Senate Fiscal Agency
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BILL ANALYSIS

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Senate Bill 3 (Substitute S-5 as passed by the Senate)
Sponsor: Senator Kristen McDonald Rivet
Committee: Housing and Human Services

Date Completed: 5-2-24

RATIONALE

The Earned Income Tax Credit (EITC) is a tax credit for low- to moderate-income families. According to testimony before the Senate Committee on Housing and Human Services, research indicates that recipients of the EITC generally use the money to pay for necessities, repair homes, maintain vehicles, and complete further education or training. These uses of the money provided by the EITC suggest that low- and moderate-income families struggle financially. In 2023, 39% of Michigan households struggled to pay for basic needs like housing, food, childcare, transportation, and healthcare.[1] Increasing the EITC's Federal match from 6% to 30% would provide relief to many low- and moderate-income families.

CONTENT **(COMPANION BILL LINK: H.B. 4001)**

The bill would amend the Income Tax Act to increase, from 6% to 30%, the EITC, beginning with the 2023 tax year, and to specify that a taxpayer who claimed the EITC in the 2022 tax year would be eligible for an additional credit equal to 24% of the amount the taxpayer would be allowed to claim as a Federal EITC in the 2022 tax year.

Under the Act, a taxpayer may credit against the individual income tax an amount equal to the specified percentages of the credit the taxpayer is allowed to claim as a credit under the Federal EITC for a tax year on a return filed under the Act for the same tax year. For tax years that begin after December 31, 2011, the specified percentage is 6%. Under the bill, this would apply for tax years that began after December 31, 2011, and before January 1, 2023. For tax years beginning after December 31, 2022, the specified percentage would be 30%.

The bill also specifies that, for the 2022 tax year only, a taxpayer who claimed the EITC on his or her individual income tax return for that year would be entitled to an additional credit of 24% of the Federal credit the taxpayer would be allowed to claim for that year. A taxpayer could not claim the additional credit on his or her return or on an amended return. Instead, the Department of Treasury would have to calculate the amount of the additional credit to be added to the taxpayer's return and recalculate the taxpayer's overpayment or tax due for the 2022 tax year. If the Department determined that the taxpayer had overpaid as a result of the additional credit, a refund would have to made as specified in Section 30 of the Act, and in the form of a fully negotiable check.

The bill states that it "is intended to be retroactive and applies retroactively effective for tax years beginning on and after January 1, 2022".

MCL 206.272

[1] Michigan Association of United Ways, "*The Alice Project*", 2024.

PREVIOUS LEGISLATION

(This section does not provide a comprehensive account of previous legislative efforts on this subject matter.)

The bill is a reintroduction of Senate Bill 417 of the 2021-2022 Legislative Session. Senate Bill 417 received hearings in the Senate Committee on Finance but saw no further action.

BACKGROUND

In the 1960's and early 1970's, there was concern in Congress over the number of individuals and families receiving welfare payments.[2] In 1964, fewer than one million families received welfare payments; by 1973, the welfare rolls had increased to 3.1 million families. This caused many policymakers to seek an alternative solution to poverty relief other than cash payments to the poor.[3] As a result, Congress considered a proposal called a "negative income tax" to aid low-income families, a tax system in which people above an income threshold pay earnings and people below an income threshold receive earnings, with received earnings gradually increasing the less an individual makes. With influence from negative income tax, President Nixon proposed the Family Assistance Plan designed to help working-poor families with children by means of a Federal minimum cash guarantee;[4] however, Senator Russell Long, Chair of the Senate Finance Committee, did not support the Plan because it distributed its largest benefits to those without earnings.[5] Instead, Senator Long proposed a "work bonus" plan which was codified into Federal statute with the Tax Reduction Act of 1975 as a temporary provision. In the years after, the work bonus plan was made permanent, expanded to distribute more money to working individuals and families, and renamed the EITC.

The Michigan EITC, a State credit that matches a percentage of the Federal credit, was enacted in 2006. Initially, the State credit was set at 10% of the Federal credit for the 2008 tax year and 20% for all subsequent tax years; however, the State credit was reduced for the 2012 tax year to 6% of the Federal credit to address the economic turmoil of the Great Recession. This State credit of 6% remained the credit at the time Senate Bill 3 was considered by the Senate Committee on Housing and Human Services on January 24, 2023. Today, the State matching rate is 30% of the Federal credit because the Legislature passed Senate Bill 3's companion bill, House Bill 4001, which took effect on February 13, 2024.

ARGUMENTS

(Please note: The arguments contained in this analysis originate from sources outside the Senate Fiscal Agency. The Senate Fiscal Agency neither supports nor opposes legislation.)

