Michigan at a Crossroads

Michigan Tax Policy for the Incoming 2019 Gubernatorial Administration

By Charles L. Ballard
Department of Economics and
Institute for Public Policy and Social Research

Michigan State University
486 W. Circle Drive, Room 110
East Lansing, MI 48824
ballard@msu.edu

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I. Brief Overview of the Michigan Tax System

The purpose of this policy brief is to provide a concise summary of some of the most important features of the tax system in Michigan, along with a brief guide to some policy proposals. For a more detailed discussion, see Chapter 6 of Ballard (2010).

We begin with Table 1, which shows state and local tax revenues as a percent of personal income, for the 50 states and the District of Columbia in 2015.

Table 1: State and Local Taxes as Percent of Personal Income, For the 50 States and the District of Columbia, 2015

Ranking	Jurisdiction	State/Local Taxes as % of Personal Income	Ranking	Jurisdiction	State/Local Taxes as % of Personal Income
1	North Dakota	16.55	26	Oregon	9.85
2	New York	14.94	27	Kentucky	9.83
3	District of Columbia	14.31	28	Nevada	9.53
4	Hawaii	12.51	29	Montana	9.52
5	Maine	11.92	30	Kansas	9.35
6	Vermont	11.87	**31**	**Michigan**	**9.31**
7	Minnesota	11.64	32	Louisiana	9.22
8	Wyoming	11.35	33	Indiana	9.17
9	Illinois	11.31	34	North Carolina	9.16
10	West Virginia	11.23	35	Utah	9.14
11	New Jersey	11.09	36	Washington	8.99
12	New Mexico	10.96	37	Colorado	8.86
13	Rhode Island	10.90	38	Idaho	8.85
14	Connecticut	10.86	39	South Carolina	8.83
15	California	10.72	40	Texas	8.81
16	Mississippi	10.57	41	Arizona	8.79
17	Maryland	10.41	42	Missouri	8.61
18	Iowa	10.40	43	Georgia	8.58
19	Nebraska	10.20	44	Virginia	8.56
20	Wisconsin	10.15	45	New Hampshire	8.52
21	Delaware	10.13	46	Oklahoma	8.42
22	Massachusetts	10.10	47	Alabama	8.23
23	Ohio	10.08	48	South Dakota	8.05
	United States	**10.08**	49	Tennessee	7.76
24	Pennsylvania	9.94	50	Florida	7.60
25	Arkansas	9.91	51	Alaska	6.20

Table 1 shows that about 9.3 percent of personal income went to state and local taxes in Michigan in 2015. This means that Michigan ranks as the state with the 30th- highest overall tax rate (or 31st if we include the District of Columbia). For the United States as a whole, about 10.1 percent of personal income was paid in state and local taxes. Thus in terms of this measure of tax effort, Michiganders are taxed at a rate that is below the median of the 50 states, and below the national average.

A somewhat different picture emerges if we look only at taxes that are collected by the state, and ignore local taxes. Whereas Michigan is below the national average and median for state and local taxes combined, it is above the national average and median for state taxes only. In 2015, about 6.3 percent of personal income in Michigan was paid in taxes to the state government, while the national average is about 5.9 percent. When we consider state taxes only, Michigan ranks 20th among the 50 states.

The data and rankings in the previous two paragraphs show that the Michigan tax system is relatively centralized, with above-average reliance on taxes collected by the state, and below-average reliance on taxes collected by local units of government. This relatively high degree of centralization is partly the result of numerous restrictions on the ability of local governments to raise taxes. It is also the result of Proposal A, enacted in 1994, which substantially reduced local property taxes, while increasing the state sales tax.

We turn next to the composition of taxes, i.e., the relative sizes of income taxes, property taxes, sales taxes, etc. Table 2 shows the percentages of total state and local tax revenues that are accounted for by eight important taxes, for Michigan and for the national average. The entries in Table 2 are ranked from the largest source of tax revenue in Michigan to the smallest. The table shows that, when we consider all state and local taxes, property taxes are the most important source of tax revenue in Michigan, raising slightly more than one-third of all tax revenues. After property taxes, income taxes and sales taxes are the next two most important sources of tax revenue. If we add these three taxes together, we find that they account for about 81 percent of total state and local tax revenues in Michigan.

