



Budget Briefing: FY 2024-25 State Tax Revenue Overview

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Briefing Topics

- Explanation of Terms
- Major State Taxes
- Recently Enacted Tax Changes
- Major State Funds
- Revenue Trends

Explanation of Terms

Fiscal Year: The state's fiscal year (FY) runs from October to September. FY 2024-25 is October 1, 2024 through September 30, 2025.

Earmark: A specific designation for some or all of the revenue generated by a tax. Earmarks can be either constitutional or statutory.

Deductions and Exemptions: Deductions and/or exemptions are amounts subtracted from the tax base before the tax rate is applied to determine the tax liability. An exemption can also mean a specific item or activity that is explicitly excluded from taxation.

Credits: Unlike deductions and exemptions, which reduce the base of a tax, credits reduce a taxpayer's liability after the rate has been applied. Credits can either be refundable, in which case a taxpayer will receive a refund if the credit exceeds the tax liability, or non-refundable, in which a credit can only be used to the point where no tax liability remains.

Note: Unless otherwise indicated, historical revenue amounts in this presentation have not been adjusted for inflation.

Major State Taxes

Major State Taxes

- Individual Income Tax, which includes the Flow Through Entity (FTE) tax
- Consumption based taxes, which include sales, use, tobacco, beer and wine, and liquor taxes. Sales, use, and tobacco taxes are by far the largest components.
- Business taxes, which are comprised of the single business tax (SBT), the Michigan business tax (MBT), the corporate income tax (CIT), and insurance company taxes.
- Statewide property taxes, which are the state education tax (SET), the real estate transfer tax (RET), the essential services assessment (ESA).
- Some of these taxes include earmarks to specific funds, such as the School Aid Fund (SAF) or the Comprehensive Transportation Fund (CTF). In general, any revenue not otherwise earmarked becomes General Fund/General Purpose (GF/GP) revenue.
- This overview does not include gasoline and diesel taxes because they are earmarked to the Michigan Transportation Fund and are discussed as part of the Transportation budget briefing.

Major State Taxes

Estimated FY 2024-25, \$ in Millions

Tax	GF/GP	SAF	Total
Individual Income Tax	\$8,419	\$3,913	\$13,001
Sales Tax	1,664	7,996	10,914
Use Tax	1,206	940	2,716
Tobacco Taxes	138	244	697
Business Taxes	1,506		1,506
State Education Tax		2,803	2,803
Real Estate Transfer Tax		385	385
TOTAL	\$12,932	\$16,281	\$32,022

Notes

- 1) All economic and revenue estimates in this budget briefing are from the January 2024 Consensus Revenue Estimating Conference.
- 2) The GF/GP and SAF amounts may not sum to the total shown due to rounding and/or because some taxes contain earmarks that direct revenues to other funds.
- 3) Business Taxes are comprised of the single business tax, the Michigan business tax, the corporate income tax, and insurance company taxes.
- 4) These taxes account for 96.4% of combined GF/GP and SAF tax revenue.

Individual Income Tax

- The starting point for the tax base is adjusted gross income (AGI) from the taxpayer's federal tax return. The tax rate is currently 4.25% (temporarily 4.05% in CY 2023) and taxpayers receive a personal exemption of \$5,400 per dependent in TY 2023 and is estimated to be \$5,600 in TY 2024.
- 2023 PA 4 provides for a phase-out of the three-tier system of taxing retirement and pension benefits.
- Both the Homestead Property Tax Credit (HPTC) and the Earned Income Tax Credit (EITC) are refundable.
- Gross income tax revenue is the sum of withholding from wages and salaries, the flow-through entity tax, estimated quarterly payments, and annual payments. Net income tax revenue is gross income tax revenue less refunds.
- Approximately 25% of gross income tax revenue is earmarked to the School Aid Fund.
- \$600 million of net income tax revenue is earmarked to the Transportation Fund and \$69 million is earmarked to the Renew Michigan Fund.
- Beginning in FY 2022-23 (TY 2023), the income tax rate will be automatically reduced if prior year GF/GP revenue is greater than 1.425 times GF/GP revenue in FY 2020-21, adjusted for inflation.

Sales Tax

- The sales tax is imposed on retailers' gross taxable sales of tangible personal property not exempt by law.
- The maximum rate as set forth in the Constitution is 4%, plus the additional 2% approved by voters in 1994.
- Major exemptions from the sales tax include food not for immediate consumption, prescription drugs, and most services.
- 100% of the net sales tax revenue from the additional 2% levy is earmarked to the School Aid Fund.
- 60% of net sales tax revenue from the 4% levy is earmarked to the School Aid Fund.
- 15% of net sales tax revenue from the 4% levy is earmarked to cities, villages, and townships, and is distributed on a per capita basis.
- Smaller distributions are made to the Comprehensive Transportation Fund and the Michigan Health Initiative.

