

INCREASE STATE PERSONAL INCOME TAX RATE

House Bill 4500

Sponsor: Rep. George Cushingberry

Committee: Tax Policy

Complete to 5-23-07

A SUMMARY OF HOUSE BILL 4500 AS INTRODUCED 3-21-07

The bill would amend the Income Tax Act to increase the personal income tax rate from 3.9% to 4.6% beginning January 1, 2007 and to reduce the rate back to 3.9% beginning January 1, 2012.

In addition, the bill would set the personal exemption amount at \$3,630 for the 2007 tax year and index that amount for inflation for each year thereafter. Under current law, the personal exemption was set \$2,500 for the 1997 tax year, with an annual adjustment for inflation. Currently, for the 2007 tax year the personal exemption amount is \$3,400.

MCL 206.30 and 206.51e

FISCAL IMPACT:

According to the income tax model (using Tax Year 2005 data), those changes would generate about \$1.1 billion on full-year basis. Because the bill would be retroactive to January 1, the revenue increase for FY2006-07 would be about \$825 million.

BACKGROUND INFORMATION:

Income Tax Rates

As originally enacted, the personal income tax rate was 2.6%. (At the time, the act also included a 5.6% tax on corporate income and 7.0% tax on the profits of financial institutions. These taxes were later repealed following the creation of the Single Business Tax.) Over the years, the rate has increased three times – in 1971, 1982, and 1983 – in response to projected budget shortfalls and downturns in the economy. In addition, there have been numerous occasions where scheduled rate reductions were postponed. This occurred, most recently, with the enactment of 2003 PA 239, which delayed by six months a scheduled reduction in the rate from 4.0% to 3.9%, to solve a projected budget deficit in the 2003-2004 fiscal year. On other occasions, the rate was changed to reflect other changes in the state's tax policy. In 1975, the rate increased from 3.9% to 4.6% to offset the exemption of food and prescription medication from the sales tax, and in 1994, the rate was reduced from 4.6% to 4.4% as part of Proposal A and the shift from property taxes to the sales tax in financing public schools.

The most recent rate reductions were set in place by Governor Engler. Following his 1999 State of the State address, the legislature passed and the governor promptly signed into law Public Acts 2-6 of 1999 (House Bills 4033 and 4034, and Senate Bills 1, 2, and 5 of 1999). The bills reduced the income tax rate from 4.4% to 3.9% beginning in 2000. Public Act 40 of 2000 further reduced the rate for the 2000 tax year from 4.3% to 4.2%. The rate was to have been reduced from 4.0% to 3.9% on January 1, 2004, although Governor Granholm and the legislature agreed to delay that reduction until July 1, 2004.

Act	Rate (%)	Effective Date
1967 PA 281	2.60	10/01/1967
1971 PA 76	3.90	08/01/1971
1975 PA 19	4.60	05/01/1975
1982 PA 155	5.60	04/10/1982
1982 PA 155	4.60	10/01/1982
1983 PA 15	6.35	01/01/1983
1983 PA 15	6.10	01/01/1984
1984 PA 221	5.35	09/01/1984
1983 PA 15	5.10	11/11/1985
1986 PA 16	4.60	04/01/1986
1993 PA 328	4.40	05/01/1994
2000 PA 40	4.20	01/01/2000
1999 PA 6	4.10	01/01/2002
1999 PA 4	4.00	01/01/2003
2003 PA 239	3.90	07/01/2004

Effective Tax Rates

Through the proliferation of credits, exemptions, and deductions against the tax, the effective income tax rate is considerably lower than the statutory rate.

Year	Statutory Rate	Effective Rate	Year	Statutory Rate	Effective Rate
1979	4.60%	2.74%	1992	4.60%	2.77%
1980	4.60%	2.65%	1993	4.60%	2.75%
1981	4.60%	2.55%	1994	4.47%	3.03%
1982	5.10%	2.81%	1995	4.40%	2.87%
1983	6.35%	3.88%	1996	4.40%	2.88%
1984	5.85%	3.76%	1997	4.40%	2.90%
1985	5.33%	3.50%	1998	4.40%	2.88%
1986	4.60%	3.04%	1999	4.40%	2.86%
1987	4.60%	3.01%	2000	4.20%	2.68%
1988	4.60%	2.95%	2001	4.20%	2.59%
1989	4.60%	2.88%	2002	4.10%	2.49%
1990	4.60%	2.85%	2003	4.00%	2.35%
1991	4.60%	2.74%	2004	3.95%	2.20%

Source: Department of Treasury, Bureau of Tax and Economic Policy

Personal Exemption Amounts

As originally enacted, the personal exemption was \$1,200. Over the course of the next 30 years, the amount was increased eight times to \$2,500. Since 1997, the personal exemption has been adjusted annually for inflation. The table below shows the history of the personal exemption amount and the inflation-adjusted amount since 1967. The chart demonstrates that inflation has eroded much of the value of the exemption. If the original \$1,200 personal kept pace with inflation over the last 30 years, it would have a value today of \$7,425.