If we compare the two columns in Table 2, we see that the state and local tax system in Michigan is quite similar to the national average. For the eight taxes shown in Table 2, the rank ordering in Michigan is nearly identical to the rank ordering for the national average, and the percentages are very similar. The state and local tax system in Michigan relies somewhat more heavily on property taxes than the national average, but none of the percentages for Michigan is dramatically different from its national-average counterpart.

In Table 3, we show the same breakdown as in Table 2, except that Table 3 applies only to the revenues collected by the State of Michigan. Most property taxes are collected at the local level. As a result, whereas property taxes are the largest source of state and local tax revenue, they are considerably smaller than sales taxes and income taxes for the state by itself. Note, however, that property taxes are considerably more important for the State of Michigan than for the national average of the 50 states. Nevertheless, our conclusion from Table 3 is once again that Michigan's tax system is fairly typical.

Table 2: Selected Taxes as Percent of Total State and Local Tax Revenues, For Michigan and for the Average of the 50 States and the District of Columbia, 2015

Type of Tax	Michigan	Average For All 50 States and D.C.
Property Taxes	34.49	31.14
Income Taxes	23.41	23.48
Sales Taxes	23.17	23.50
Corporate Taxes	2.98	3.65
Motor Vehicle License Fees	2.56	1.69
Motor Fuel Taxes	2.54	2.80
Tobacco Taxes	2.41	1.16
Alcoholic Beverage Taxes	0.37	0.45

Table 3: Selected Taxes as Percent of Total State Tax Revenues, For the State of Michigan and for the Average of the 50 States, 2015

Type of Tax	Michigan	Average For All 50 States
Sales Taxes	34.17	31.43
Income Taxes	32.74	36.91
Property Taxes	7.28	1.68
Corporate Taxes	4.40	5.34
Motor Vehicle License Fees	3.78	2.69
Motor Fuel Taxes	3.75	4.66
Tobacco Taxes	3.56	1.94
Alcoholic Beverage Taxes	0.54	0.71

II. What Would a "Good" Tax System Look Like?

Now that we have described the Michigan tax system, it makes sense to ask what characteristics a "good" tax system would have. We put "good" in quotes, because the characteristics that we discuss here are sometimes in conflict with each other. Also, there is great disagreement, among economists and in the broader public, about how taxes should be distributed across income classes. Consequently, we cannot describe a tax system that would be universally accepted as the optimal system, but we can lay out the major issues.

Raising Revenues

Without the need to raise revenue to pay for government expenditures, most taxes would not exist. (Exceptions include the taxes on alcoholic beverages and tobacco products, which are often justified on the basis that they discourage unhealthy behaviors.) Thus raising adequate revenue is the single most important criterion for a good tax system. However, there is great controversy about the optimal level of expenditure that should be undertaken by governments at all levels. We cannot resolve that controversy, in large part because it depends on moral values. However, we can note that, as shown in Table 1, Michigan is a relatively low-tax state. If state and local tax revenues in Michigan were at the national average (as a fraction of personal income), the total amount of tax revenue available for governments in Michigan would increase by more than $3 billion per year. Moreover, the portion of income that is paid in state and local taxes has decreased substantially in recent decades. If state and local tax revenues collected in Michigan were to account for the same fraction of personal income that they accounted for in the 1970s, they would be larger than they are now by more than $10 billion per year. Thus it is possible to provide a major increase in revenues for education, infrastructure, and other needs without making Michigan a high-tax state, relative to other states or to the level of state and local taxes that were once collected in Michigan.