Supporting Argument

The Michigan EITC requires almost no bureaucracy within State government. Most of the work performed to calculate the State credit is done by the Federal government. After the Federal credit is calculated, State bureaucrats multiply the Federal credit by the percentage the State is matching. This process ensures that administrative costs are low and tax relief is efficiently offered to Michigan taxpayers.

Supporting Argument

The EITC has a proven track record of incentivizing individuals to rejoin the work force. In particular, EITC expansions contribute to increases in work among single mothers and female

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[2] Congressional Research Service, "*The Earned Income Tax Credit: A Brief Legislative History*", March 2018.
[3] *Id*.
[4] *Id*.
[5] *Id*.

heads of households.[6] According to testimony before the Senate Committee on Housing and Human Services, 40% of individuals who want to return to the workforce are women who need money for reliable childcare. Finally, women who benefit from EITC expansions also experience higher wage growth in subsequent years than similar women who don't benefit from the EITC.[7]

<u>Supporting Argument</u>
The EITC is effective at keeping children out of poverty and improving youth educational outcomes. The EITC has kept more children living above the poverty level than any other tax credit program in United States history. Specifically, in 2018, individual EITC's kept 5.6 million people, over half of them children, out of poverty.[8] According to testimony before the Senate Committee on Housing and Human Services, the bill was estimated to lift 32,000 Michigan residents, over half of them children, out of poverty.[9] In addition, the EITC leads to improved educational outcomes for young children in low-income households. For each $1,000 increase in annual income over two to five years, children's school performance improves on a variety of measures, including academic test scores.[10]

<u>Supporting Argument</u>
According to testimony before the Senate Committee on Housing and Human Services, the EITC is claimed on average for two years. Specifically, about 67% of claimants only claim the EITC for one or two years. The EITC generally serves as a transition into economic security, not a credit that people claim for long periods of time, which proves that the EITC is effective at reducing poverty.

<u>Opposing Argument</u>
For Fiscal Year 2020, the Internal Revenue Service (IRS) estimated that 23.5% of EITC payments were improper.[11] Federally, this accounted for $16.0 billion a year.[12] Without sufficient protections against fraud, money from the State EITC may not support the intended recipients of the credit.

<u>Response</u>: The improper payments cited by the IRS mostly consist of overpayment, not fraud, which generally concern when children can and cannot be claimed. Overpayments are often associated with a divorce decree and result in people incorrectly claiming the EITC when they believed they could. The EITC does not see a larger overpayment rate than other credits of its kind.[13]

<u>Opposing Argument</u>
According to testimony before the Senate Committee on Housing and Human Services, approximately 39% of households in Michigan struggle to meet basic needs, yet the EITC only covers 15% of households in Michigan.[14] Many working families who cannot claim the EITC would benefit if the money involved in the EITC's expansion instead came in the form of an income tax cut.

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[6] Marr, C., *et al*., Center on Budget and Policy Priorities, "*EITC and Child Tax Credit Promote Work, Reduce Poverty, and Support Children's Development*", Research Finds, October 2015.
[7] *Id*.
[8] Williams, Erica, et al, *States Can Adopt or Expand Earned Income Tax Credits to Build a Stronger Future Economy*, March 2020.
[9] Michigan League for Public Policy, *Testimony supporting Senate Bill 3 to increase Michigan's Working Families Tax Credit*, January 2023.
[10] Marr, C., *et al.*, Center on Budget and Policy Priorities.
[11] McTigue, J., *Tax Compliance*: *IRS Audit Trends for Individual Taxpayers Vary by Income*, p. 4, 2022.
[12] *Id*.
[13] *Id*.
[14] Michigan Association of United Ways, "*The Alice Project*", 2024.

Response: The EITC specifically targets individuals with low- to moderate-incomes who generally use the money to pay for necessities. An income tax cut would broaden the base of individuals who received tax relief to include taxpayers who may not need the money for necessities or to elevate themselves out of poverty. Therefore, a tax cut would take money away from individuals who used the tax relief for these purposes. The targeted relief provided by an expansion to the EITC would be better than the broad relief provided by a tax cut because more money would go toward necessities and poverty-relief.

Legislative Analyst: Eleni Lionas

FISCAL IMPACT

Based on EITCs filed between tax year 2012 and 2019, the bill would reduce General Fund revenue by approximately $441.6 million per year beginning in Fiscal Year 2022-23. The total amount claimed under the Michigan EITC has remained relatively stable, averaging $110.4 million per year between tax year 2012 and 2019. The bill would not affect School Aid Fund revenue because individual income tax revenue to the School Aid Fund is based on gross collections, which exclude the revenue impact of tax credits.

Fiscal Analyst: David Zin

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