	Actual	Real		Actual	Real
Year	Amount	Amount	Year	Amount	Amount
1967	\$1,200	\$1,200	1987	\$1,600	\$470
1968	\$1,200	\$1,152	1988	\$1,800	\$319
1969	\$1,200	\$1,092	1989	\$2,000	\$539
1970	\$1,200	\$1,033	1990	\$2,100	\$537
1971	\$1,200	\$990	1991	\$2,100	\$515
1972	\$1,200	\$959	1992	\$2,100	\$500
1973	\$1,500	\$1,128	1993	\$2,100	\$485
1974	\$1,500	\$1,016	1994	\$2,100	\$473
1975	\$1,500	\$931	1995	\$2,400	\$526
1976	\$1,500	\$881	1996	\$2,400	\$511
1977	\$1,500	\$827	1997	\$2,500	\$520
1978	\$1,500	\$768	1998	\$2,800	\$519
1979	\$1,500	\$690	1999	\$2,800	\$561
1980	\$1,500	\$608	2000	\$2,900	\$563
1981	\$1,500	\$551	2001	\$2,900	\$547
1982	\$1,500	\$519	2002	\$3,000	\$557
1983	\$1,500	\$503	2003	\$3,100	\$563
1984	\$1,500	\$482	2004	\$3,100	\$548
1985	\$1,500	\$466	2005	\$3,200	\$547
1986	\$1,500	\$457	2006	\$3,300	\$547

Source: "Michigan's Personal Income Tax" (p.540) in *Michigan at the Millennium*.

Constitutional Considerations

Article 9, Section 7 of the 1963 State Constitution states, "No income tax graduated as to rate or base shall be imposed by the state or any of its subdivisions." This was a new provision added to the constitution with the 1961-62 Constitutional Convention, although not without a fair amount of debate among delegates as to whether an income tax, if authorized by the legislature, should have a flat or graduated rate. In adding the prohibition against a graduated income tax, backers of the provision (included in Committee Proposal 51) stated:

The provision makes it clear that neither the state nor any local unit of government may impose a graduated income tax. The words 'or base' are necessary to prevent 'piggyback' taxation based on the federal tax liability. Without such language, a tax nominally imposed at a flat rate might actually adopt all of the graduation of the federal tax. A flat rate income tax is clearly permitted, and could, in the opinion of the committee, be imposed on a 'piggyback' basis on income computed for federal tax purposes. The legislature could prescribe reasonable exemptions for a flat rate income tax.

The imposition of this limitation on legislative power seems desirable in order to avoid confiscatory taxation to avoid the use of a revenue measure as a device for social reform, and to prevent the entry by the state into a field largely preempted by the federal government. A further advantage of the limitation is that with it, a legislator, who votes for an income tax will do so with the knowledge that it will fall proportionally as heavily on himself as upon others – a safeguard which a majority of the committee deems important.¹

A number of delegates, however, felt that the legislature should be free to determine the structure of an income tax. They made the following arguments:

1. "It freezes into the constitution unnecessary and undesirable restriction on the legislative power to levy taxes in the future. No authority has been cited for the advisability of inserting this unique provision into a state constitution. It does not make allowance for drastically changed circumstances beyond our present anticipation."
2. "The prohibition of a graduated income tax, statutory in nature, does not have the faithful sanctity of the other restrictive measures written into the constitution, such as the sales tax rate limitation, achieved through prior approval of the people at the polls."
3. "It freezes present and potential inequities in the Michigan tax structure by prohibiting the legislature from correcting them, should it desire to do so."
4. "The majority committee report implies that graduation of taxes bases is preempted by the federal government. There is no legal authority for this presumption."
5. "Progressive taxation, accomplished through graduated rate structures, is not a device for social reform; on the contrary, it is a very equitable device for raising the maximum amount of revenues, without unduly burdening any individual taxpayer on the ability to pay. Its effect does not need to be 'soak the rich' or 'pamper the poor.' Experience actually proves these descriptions more propaganda than reality. However, there is obviously a basic difference between the majority and minority emphasis on the equity of the Michigan tax system, particularly in terms of the impact on low income and middle income families, pensioners, and those on fixed incomes."
6. "Ignored in the proposal is the experience of the overwhelming majority of the state which have income taxes, all but two (33 of the 35) having adopted