Use Tax

- The use tax complements the sales tax in that it applies to purchases subject to the sales tax but on which no sales tax was collected. In addition, the use tax applies to some services.
- The most prominent examples of the use tax are auto leases, rental cars, telecommunications, and mail order or Internet purchases on which the seller does not collect and remit the sales tax.
- The maximum rate is 4%, plus the additional 2% approved by voters in 1994.
- 100% of the net use tax revenue from the additional 2% levy is earmarked to the School Aid Fund.
- About one-third of the 4% amount (\$569.8 million in FY 2024-25) is levied by the Local Community Stabilization Authority to reimburse local units of government for the loss of personal property tax revenue due to the phase-out.
- The remainder of the 4% amount accrues to the General Fund.

Tobacco Taxes

- Both cigarettes and other tobacco products (cigars, pipe tobacco, smokeless tobacco, etc.) are subject to tobacco taxes.
- Cigarettes are taxed at a rate of \$2.00 per pack while other tobacco products are taxed at 32% of the wholesale price. Vaping products are not subject to tobacco taxes.
- Approximately 41.4% of cigarette tax revenue is earmarked to the School Aid Fund. The SAF receives about 35.0% of all tobacco tax revenue.
- Approximately 19.0% of cigarette tax revenue is earmarked to the General Fund. The GF receives about 19.9% of all tobacco tax revenue.
- Approximately 31.6% of cigarette tax revenue and 38.3% of all tobacco tax revenue is earmarked to the Medicaid Trust Fund.
- Smaller distributions are earmarked to the Healthy Michigan Fund, the Health and Safety Fund, the Michigan State Capitol Historic Site Fund, and to Wayne County for indigent health care.

Business Taxes

- The single business tax was enacted in 1976 but was subsequently repealed effective December 31, 2007.
- It was a value added tax imposed on all business activity in Michigan, regardless of business classification (sole proprietorship, partnership, S Corporation, C Corporation, etc.).
- The SBT was replaced by the Michigan business tax effective February 1, 2008, although the MBT was subsequently repealed effective December 31, 2011.
- Like the SBT, the MBT was broad-based in that it applied to all business activity in Michigan, regardless of organizational structure.
- Although the MBT was been repealed, taxpayers with existing certificated credits issued by the Michigan Economic Growth Authority (MEGA) must continue filing under the MBT to receive the credits.
- The credits are expected to reduce GF/GP revenue by about \$503 million in FY 2024-25.

Business Taxes

- The Corporate income tax replaced the MBT effective February 1, 2012.
- Unlike the SBT and MBT, the CIT only applies to C Corporations, which has significantly reduced the number of taxpayers.
- The CIT rate is 6%, and it applies to business income apportioned to Michigan.
- While the SBT and MBT both allowed several types of credits, the only CIT credit is for small businesses.
- The transition from the MBT to the CIT reduced revenue derived from business taxes by over \$1.0 billion.
- Both Michigan and foreign (non-Michigan based) insurance companies are taxed at a rate of 1.25% of gross direct premiums written.
- 2023 PA 4 earmarked \$600.0 million of CIT revenue: SOAR Fund (\$500.0 million through FY 2025), Revitalization and Placemaking Fund (\$50.0 million through FY 2025), and MI Housing and Community Development Fund (\$50.0 million in perpetuity).

State Property Taxes

- The state education tax (SET) is a 6-mill levy against the taxable value of real property (land and structures) and personal property not otherwise exempt.
- The real estate transfer tax (RET) is assessed at 0.75% of the fair market value of real property.
- The state essential services (ESA) levy is imposed on businesses that reduce their liabilities by virtue of the phase-out of eligible manufacturing personal property (EMPP).
- All revenue from the SET and RET is earmarked to the School Aid Fund.
- Revenue from the ESA accrues to the General Fund.

Recently Enacted Tax Changes

Transportation Revenue

- Public Acts 174-180 of 2015 implemented a number of tax changes with the intent of generating new revenue as well as redirecting existing revenue for road maintenance.
- Per gallon tax rates of \$0.19 for gasoline and \$0.15 for diesel increased to \$0.263 on January 1, 2017 and will be adjusted annually for inflation beginning in CY 2022 with a maximum annual increase of 5%.
- The current per gallon rates are \$0.300 as of January 1, 2024.
- Registration fees increased by about 20% on January 1, 2017. Electric and hybrid vehicles are subject to an additional surcharge.
- A portion of GF/GP individual income tax revenue is earmarked to the Michigan Transportation Fund. The legislation redirects \$600 million in FY 2020-21 and each year there after.