Part of the long-term decline in tax revenues in Michigan has been due to explicit reductions in tax rates. However, a great deal of the decline has been the result of structural features of the tax system. As a result of these structural features, the real revenue-raising capacity of the tax system has decreased over time, even when tax rates have stayed the same.

The largest of these structural features is the non-taxation of most services and entertainments in the sales tax. For decades, services and entertainments have grown more rapidly than the things that are taxed. As a result, the sales tax (in Michigan and in most of the other 45 states that have a sales tax) applies to an ever-shrinking portion of the economy. In recent years, the sales tax has applied to less than 40 percent of Michigan's economy.

Another structural feature that inhibits revenue growth is the unusual way in which alcoholic beverages are taxed. Most taxes are levied on an *ad-valorem* basis, which means that the tax is a percentage of the dollar value of some transaction. Income taxes, property taxes, and sales taxes are all examples of *ad-valorem* taxes. If inflation pushes prices up, then the revenue generated by an *ad-valorem* tax will also rise. However, alcoholic beverages are taxed on a *per-unit* basis. Taxes on alcoholic beverages are a particular number of dollars per barrel, or per gallon. Unless the tax rate is explicitly raised, the real (inflation-adjusted) value of the tax revenue will decrease over time. The tax rate on wine has stayed the same since 1981, and the tax rate on beer has stayed the same since 1966. The inflation of the last half century has meant that the revenues from these taxes are only a shadow of what they once were. (The taxes on tobacco products and motor fuels are also levied as unit taxes, but the tax rates on these products have been increased on occasion, so that the revenues have not eroded as much as the revenues from the taxes on alcoholic beverages.)

The population in Michigan is aging, just as it is aging in most regions of the United States. Also, the income tax in Michigan is very generous toward retirement income. (We will discuss this in more detail below.) When we combine an aging population with an income tax that does not apply to retirement income as much as it applies to labor income, we have another feature of the tax system that collects a shrinking share of the economy over time.

One final structural feature that curtails tax revenues in Michigan is the taxable value cap in the property tax. Since the passage of Proposal A in 1994, the rate of growth of the taxable value of any property has been effectively limited to the overall rate of inflation, which has typically been around 2 percent during that period. Thus, when the true market value of a property increases more rapidly than inflation, the taxable value will fall further and further below the market value. The revenue losses from this feature of the tax system are compounded by the fact that the market value of many properties declined substantially in the middle of the first decade of the 21st century, which caused the taxable values of many properties to be re-set to the lower value. However, when property values rebounded, the taxable value cap put severe limits on the speed with which revenues could recover.

Revenue Stability

In the preceding section, we discussed the *level* of tax revenue. A related issue is the *stability* of tax revenue. Even if tax revenues are considered to be adequate when averaged over a number of years, it is problematic if revenues are unstable from year to year. Revenue instability emerged as a major issue in the late 1960s and early 1970s, when Michigan had a corporation income tax. Corporate profits have bigger cyclical ups and downs than most other sources of income, and the cyclical swings can be especially large in a state like Michigan, in which the economy depends to

a significant degree on the durable-goods manufacturing sector. As shown by Hines (2003), corporate income tax revenues in Michigan plummeted downward by 38 percent from 1969 to 1971, surged upward by more than 100 percent from 1971 to 1973, and then fell by more than 40 percent from 1973 to 1975.

In response to this roller-coaster ride of revenues, Michigan discontinued the corporation income tax in 1975. The revenues from the corporation income tax and several other taxes were replaced by the "Single Business Tax" (SBT). The SBT was a type of value-added tax, and its effects were similar to the effects of a uniform sales tax. As shown by Hines (2003), the SBT succeeded in producing a much more stable revenue stream than that of the corporate tax.

Despite its many favorable features, the SBT came under political attack on many occasions, and it became riddled with a variety of special provisions. It was finally replaced by the "Michigan Business Tax" (MBT) in 2007. The MBT included a modified version of a gross-receipts tax, which is one of the most inefficient taxes ever devised. In many respects, the MBT was worse than its predecessor, the SBT. Finally, in 2011, the MBT was replaced with a corporation income tax.