¹ Constitutional Convention Record, p.854, February 7, 1962.

graduated rate structures. Michigan would be placed in a unique category and at a potential disadvantage in relation to other state in its ability to raise revenue from income taxation."²

Over the years, there have been several ballot proposals, both before and after the 1963 state constitution, to enact a graduated income tax. Between 1922 and 1936 there were four proposals, none of which passed. In the years after the enactment of the income tax, the issue of a graduated rate structure has been before, and rejected by, the voters on three occasions – in 1968 (23.3% Yes, 76.7% No), 1972 (31.3% Yes, 68.7% No), and 1976 (27.8% Yes, 72.2% No).

Interstate Comparisons

The following series of charts allow for comparisons of income tax features among the states. The first chart shows tax rates and income brackets of the states. The second chart shows state income taxes as a percentage of personal income and the total state and local tax burden as a percentage of personal income. The third chart shows per capita income taxes collections and per capita total state and local tax collections.

Tax Rates and Brackets

State	Marginal Tax Rates		Number of Brackets	Income Brackets	
	Lowest	Highest		Low	High
Alabama	2.00%	5.00%	3	\$500	\$3,000
Alaska			No Personal Income Tax		
Arizona	2.59%	4.57%	5	\$10,000	\$150,000
Arkansas ¹	1.00%	7.00%	6	\$3,599	\$30,100
California ¹	1.00%	9.30%	6	\$6,622	\$43,468
Colorado	4.63%	4.63%	1	Flat Rate	
Connecticut	3.00%	5.00%	2	\$10,000	\$10,000
Delaware	2.20%	5.95%	6	\$5,000	\$60,000
Florida			No Personal Income Tax		
Georgia	1.00%	6.00%	6	\$750	\$7,000
Hawaii	1.40%	8.25%	9	\$2,400	\$48,000
Idaho ¹	1.60%	7.80%	8	\$1,198	\$23,964
Illinois	3.00%	3.00%	1	Flat Rate	
Indiana	3.40%	3.40%	1	Flat Rate	
Iowa ¹	0.36%	8.98%	9	\$1,343	\$60,436
Kansas	3.50%	6.45%	3	\$15,000	\$30,000
Kentucky	2.00%	6.00%	6	\$3,000	\$75,000
Louisiana	2.00%	6.00%	3	\$12,500	\$25,000
Maine ¹	2.00%	8.50%	4	\$4,550	\$18,250
Maryland	2.00%	4.75%	4	\$1,000	\$3,000
Massachusetts	5.30%	5.30%	1	Flat Rate	

² Constitutional Convention Record, pp. 854-5, February 7, 1962.

MICHIGAN	3.90%	3.90%	1	Flat Rate	
Minnesota ¹	5.35%	7.85%	3	\$21,310	\$69,991
Mississippi	3.00%	5.00%	3	\$5,000	\$10,000
Missouri	1.50%	6.00%	10	\$1,000	\$9,000
Montana ¹	1.00%	6.90%	7	\$2,300	\$14,500
Nebraska ¹	2.56%	6.84%	4	\$2,400	\$27,001
Nevada	No Personal Income Tax				
New Hampshire	Income Tax is Limited to Dividends and Interest Income Only				
New Jersey	1.40%	8.97%	6	\$20,000	\$500,000
New Mexico	1.70%	5.30%	4	\$5,500	\$16,000
New York	4.00%	6.85%	5	\$8,000	\$20,000
North Carolina	6.00%	8.00%	4	\$12,750	\$120,000
North Dakota ¹	2.10%	5.54%	5	\$30,650	\$336,550
Ohio ¹	0.649%	6.555%	9	\$5,000	\$200,000
Oklahoma	0.50%	5.65%	7	\$1,000	\$10,000
Oregon ¹	5.00%	9.00%	3	\$2,750	\$6,851
Pennsylvania	3.07%	3.07%	1	Flat Rate	
Rhode Island	25% of Federal Tax Liability				
South Carolina ¹	2.50%	7.00%	6	\$2,570	\$12,850
South Dakota	No Personal Income Tax				
Tennessee	Income Tax is Limited to Dividends and Interest Income Only				
Texas	No Personal Income Tax				
Utah	2.30%	6.98%	6	\$1,000	\$5,501
Vermont ¹	3.60%	9.50%	5	\$30,650	\$336,551
Virginia	2.00%	5.75%	4	\$3,000	\$17,000
Washington	No Personal Income Tax				
West Virginia	3.00%	6.50%	5	\$10,000	\$60,000
Wisconsin ¹	4.60%	6.75%	4	\$9,160	\$137,411
Wyoming	No Personal Income Tax				
District of Columbia	4.50%	8.70%	3	\$10,000	\$40,000