Other Recent Tax Issues

- The Department of Treasury issued Revenue Administrative Bulletin 2018-16 on August 1, 2018 to implement essentially the same provisions as South Dakota to require certain out-of-state retailers to remit sales tax revenue. Public Acts 145 and 146 of 2019 codified this treatment.
- Public Acts 143 and 144 of 2019 extended the requirement to collect and remit sales and use tax revenue on remote sales to marketplace facilitators.
- Initiated Law 1 of 2018 legalized recreational marihuana, subject to certain conditions, and established a 10% excise tax. The revenue is earmarked to the School Aid Fund (35%), Transportation Fund (35%), counties where businesses are located (15%), and local governments where businesses are located (15%).

Other Recent Tax Issues

- Public Act 152 of 2019 legalized Internet gaming in Michigan and imposed tax rates of between 20% and 28% on the adjusted gross receipts of an Internet gaming provider.
- Public Act 134 of 2021 created the flow-through entity tax that allows non-C corporations (which file under the corporate income tax) to elect to file either at the entity level or have the recipients of flow-through income claim it on their individual income tax returns. The flow-through entity tax rate is 4.25%, the same as the individual income tax.
- Public Act 150 of 2021 increased the personal property true cash value exemption threshold from \$80,000 to \$180,000.
- Public Act 4 of 2023 included a phase-out of the three-tier system of taxing retirement and pension benefits, increased the value of the state earned income tax credit to 30% of the federal benefit, and earmarked up to \$600.0 million of corporate income tax revenues.