Thus we have come full circle, eliminating the corporation income tax in 1975 and bringing it back in 2011. As described above, the revenues from a corporation income tax can vary substantially over the business cycle. So far, fortunately, the U.S. economy has continued to expand throughout the period of the new corporation tax in Michigan. If the current expansion continues until the autumn of 2019, it will be the longest economic expansion in American history. However, there is no reason to believe that recessions have been permanently repealed. When the next recession comes, revenues from many sources can be expected to fall, and revenues from the corporation income tax can be expected to fall more than most other sources. On the bright side, there is reason to believe that the revenues from the corporation income tax may not be as unstable as they were from 1969 to 1975. This is because Michigan's reliance on the cyclically sensitive durable-goods manufacturing sector is not nearly as heavy as it once was.

Minimizing the Costs of Administration and Compliance

Every tax imposes costs on society, over and above the actual revenue that is raised. These include the costs of administration and compliance. Administrative costs are the costs that are incurred by the government when it collects taxes. These include the salaries of the auditors, attorneys, and clerks who run the tax system, as well as various other costs. Compliance costs are the costs that the taxpayers incur, when they spend time keeping records and filling out forms, or when they spend money to hire tax preparers. All else equal, it would be good for the costs of administration and compliance to be as small as possible.

Our assessment is that the Michigan tax system scores reasonably well, in terms of keeping administrative and compliance costs in check. One reason for this is that most taxes in Michigan (as in other states) are remitted by businesses. Employers withhold income taxes, and transmit them to the State government and to the cities that levy a separate income tax. Retail establishments remit sales taxes to the State government. Financial institutions assist with the payment of property taxes. These arrangements help to reduce administrative and compliance costs, since businesses have administrative infrastructures that allow them to process these payments efficiently. Another thing that reduces administrative and compliance costs is that the Michigan individual income tax "piggy-backs" on the federal income tax.

Although the administrative and compliance costs of taxes in Michigan are reasonably low, there still are ways in which these costs could be reduced further. Often, administrative and compliance costs can be reduced by making the tax system simpler. In the case of the income tax, this would involve a reduction in the number of credits. In the case of other taxes, simplification would involve taxing things in a more uniform way.

Economic Efficiency

Taxes distort the behavior of households and businesses, by affecting decisions about what to produce, what to buy, how much to work, and how much to save. For example, an income tax or a payroll tax may lead some people to change their decisions about how many hours to work, or whether to work at all. Another example of a tax-related distortion comes from the fact that, although consumers are supposed to pay sales tax on interstate mail-order or Internet purchases, these taxes are often evaded. As a result, some consumers may choose to do their shopping over the Internet in an effort to reduce taxes, even though (in the absence of tax considerations) it would have been better to shop at a local brick-and-mortar store. Another example of a tax distortion is a result of the fact that different states have different rates of sales tax, as well as different rates of tax on motor fuels and tobacco products. As a result, some consumers will cross state lines to make their purchases in an effort to reduce taxes, even though (in the absence of tax considerations) it would have been better to stay closer to home, and thus to avoid the time costs and other costs of a trip across state lines.

It can be said that these and other tax-related distortions mess up the allocation of resources in the economy, as people and businesses make their decisions on the basis of tax considerations, rather than on the basis of the fundamentals of cost and value. In the jargon of economists, tax-related distortions can generate "economic inefficiency", and economists have developed methods for measuring the dollar amount of these inefficiencies. In other words, it is possible to estimate that a particular tax is associated with a particular dollar amount of economic inefficiency. All else equal, it would be good to minimize these inefficiencies.

The size of the inefficiencies will depend on the size of the tax—all else equal, higher tax rates are associated with larger

inefficiencies. The size of the inefficiencies also depends on the extent to which households and businesses respond to the taxes—all else equal, the inefficiencies will be larger if households and businesses change their behavior more in response to the tax, rather than less. (In the jargon of economists, the inefficiencies are greater when the elasticities of the taxed behaviors are greater.)

