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**Navigating Tax Reform in Michigan:
How Current Proposals Would Affect Working Families**

In the last few years, many families and young people have faced increasing challenges in their lives that have exceeded their ability to solve on their own. Critical services are infeasibly expensive for most individual budgets, and they simply do not exist at adequate levels in many parts of the state. The results are dire. Children, youth, and families cannot get the mental health care they need; literacy and high school graduation rates are falling; and parents lose out on work because they cannot find child care or afterschool and summer programs to keep their children engaged and safe while they work.

Layering onto this reality is the additional trend of rising costs of basic needs, including food, rent, and transportation. These increased costs are being borne most heavily by lower income working families and young people.

Michigan has billions of dollars in unspent federal and state revenues, which has encouraged calls for dramatically cutting our state taxes. But the fact is that our state is still failing to ensure access to critical services for young people and families, which overwhelming majorities of Michigan voters across the political spectrum support. Facing the dual crises of unavailable services and rising costs, Michigan's tax system must preserve the state's ability to invest in growing access to essential services while easing the burden of rising costs for working families and young people who have lower incomes.

Michigan's Governor and Legislature have proposed different mechanisms to return tax dollars directly to people in Michigan. These ideas vary widely in how they address the issues of maintaining strong state capacity to ensure services, which private markets have failed to provide themselves, while also relieving the current costs facing Michigan's most struggling working households.

Personal Income Tax Cut

The Michigan Legislature has proposed lowering the individual income tax rate from 4.25 percent to 3.9 percent beginning in the 2022 tax year. This would distribute widely unequal benefits, making little to no difference in the budgets of working families who struggle the most with rising costs, while delivering huge sums to the richest taxpayers. Analysis from the Michigan League for Public Policy and the Institute on Taxation and Economic Policy finds that these changes would result in $12 for the lowest 20 percent (less than $23,000) of earners; $92 for the middle ($41,000-$70,000); and $4,901 for the top 1 percent (making $539,000 or more) of Michigan earners. 69 percent of the cuts would benefit the wealthiest 20 percent, but only 31 percent of the benefits will go to the bottom 80 percent of workers.

The latest official state analysis, from the Senate Fiscal Agency, projects that this plan would reduce state revenues by $500 million in FY 2021-22, and by over $1 billion in each year going into the future.

Retirement Income Taxation

Michigan was one of 14 states with a tax loophole that exempted retirement income, but broadly restricted that loophole in 2011. Currently, individual retirees aged 70-76 can deduct $20,000 of retirement income ($40,000 for joint filers). Retirees born after 1952 can exempt less retirement income from their taxes once they turn 67. The Governor and Legislature have both proposed reinstating the loophole without a plan to replace hundreds of millions of dollars in lost revenue that would result.

The Governor's plan would phase in the loophole for retirement income for pensions, individual retirement accounts (IRAs), and some income from 401(k) accounts. Beginning for the 2022 tax year, 25 percent of this income would be made exempt from taxes, reaching 100 percent by 2025. Public-sector pensions would be entirely exempt immediately. Age eligibility would begin in 2022 for people 65 and older, lowering the next year to age 62, then age 59, and eventually any retiree by 2025. The plan would reduce state revenues by $500 million a year when fully phased in.

The Legislature's plan would increase the retirement income loophole to $40,000 for individuals and $80,000 for couples. The plan would reduce the eligibility age from 67 to 62 immediately for the 2022 tax year. When fully phased in, this plan is projected to reduce future revenues by $600-700 million. The Senate Fiscal Agency states, "These reductions would continue to rise in magnitude as population demographics increased the number of taxpayers eligible for the deductions provided under the bill."

Neither proposal has any income eligibility cap, or "means test", which means that the wealthiest retirees would be able to include their retirement income through the proposed loopholes, instead of paying a fairer share of their surplus income to invest in the needs of struggling workers and our future generations. With no means test, these proposals give more "relief" to wealthier households who are managing their finances well and have no need of state support. Neither proposal recommends any revenue increase to replace what would be lost to carry out these inequitable plans.

Earned Income Tax Credit (EITC)

The Earned Income Tax Credit EITC is one of our most effective methods of economic relief for working families who struggle most greatly with expenses. The Federal EITC is available to parents and calculated as a percentage of income. The maximum amount begins at $3,526 for one child and rises to $6,557 for three or more children. The EITC is also available at a reduced rate for childless individuals (ages 25 to 65) with an earned income, for a maximum amount of $529. The current Michigan EITC is written to mirror the eligibility of the federal EITC, and rewards 6 percent of the total federal credit, and is fully refundable. The state EITC used to reward 20 percent of the federal EITC but has since been reduced.

The Governor has recommended increasing the state's EITC from 6 percent to 20 percent of the federal credit, which would increase tax refunds by potentially thousands of dollars for many working families across the state who earn less than $42,000 or $57,000, depending on the number of children in their household. This is projected to cost the state $262 million each year.

While the Legislature has moved its other tax proposals to the Governor's desk, one proposal sponsored by Republican Wayne Schmidt has stalled. SB 417 would move the EITC to 30 percent gradually, by 2024. It would ultimately cost $460 million per year.