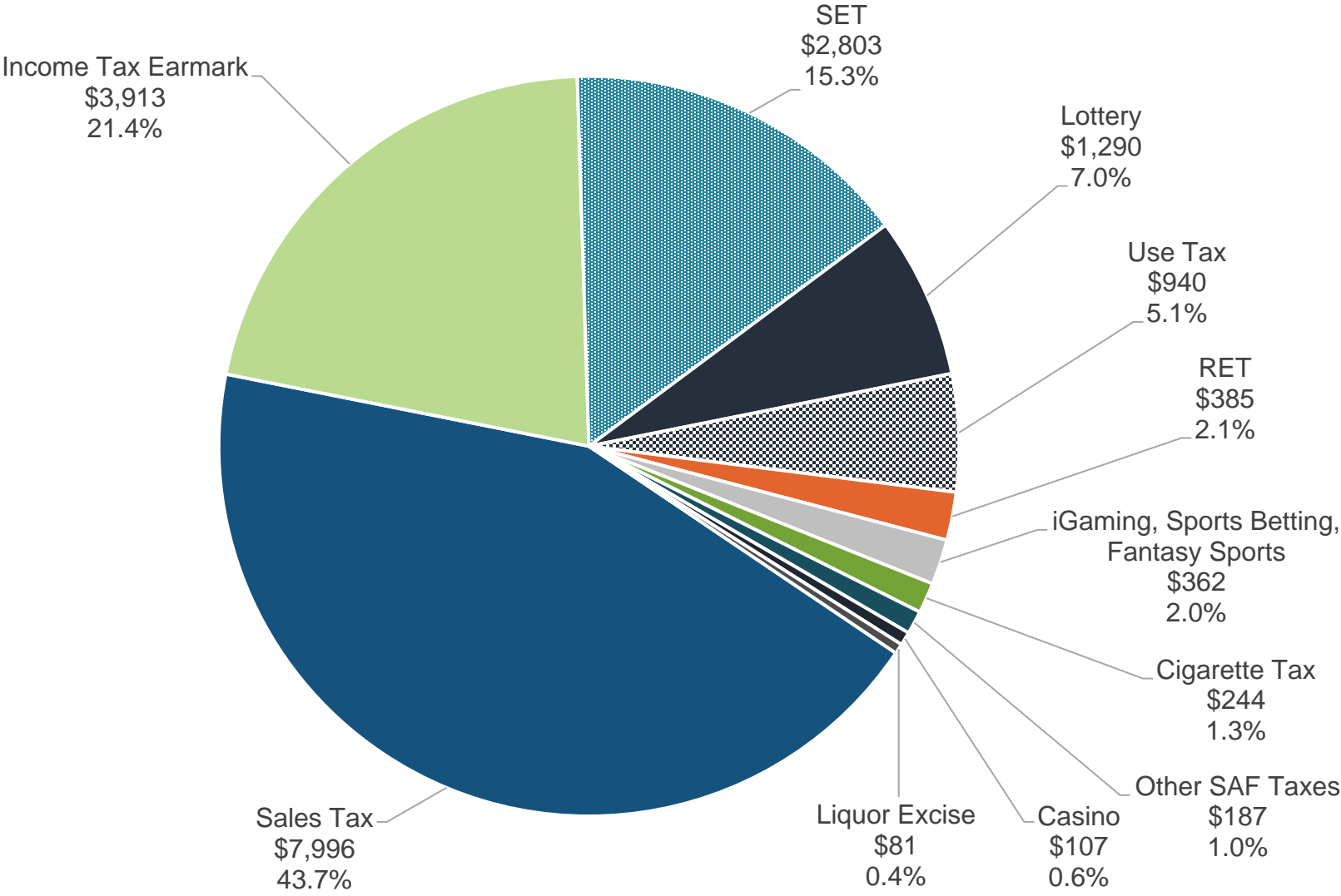
Major State Funds

Major State Funds

- The School Aid Fund is used primarily to fund K-12 education, although a portion is also appropriated to community colleges.
- The major sources of SAF revenue are the earmark from the individual income tax, consumption taxes, the 6-mill state education tax, the real estate transfer tax, online and casino gaming revenue, the excise tax on recreational marihuana, and net lottery proceeds.
- Unless otherwise specified, most remaining revenue becomes General Fund/General Purpose revenue.
- GF/GP revenue can be appropriated to any specific budget and/or program.
- Major sources of GF/GP tax revenue include the individual income tax, consumption taxes, and business taxes.

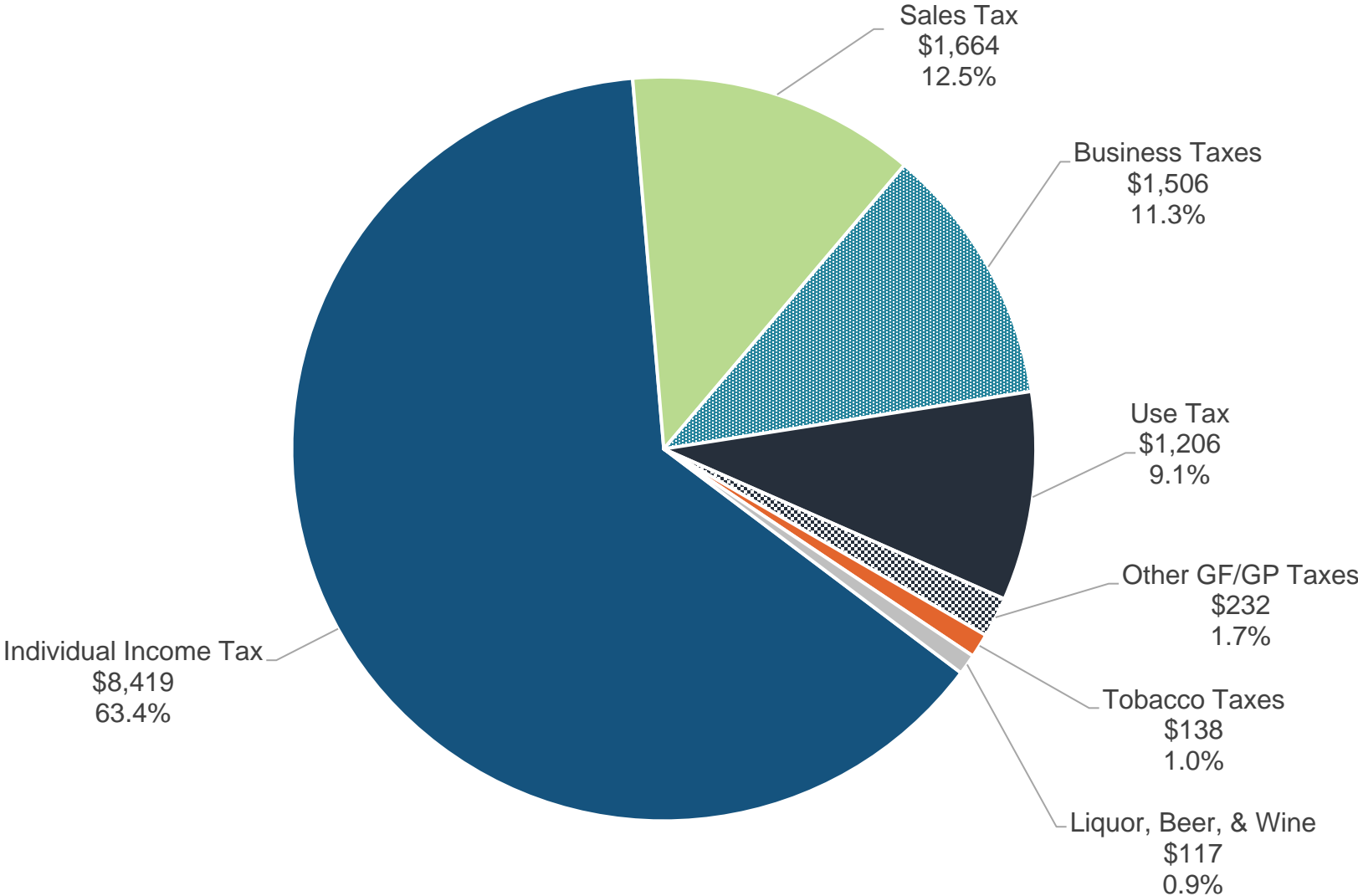
FY 2024-25 SAF Tax and Lottery Revenue

The School Aid Fund is projected to total approximately \$18.3 billion in FY 2024-25. Dollar amounts below are in millions.



