurate fiscal impact for House Bill 5765. However, the HFA notes that each \$5,000 contribution to a worker financial security account (and reduction in taxable income) would reduce state income tax revenue by about \$200. In 2001, there were more than five million taxpayers filing returns. If one percent (or 50,000) opened accounts and contributed the maximum, income tax revenues would fall by more than \$10 million. All of the lost revenue would come from the general fund, the HFA notes. House Bill 5764, by itself, should not have any significant fiscal impact, other than some small administrative costs. (HFA floor analysis dated 4-17-02) The impact of House Bill 5766 cannot be estimated with certainty but is likely to be under \$1 million, and House Bill 5767 is likely to have a small impact on revenue. (HFA committee analyses dated 4-16-02)

ARGUMENTS:

For:

The bills aim to provide several different kind of tax benefits to unemployed workers to assist them in times of vulnerability and hardship. Two of the bills would in tandem allow for the creation of special savings accounts something like IRAs, 401(k)s, and education savings accounts, so that workers could be rewarded for exercising personal responsibility in setting money aside for use when out of work and suffering from a reduced income. Individuals could set aside \$5,000 per year (and couples \$10,000)

exempt from state income taxes. The savings would grow tax free and the withdrawals would also be tax free if used for reasonable living expenses. This is a voluntary program, another savings option that individuals and families could use to protect themselves against adverse future events or anticipated future challenges. It is a legitimate use of state tax policy to provide an incentive and a reward for responsible individual financial behavior.

Another of the bills would forgive unemployed taxpayers the penalties and interest associated with paying state taxes late. It would delay penalties and interest for six months past the filing date. Note that it does not say the taxes do not need to be paid or the return filed on time; it simply provides some extra time for taxes to be paid without any additional expense during times when money is tight due to unemployment.

A third would allow unemployed taxpayers to deduct from taxable income the cost of college tuition or tuition to other postsecondary institutions, up to \$2,500 per student per year, in recognition of the hardship that can occur in families paying for higher education when their income is sharply reduced temporarily due to loss of work.

Against:

A variety of concerns have been raised about the bills. A principal concern is the loss of general fund revenue. While no firm estimates have been made, the fiscal impact could be significant. Representatives of education interests argue that with the passage of Proposal A, establishing a new school finance system, schools lost the ability to pass local millages for operating schools in exchange for a stable source of dedicated revenue, including revenue from the general fund. Since then, there have been a number of major cuts in this revenue. This package would further reduce revenues for the state's schoolchildren. Moreover, higher education depends on general fund revenues as well. At a time when state budgets are extremely tight, are these tax exemptions the best way to "spend" general fund revenues?

Among the other concerns expressed are the following:

-- Will the special savings accounts for the unemployed really reach the people they are supposedly intended to reach? Will lower wage workers have the wherewithal to set aside significant amounts of their income for use during times of unemployment, considering that, in addition to

simply trying to make ends meet, some of them are already trying to fund retirement accounts and college savings accounts?

-- Shouldn't the new savings accounts have an income limit, so that they do not become simply a tax shelter for taxpayers with high incomes and considerable assets? Note that money can accumulate in these accounts tax free until a person reaches 65 and then can be withdrawn tax free whether a person has ever been unemployed or not. In fact, a person could open such an account as he or she approaches or reaches 65 simply to avoid state income taxes (once other kinds of shelters were exhausted). Further, the proposal to postpone interest and penalties on late state taxes for six months would appear to apply to all taxpayers 65 and older who are retired. If so, is this wise?

-- Withdrawals can only be made from the new accounts for "reasonable living expenses", and the Department of Treasury is supposed to determine -- and then monitor -- what counts. Is the department prepared for this task? Additionally, shouldn't there be some accommodation made for withdrawals without penalty for emergencies or hardships? Couldn't the age at which retired persons could withdraw money tax free be lowered to below 65?

-- Wouldn't it be preferable to remove the state income tax on unemployment benefits? That would provide an immediate tangible benefit to the unemployed and make the benefits go farther.

-- Could this approach in the long run be used to weaken the existing unemployment insurance system, by moving away from standard pooled benefits towards individual contributory accounts?

Response:

Supporters of the proposal concede that modifications may be necessary as the package moves through the legislature. Moreover, they concede that the new savings account may not be for everyone. They argue, however, that it is presumptuous to say that low and moderate income workers are unable to set money aside for future exigencies, that they are unable to judge for themselves the likelihood of future periods of unemployment and assume personal responsibility for their financial futures. Further, it is unlikely, given all the tax shelters available to knowledgeable taxpayers, that worker financial security accounts would be chosen simply for that purpose. Proponents of this package also reject the notion that it in any way weakens the existing unemployment benefits

system, which has recently been improved through legislative action.

POSITIONS:

The Michigan State AFL-CIO is neutral on House Bills 5764 and 5765 and supports House Bills 5766 and 5767. (4-17-02)

The Michigan Education Association is opposed to House Bills 5764, 5765, and 5767. (4-17-02)

The Department of Treasury is opposed to the bills. (4-17-02)

Analyst: C. Couch

■ This analysis was prepared by nonpartisan House staff for use by House members in their deliberations, and does not constitute an official statement of legislative intent.