Source: Federation of Tax Administrators. Information is for the 2007 tax year, as of January 1, 2007. (1) These states have an automatic inflation adjustment for tax brackets, (2) Georgia: Tax brackets above are for single returns. For joint returns brackets range from \$500 to \$5,000 for married, filing separately, and \$1,000 to \$10,000 for married, filing jointly; (3) Minnesota: Tax brackets above are for single returns. For married filing jointly, the rates range from 1.4% to 8.97%, with 7 tax brackets ranging from \$20,000 to \$500,000; (4) Nebraska: Tax brackets above are for single returns. For married, filing jointly, brackets range from \$4,000 to \$50,001; (5) New Jersey: Tax rate and brackets above are for single returns. For married filing jointly tax rates range from 1.4% to 8.97%, with 7 brackets ranging from \$20,000 to \$500,000; (6) New Mexico: Tax brackets above are for single returns. For married filing jointly, brackets range from \$8,000 to \$24,000; (7) North Carolina: Tax brackets above are for single returns. For married filing jointly, brackets range from \$21,250 to \$200,000; (8) North Dakota: Tax brackets above are for single returns. For married filing jointly, brackets range from \$51,200 to \$336,551; (9) Vermont: Tax brackets above are for single returns. For married filing jointly, brackets range from \$51,200 to \$336,551; (10) Wisconsin: Tax brackets above are for single returns. For married filing jointly brackets range from \$12,210 to \$183,221; (11) California: An additional tax of 1% is imposed on taxable income over \$1 million.

2005 Tax Burden as a Percent of Personal Income

State Income Tax			Total State and Local Tax Burden		
State	Percentage	Rank	State	Percentage	Rank
Oregon	4.22%	1	Wyoming	15.1%	1
New York	3.91%	2	New York	15.0%	2
Massachusetts	3.56%	3	Hawaii	13.4%	3
Minnesota	3.39%	4	Maine	13.3%	4
Hawaii	3.30%	5	Alaska	13.2%	5
California	3.30%	6	Vermont	13.2%	5
North Carolina	3.30%	7	Rhode Island	12.3%	7
Maine	3.29%	8	Wisconsin	12.1%	8
Wisconsin	3.21%	9	West Virginia	12.1%	8
Connecticut	3.18%	10	New Mexico	12.0%	10
Virginia	3.08%	11	Connecticut	11.9%	11
Utah	3.02%	12	Ohio	11.8%	12
Delaware	2.94%	13	Nebraska	11.8%	12
Montana	2.75%	14	Louisiana	11.7%	14
Georgia	2.68%	15	New Jersey	11.7%	14
Idaho	2.64%	16	California	11.6%	16
Rhode Island	2.63%	17	Utah	11.5%	17
Arkansas	2.62%	18	North Dakota	11.5%	17
Ohio	2.62%	19	Nevada	11.4%	19
Kentucky	2.61%	20	Indiana	11.4%	19
West Virginia	2.56%	21	Minnesota	11.4%	19
Oklahoma	2.52%	22	Arkansas	11.4%	19
Maryland	2.52%	23	Delaware	11.2%	23
Vermont	2.52%	24	Arizona	11.2%	23
Nebraska	2.50%	25	Pennsylvania	11.1%	25
Kansas	2.41%	26	Illinois	11.1%	25
South Carolina	2.32%	27	MICHIGAN	11.0%	27
Missouri	2.30%	28	Kansas	11.0%	27
Iowa	2.24%	29	Kentucky	11.0%	27
Colorado	2.24%	30	Idaho	10.9%	30
New Jersey	2.23%	31	Maryland	10.8%	31
Indiana	2.19%	32	North Carolina	10.8%	31
Louisiana	2.18%	33	Mississippi	10.8%	31
New Mexico	1.98%	34	Massachusetts	10.7%	34
Pennsylvania	1.98%	35	Iowa	10.6%	35
Alabama	1.91%	36	Florida	10.6%	35
MICHIGAN	1.85%	37	Washington	10.6%	35
Illinois	1.77%	38	Montana	10.6%	38
Arizona	1.71%	39	South Carolina	10.4%	39
Mississippi	1.68%	40	Georgia	10.4%	39
North Dakota	1.27%	41	Virginia	10.4%	39
New Hampshire	0.14%	42	Oklahoma	10.1%	42
Tennessee	0.09%	43	Missouri	10.0%	43
Alaska	0.00%	-	Texas	10.0%	43
Florida	0.00%	-	Oregon	10.0%	43
Nevada	0.00%	-	Colorado	9.5%	46
South Dakota	0.00%	-	Alabama	9.2%	47