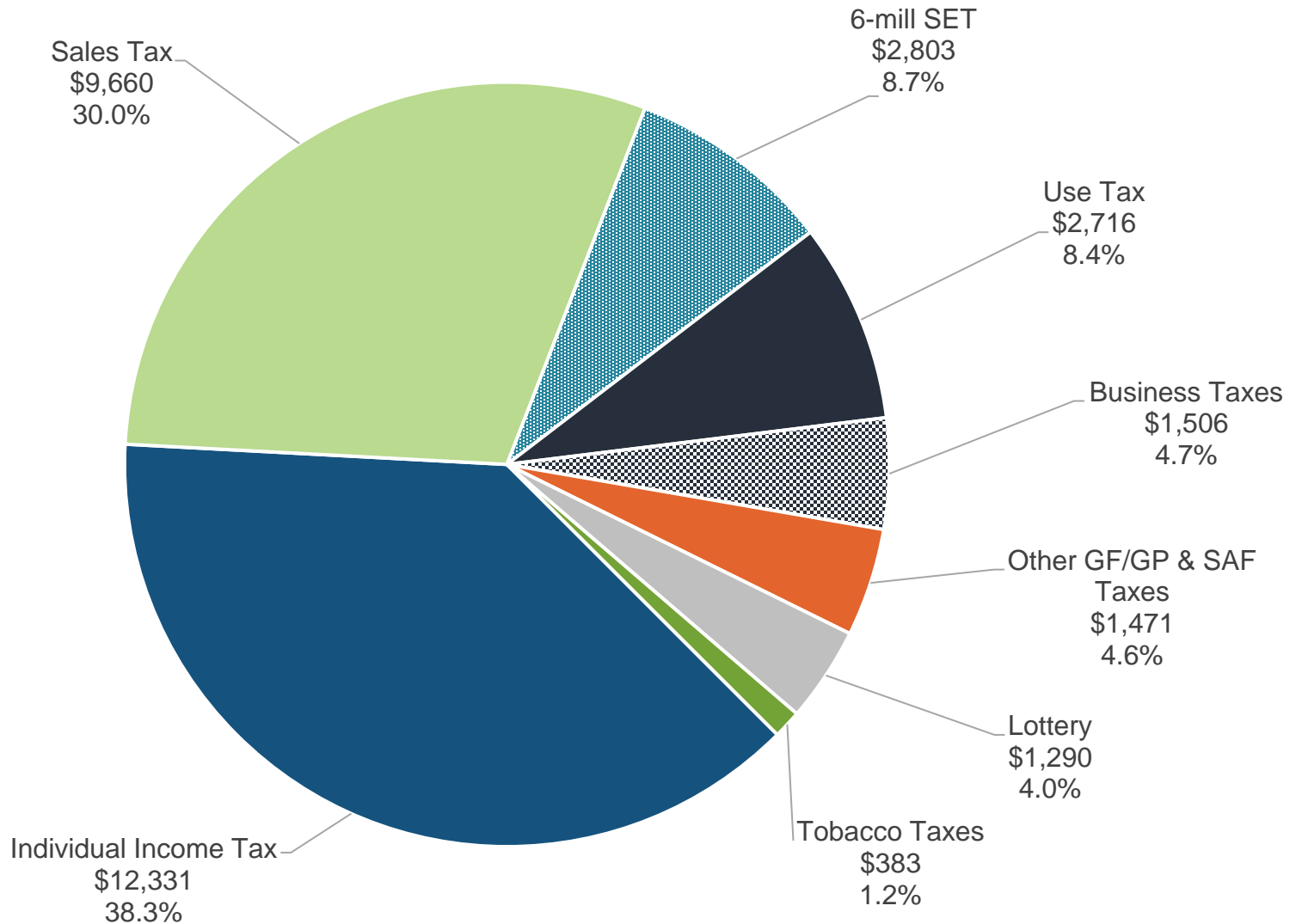
FY 2024-25 GF/GP Tax Revenue

The General Fund/General Purpose tax revenue is projected to total about \$13.3 billion in FY 2024-25. Dollar amounts below are in millions.



FY 2024-25 Combined GF/GP and SAF Tax and Lottery Revenue

Combined GF/GP and SAF tax and lottery revenue is projected to total about \$32.2 billion in FY 2024-25. Dollar amounts below are in millions.