We have seen that Michigan is generally a low-tax state. Thus, when we focus on tax rates, the inefficiencies created by the Michigan tax system are probably smaller than average. In addition, in Michigan (as in most states) a substantial fraction of taxes is levied on labor earnings. Labor earnings do not typically respond a great deal to taxes, which means that the inefficiencies associated with taxes on labor earnings are smaller than the inefficiencies associated with some other taxes. This is another way in which the Michigan tax system scores reasonably well in terms of economic efficiency.

However, the sales tax creates inefficiencies that are far larger than necessary. The reason for this, as mentioned above, is that the sales tax in Michigan only applies to a fraction of the economy. If we were to broaden the base of the sales tax to include services and entertainments, it would be possible to raise the same amount of revenue that is currently raised by the sales tax, while reducing the rate of the sales tax from its current 6 percent to a substantially lower rate. The same would be true if we were to broaden the base of the sales tax by stronger enforcement of taxes on interstate mail-order and Internet sales. This would improve the efficiency of the sales tax substantially. In other words, if we were to broaden the base of the sales tax and lower the rate, inefficiency would be reduced.

Fairness

All else equal, it would be good to have a tax system that is "fair". However, there is wide disagreement about what constitutes fairness. We cannot resolve these disagreements, although we can provide some vocabulary and examples.

Horizontal Equity

Economists refer to two categories of fairness. The first is called "horizontal equity", which is the principle that similar taxpayers should be taxed similarly. We have already mentioned the taxable value cap in the property tax in Michigan. Over time, the taxable value of a property can fall substantially below its market value. However, when the property is sold, the taxable value "pops up" to the true market value. This means that a long-time homeowner may pay substantially less property tax than one who has only recently purchased a home, even if the two properties have the same market value. Thus neighbors in identical houses may be required to pay very different amounts of property tax. This is widely viewed as a violation of horizontal equity. See Skidmore, Ballard, and Hodge (2010).

As mentioned above, the sales tax in Michigan applies only to a fraction of the economy. Thus two people who spend the same amount of money will pay different amounts of sales tax, depending on whether they buy taxable goods or untaxed services. If you buy a lawnmower, you pay tax. If you hire a lawn-mowing service, you pay no tax. This is another source of horizontal inequity.

The Michigan income tax has long been very generous toward retirement income. Thus a retiree would pay much less income tax than a worker, even if the two have exactly the same income. This is clearly a violation of horizontal equity. Until 2011, the Michigan income tax was truly extraordinary in its generosity toward retirement income. As discussed by Menchik (2003), the Michigan income tax excluded Social Security income and public pension income from tax entirely, and it provided a large exemption for private pension income. In addition, the Michigan income tax provided senior citizens with a substantial exemption for interest, dividends, and capital gains. Data from 1999 indicate that the overwhelming majority of Michigan residents aged 65 and over paid no income tax to the State of Michigan. In addition, many received an enhanced refundable credit in the income tax, as part of an effort to offset the effects of property taxes. Thus, on net, Michigan seniors paid less than zero in income taxes. Menchik (2003) finds that the average tax rate for senior citizens in the Michigan income tax was negative 3.4 percent.

In 2011, the tax preferences for retirement income were scaled back slightly. The previous treatment was essentially maintained for those born before 1946. Those born between 1946 and 1952 are eligible for special deductions (not available to younger persons) of $20,000 for single persons or married couples filing separately, and $40,000 for married couples filing jointly. For those born after 1952, most pension benefits are taxable. However, Social Security benefits included in adjusted gross income, military pensions, Michigan National Guard pensions, and Railroad Retirement benefits continue to be exempt from the Michigan income tax. Thus the treatment of retirement income in the Michigan income tax has gone from extraordinarily generous to merely very generous. As a result, the tax treatment of retirement income is still a source of horizontal inequity, although the horizontal inequity is not as severe as it once was.