Texas	0.00%	-	Tennessee	9.2%	48
Washington	0.00%	-	New Hampshire	9.1%	49
Wyoming	0.00%	-	South Dakota	8.7%	50

Source: Census Bureau, Bureau of Economic Analysis, and Federation of Tax Administrators

2005 Per Capita Tax Collections

State Income Taxes			Total State and Local Tax Collections		
State	Per Capita	Rank	State	Per Capita	Rank
New York	\$1,561	1	New York	\$5,752	1
Massachusetts	\$1,548	2	Connecticut	\$5,398	2
Connecticut	\$1,506	3	Wyoming	\$5,251	3
Oregon	\$1,362	4	New Jersey	\$4,890	4
Minnesota	\$1,266	5	Massachusetts	\$4,470	5
California	\$1,219	6	Alaska	\$4,443	6
Virginia	\$1,156	7	Hawaii	\$4,338	7
Hawaii	\$1,140	8	Maryland	\$4,276	8
Delaware	\$1,091	9	Rhode Island	\$4,191	9
Wisconsin	\$1,070	10	Vermont	\$4,137	10
Maryland	\$1,058	11	Minnesota	\$4,088	11
North Carolina	\$1,023	12	California	\$4,055	12
Maine	\$1,014	13	Maine	\$3,960	13
New Jersey	\$978	14	Delaware	\$3,894	14
Rhode Island	\$928	15	Wisconsin	\$3,872	15
Colorado	\$839	16	Illinois	\$3,849	16
Ohio	\$833	17	Nevada	\$3,749	17
Georgia	\$829	18	Nebraska	\$3,746	18
Utah	\$826	19	Pennsylvania	\$3,710	19
Vermont	\$824	20	Virginia	\$3,657	20
Nebraska	\$824	21	Washington	\$3,651	21
Montana	\$797	22	Ohio	\$3,637	22
Kansas	\$791	23	MICHIGAN	\$3,494	23
Oklahoma	\$756	24	Kansas	\$3,415	24
Idaho	\$751	25	Indiana	\$3,405	25
Kentucky	\$737	26	Florida	\$3,369	26
Missouri	\$720	27	Colorado	\$3,363	27
Iowa	\$711	28	North Dakota	\$3,343	28
Arkansas	\$698	29	New Hampshire	\$3,306	29
Pennsylvania	\$690	30	Iowa	\$3,273	30
Indiana	\$682	31	Louisiana	\$3,173	31
West Virginia	\$676	32	New Mexico	\$3,151	32
South Carolina	\$656	33	North Carolina	\$3,149	33
Illinois	\$643	34	Arizona	\$3,079	34
MICHIGAN	\$608	35	West Virginia	\$3,060	35
Alabama	\$565	36	Oregon	\$3,052	36
New Mexico	\$551	37	Texas	\$3,015	37
Louisiana	\$538	38	Georgia	\$3,010	38
Arizona	\$512	39	Missouri	\$2,997	39

Mississippi	\$422	40	Kentucky	\$2,939	40
North Dakota	\$397	41	Utah	\$2,933	41
New Hampshire	\$54	42	Idaho	\$2,926	42
Tennessee	\$27	43	Montana	\$2,913	43
Alaska	\$0	-	Arkansas	\$2,902	44
Florida	\$0	-	Oklahoma	\$2,843	45
Nevada	\$0	-	South Carolina	\$2,779	46
South Dakota	\$0	-	South Dakota	\$2,715	47
Texas	\$0	-	Tennessee	\$2,685	48
Washington	\$0	-	Mississippi	\$2,575	49
Wyoming	\$0	-	Alabama	\$2,569	50

Source: Census Bureau, Bureau of Economic Analysis, and Federation of Tax Administrators

Further Information

Additional information on the state income tax can be found in a July 2006 report by the Department of Treasury (http://www.michigan.gov/documents/IIT_2004_167686_7.pdf), an April 1999 report by the HFA (http://www.house.mi.gov/hfa/PDFs/inco_tax.pdf) and in the chapter on Michigan's income tax in *Michigan at the Millennium* (MSU Press, 2003).

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■ 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.