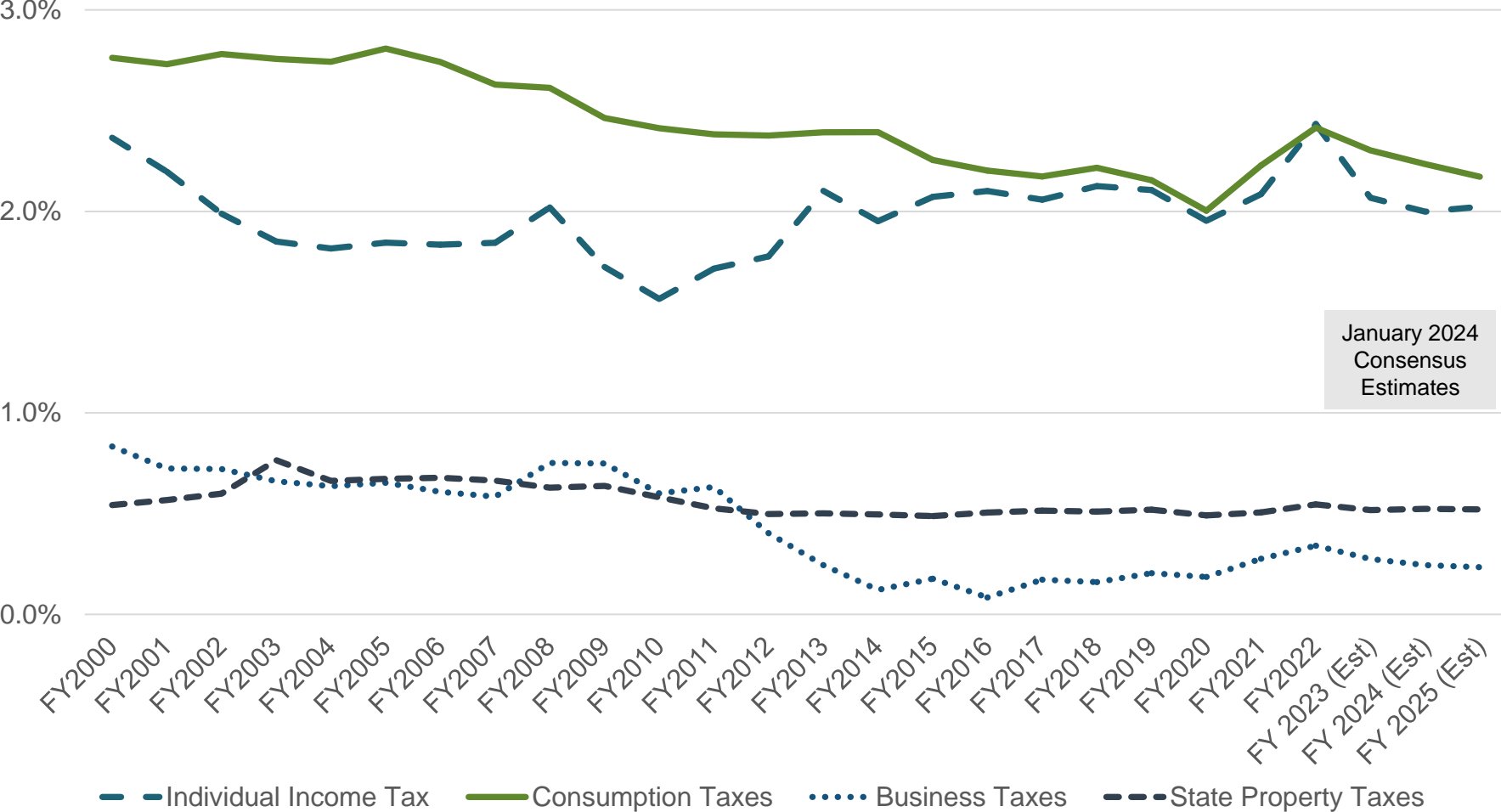
Revenue Trends

Revenue Trends of Major Taxes

- Between CY 2000 and CY 2022, estimated personal income in Michigan grew at an average annual rate of 3.0%. However, since CY 2000, revenue generated from Michigan's major taxes as a percent of personal income has generally declined.
- Sales tax revenue has grown since FY 2000, albeit generally at a slower rate than for personal income. That trend eroded somewhat during the pandemic as consumers purchased more taxable goods and fewer services but has begun to revert to trend. Tobacco taxes are decreasing as tobacco use becomes less prevalent.
- The individual income tax revenue has shown the most volatility, partially because of fluctuations in withholding and estimated payments. Revenue increases since FY 2012 can be partially attributed to the taxation of most retirement income, which began a phase out of the three-tier system in TY 2023.
- Despite the sharp decline in property values beginning in FY 2008, statewide property taxes as a percent of personal income have remained relatively constant.