Vertical Equity

The second category of fairness is called "vertical equity", which is the principle that those with higher incomes should pay more in tax than those with lower incomes. In fact, there is fairly wide agreement that a household with $1,000,000 of income should pay more in taxes than a household with income of only $30,000. However, there is extremely wide disagreement about *how much* more the more affluent household should pay.

If the percentage of income paid in tax increases as income increases, we say that the tax is "progressive". If the percentage of income paid in tax remains constant as income increases, we say that the tax is "proportional". If the percentage of income paid in tax decreases as income increases, we say that the tax is "regressive".

Most economists agree that sales taxes are regressive. This is because a sales tax applies only to expenditures, so that saving is untaxed by the sales tax. Since more affluent households have a higher propensity to save, the percentage of their income that is paid in sales tax will be lower than the percentage paid in sales tax by low- and middle-income households.

The Michigan income tax is somewhat progressive over much of the range of incomes. This is because the income tax has personal exemptions. As of this writing, the exemption is $4000 per person. This means that, for a family of four, the first $16,000 of income is exempt from any income tax. An exemption of $16,000 will eliminate the income tax entirely for the very poorest families, and it will remove half of income from tax for a family with income of $32,000. On the other hand, a $16,000 exemption will shield only a small fraction of income from tax for a household with income in the hundreds of thousands of dollars. This means that the average tax rate will gradually increase as income increases, because the exemption will apply to a shrinking fraction of income as we go up the income scale. Consequently, the exemptions impart some progressivity to the income tax, mainly in the lower and middle income ranges.

However, the progressivity of the Michigan income tax is limited, because all taxable income is taxed at the same rate of 4.25 percent. In an income tax with a single marginal rate, such as in Michigan, the exemptions impart some progressivity at low and middle incomes, but the tax becomes very close to proportional at higher incomes. By contrast, the federal government, 36 states, and the District of Columbia have income taxes with graduated marginal rates, *i.e.*, marginal tax rates that increase as we move up the income scale. An income tax with graduated marginal rates can have substantial progressivity at much higher income levels than an income tax with a single flat rate.

The Earned Income Tax Credit (EITC) is an earnings subsidy for low-income households. It operates as a refundable credit, which means that if the household's tax liability is zero, the household will receive a check from the government. Since it is targeted at low-income households, the EITC is clearly motivated (at least in part) by a desire to increase the progressivity of the tax system. Unlike old-style cash-assistance programs, the EITC encourages labor supply, since it can only be received by households with labor income. Thus, for households with at least one able-bodied person, the EITC is widely regarded by economists as being more effective at helping low-income households than either cash-assistance programs or minimum-wage laws.

The federal EITC was signed into law by President Gerald Ford in 1975. Expansions of the EITC were signed by Presidents Ronald Reagan, George H.W. Bush, and Bill Clinton. Over the years, many states decided to supplement the EITC; Michigan did so in 2007. The Michigan EITC originally was equal to 20 percent of the federal EITC, but it was scaled back to 6 percent of the federal EITC in 2011.

We have already mentioned the fact that the taxes on alcoholic beverages are levied on a per-unit basis, whereas income taxes, sales taxes, and property taxes are levied on an *ad-valorem* basis. In addition to eroding the revenue-raising capacity of the tax over time, unit taxes also introduce an odd type of vertical inequity. The tax on a $6 bottle of wine is the same number of dollars as the tax on a $60 wine, which means that the tax on the $6 bottle is a much larger *percentage*. Since consumption of high-end beverages is correlated with income, this means that high-income drinkers of alcoholic beverages will pay lower tax rates than those with lower incomes. This also introduces a type of horizontal inequity.

III. Policy Proposals

Most proposed changes in tax policy will be met with political opposition. Thus, from a *political* perspective, tax reform is rarely easy. However, the purpose of this policy brief is to provide background from an *economic* perspective. Thus, we now proceed to some policy proposals, with the full understanding that it may be difficult to enact them into law, even if the economic arguments are unassailable.