While increasing the state EITC is a strong step, costs for families have risen since that high-water mark of 20 percent or even 30 percent. Increasing the state EITC up to 60 percent would have a greater benefit for the overall economy. This increase would support working families who are struggling most with rising expenses, and who would spend that money in local economies and on needs for their families. It would total around $1 billion, less than the eventual cost of the costliest existing proposal for lowering the income tax.

Furthermore, lowering the age threshold for eligibility for the Michigan EITC to 19 for all childless adults and to age 18 for youth who recently experienced foster care or homelessness would also help young people. This would benefit young adults at a time when they are at their lowest-earning years, bolstering their incomes, stabilizing their essential needs, and helping them move forward with school or other credential opportunities. Current proposals to increase the value of the state EITC to 20 percent and 30 percent include no expansion of age eligibility for childless adults, or for our most vulnerable young people who are struggling to build a stable life for themselves during an unprecedented time to come of age as a working person.

Expanding childless EITC eligibility to young adults ages 19-24 is likely to cost from $22-$66 million based on how much the EITC increases. Creating eligibility for youth age 18 who have experienced foster care and homelessness can be conservatively estimated to cost from $512,000-$1.5 million per year.

Non-Refundable Dependent Tax Credit

Raising children and other dependents carries tremendous public benefit but brings increased expenses. The federal Child Tax Credit provides a tax credit with a maximum value of $2,000 per child in a family up to age 16. The credit phases out for individuals or joint filers with incomes of $200,000 and $400,000 respectively. Six states currently offer their own child tax credit. Michigan is not one of those states.

The Legislature's plan would allow a taxpayer to claim, beginning in the 2022 tax year, a credit against the individual income tax of $500 for each dependent under the age of 19 of the taxpayer. This is projected to reduce future revenues by $775 million annually, mostly affecting the state's General Fund but with potentially some reduction to School Aid Fund revenues as well.

However, the proposed credit is non-refundable, meaning that the savings a tax filer gets from this credit cannot exceed the amount that they owe. This means that for families who do not earn enough to owe taxes after other deductions, they would not receive support for the additional costs of caring for dependents including their kids. The credit also has no income cap, meaning that the wealthiest families, who can more than afford the costs of raising their own kids, would get a handout when the most struggling families wouldn't even be able to access a helping hand. A workable state-level dependent tax credit would be written to mirror the eligibility and refundability of the federal Child Tax Credit, especially the now-expired version that was enacted under the American Rescue Plan Act.

"Paying" for Equitable Tax Changes

There are opportunities to pay for fairer tax proposals including a dramatically expanded EITC that voters would support. Polling commissioned by Michigan's Children finds that over half of Democrats, Independents, and Republicans (63% Democrats, 53% Independents, 56% Republicans) would support cutting tax incentives for big businesses in order to pay for investing in children, youth, and families. Additionally, Democratic and Independent voters (82% Democrats, 45% Independents) strongly support increasing taxes on the wealthiest and big corporations instead of cutting other areas of the budget.

Increasing the wealthiest corporations' share of taxes in Michigan is now more economically feasible than it has ever been. Michigan's House Fiscal Agency reports that in the 2020-2021 Fiscal Year, "corporate income tax revenue reached new highs due to strong corporate profits." Corporate income tax revenues grew by 54 percent. Michigan can now afford a substantial tax break for struggling families.

Equitable tax policies would also cost less than initial "revenue reduction" forecasts because Michigan would recoup a great deal of that not only through increased sales tax revenue and economic growth, but also through reduced social spending needs from lifting thousands of families out of poverty.

The current state budget surplus presents an opportunity to invest in these long-suffering needs that affect young people and families in every community across our state and to prioritize tax policies that benefit families who shoulder the greatest challenges rather than the state's wealthiest earners.

Recommendations

- **Support expanding the age eligibility for the Earned Income Tax Credit and increasing its value to over 30%**. The EITC will deliver a greater share of benefit to working families and young people, who are struggling the most with rising costs, than any other proposed mechanism. An increase to 30% should be considered the low-end for possible outcomes.

- **Only support a retirement tax loophole that is means-tested** to not disproportionately benefit the wealthiest retirees **and that is paid-for** by replacing revenue from another stream.

- **Reject outright the current proposals to cut general state income taxes**, all of which provide incredibly disproportionate benefit to the wealthiest households.

- **Only support a state-level dependent tax credit (child tax credit) that mirrors the eligibility and refundability of the federal Child Tax Credit**, ideally the now-expired version that was enacted under the American Rescue Plan Act, which then would proportionately benefit families who are struggling the most with increased expenses.

- **Encourage lawmakers to only consider temporary relief to taxes on gasoline as part of the entire package of tax reforms and not as a separate effort** so we can most wisely consider the ultimate cost of reduced revenue to the state.

- **Encourage that any tax plans to benefit working families are paced to avoid returning one-time American Rescue Plan Act funds to the federal government.** These one-time federal revenues can be used to invest in growing our mental health and child care workforces, and increase critical infrastructure such as affordable housing and clean water that families need.