Major State Taxes as a Percentage of Michigan Personal Income

Recent growth in state revenue has been driven by the income tax. Consumption taxes grew mainly driven by COVID consumption patterns before declining back to trend. Other major state taxes have declined as a percentage of state personal income because of economic trends or tax policy decisions.

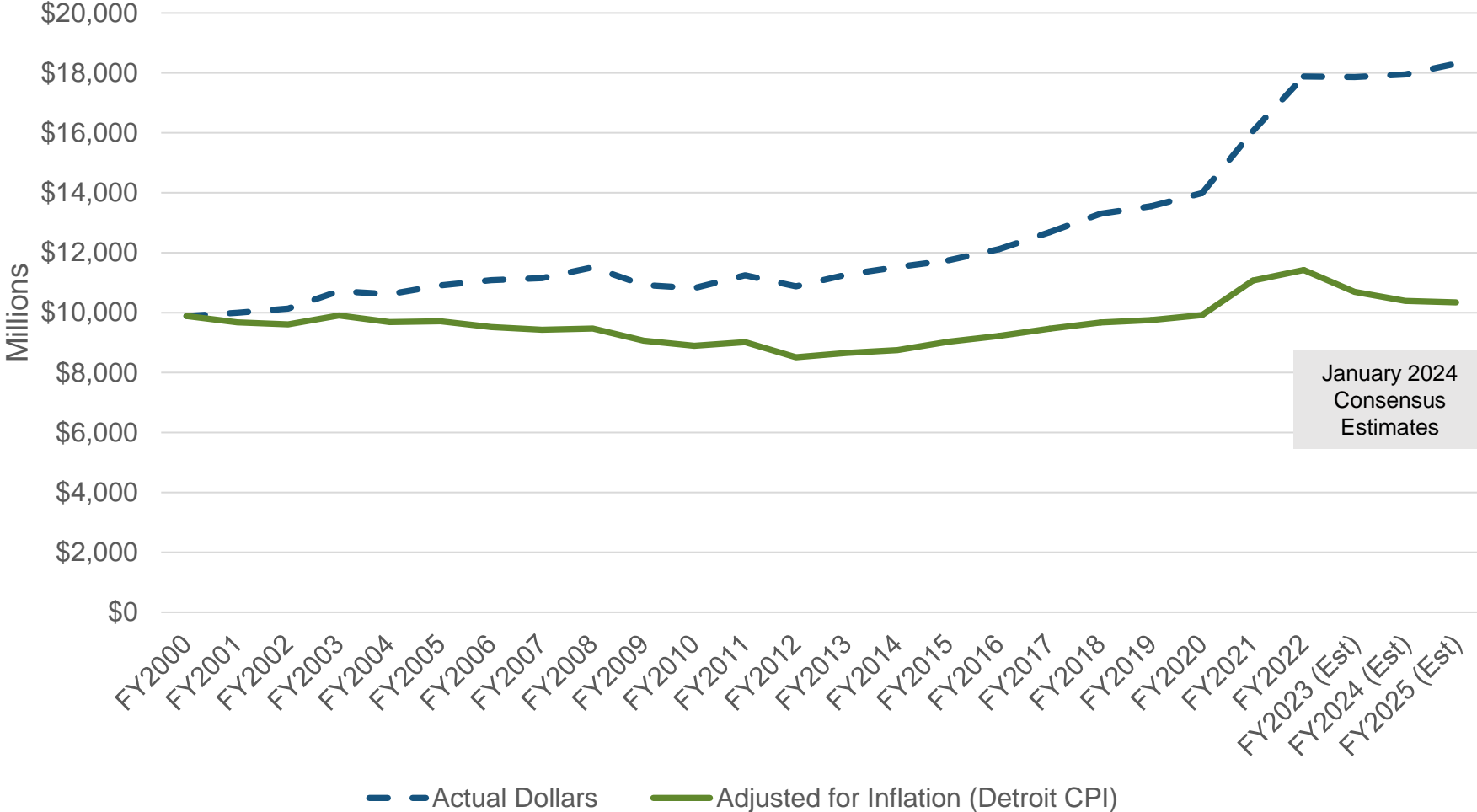


Revenue Trends of Major Funds

- Between FY 1999-00 and FY 2022-23, School Aid Fund revenue grew at an annual average rate of 2.7%.
- When adjusted for inflation using the Detroit CPI, SAF revenue grew at 0.3% per year between FY 1999-00 and FY 2022-23.
- SAF revenue, which was 3.3% of personal income in FY 1999-00, is estimated to decline to 3.0% of personal income in FY 2022-23.
- Between FY 1999-00 and FY 2022-23, General Fund/General Purpose revenue increased at an annual average rate of 1.2%.
- When adjusted for inflation using the Detroit CPI, GF/GP revenue declined at an average annual rate of 1.1% between FY 1999-00 and FY 2022-23.
- GF/GP revenue, which was 3.5% of personal income in FY 1999-00, is estimated to decline to 2.3% of personal income in FY 2022-23.
- Diversion of GF/GP revenue for both personal property tax reform, transportation funding, and additional tax changes will continue to limit GF/GP revenue going forward.