Extending the Sales Tax to Service and Entertainments

The sales tax applies to most items that are bought in a hardware store or department store, but it applies to very few services and entertainments. We have seen that this creates economic inefficiency and horizontal inequity, and it erodes the revenue-raising capability of the sales tax over time. If there could ever be a slam dunk for economic policy, it would be to extend the sales tax to services and entertainments. This would shore up the revenue-raising capacity of the tax system, and it would make the tax fairer and more efficient. Broadening the base of the sales tax is an especially attractive policy for those who would like to raise more revenue to provide for investments in education and infrastructure. If we were to broaden the base of the sales tax, it would be possible to *increase* tax revenues while *reducing* the tax rate. The same would be true if we were to strengthen the enforcement of the tax on interstate mail-order and Internet purchases.

Converting the Taxes on Alcoholic Beverages to an Ad-valorem Basis

As mentioned above, the taxes on alcoholic beverages are levied on a unit basis. This erodes the revenue-raising capacity of these taxes over time, and it introduces horizontal and vertical inequity. The solution, which is very simple, is to convert these taxes to an *ad-valorem* basis. It would be straightforward for

economists in the Michigan Department of Treasury to calculate the *ad-valorem* tax rates that would raise the same amount of tax revenue that is currently being raised. At the same time, it would also be reasonable to consider an *ad-valorem* tax rate that would raise *more* revenue than is currently being raised. This could offset the erosion that has taken place as a result of inflation over the last several decades. Also, higher taxes on alcoholic beverages may have the beneficial effect of reducing some of the anti-social behaviors associated with excessive consumption of alcohol. Thus, a case can be made for raising the real, inflation-adjusted tax rates on alcoholic beverages to something like their previous levels, both in term of tax policy and in terms of public health.

Removing or Relaxing the Taxable Value Cap in the Property Tax

As we have seen, the taxable value cap reduces the revenue-raising capacity of the property tax, and it introduces horizontal inequity. These problems could be reduced by increasing the limit on the amount by which taxable value can increase in a given year, and they could be eliminated by removing the limit.

Establishing a Graduated Income Tax

It would be straightforward to design a graduated income tax that provides a tax cut to 90 percent of Michigan households, while still raising an amount of revenue that is as great as or greater than the amount raised currently.

It can be argued that the biggest economic phenomenon in the United States in our lifetime is the remarkable increase in income inequality. Other than raising revenue, the main purpose of a graduated income tax is to augment the progressivity of the tax system, in an effort to reduce inequality.

It should be noted that, unlike the other policies discussed here, a graduated income tax would require an amendment to the Michigan Constitution.

Increasing the Earned Income Tax Credit

The federal EITC provides the largest amounts for families with children. Since the Michigan EITC is calculated as a percentage of the federal EITC, it follows that the Michigan EITC also provides the largest amounts for families with children. Michigan formerly augmented the federal EITC by 20 percent, but this was reduced to 6 percent in 2011. If the EITC were increased, to 20 percent or to some other figure, it would increase the incomes of low-income working households, especially those with children. The EITC is similar to the graduated income tax, in that it increases the progressivity of the tax system.

Cutting Tax Rates

In 2017, there was active discussion of a reduction in the rate of the Michigan income tax, from its current 4.25 percent to 3.9 percent. This measure failed in the Michigan House of Representatives, but the proposal continues to receive attention. If enacted, this proposal would provide no benefits for those whose incomes are sufficiently low that they do not currently pay income tax, and it would provide the largest benefits to those with high incomes. Thus this proposal goes in the opposite direction from the proposals for a graduated income tax or an EITC, by reducing the progressivity of the tax system.

During the debate in the House of Representatives in 2017, some argued that a tax cut would provide such a large amount of additional economic growth that it would pay for itself. There is no reason to believe that this will occur. In all likelihood, if such a tax cut were enacted, it would reduce revenues by several hundred million dollars per year.

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