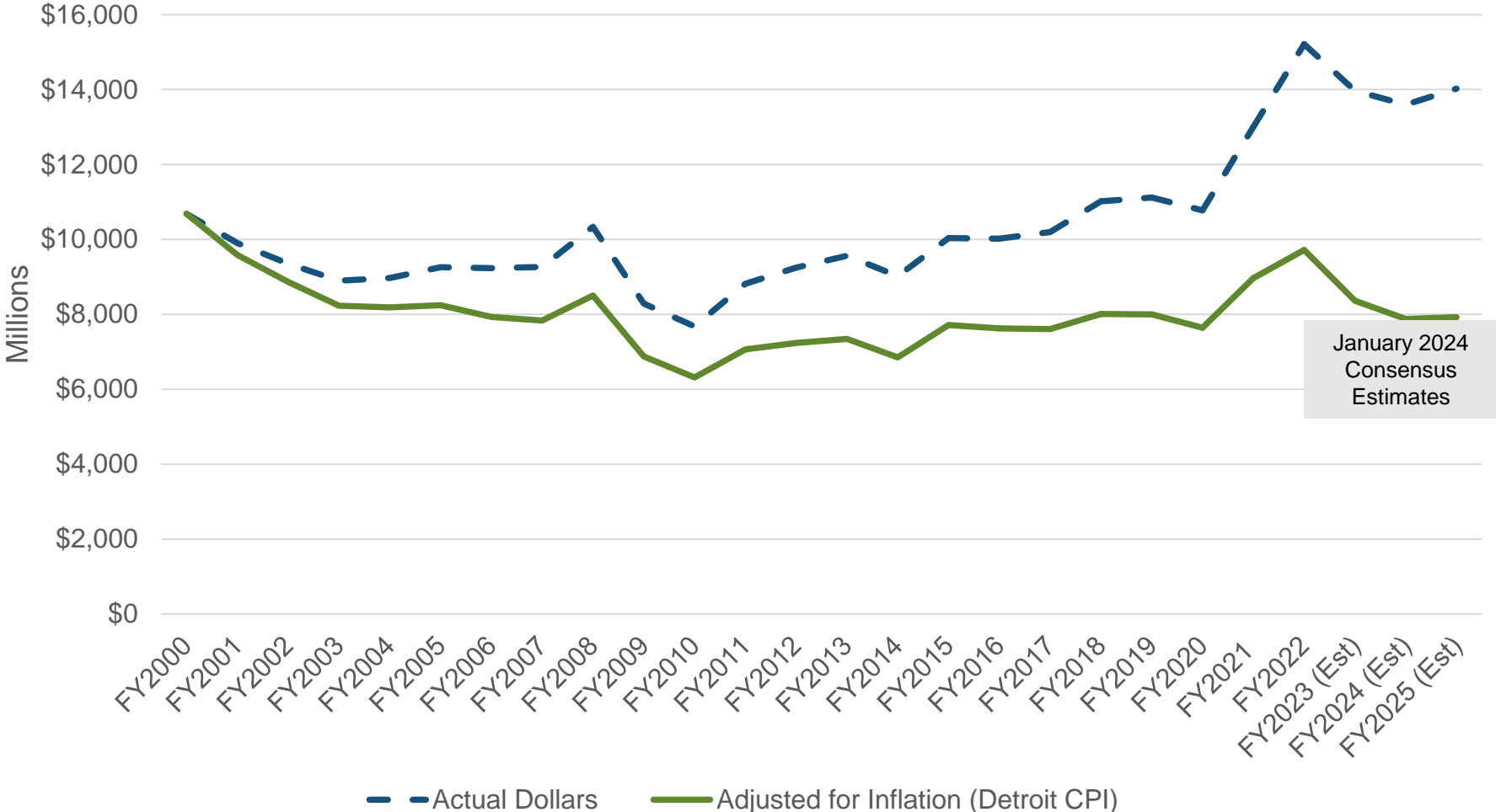
School Aid Fund Revenue

Nominal SAF revenue has grown steadily since FY 2011-12. In inflation-adjusted terms, however, SAF revenue remained below the FY 1999-00 level until FY 2020-21. Recent elevated inflation has minimized real gains in SAF revenue.



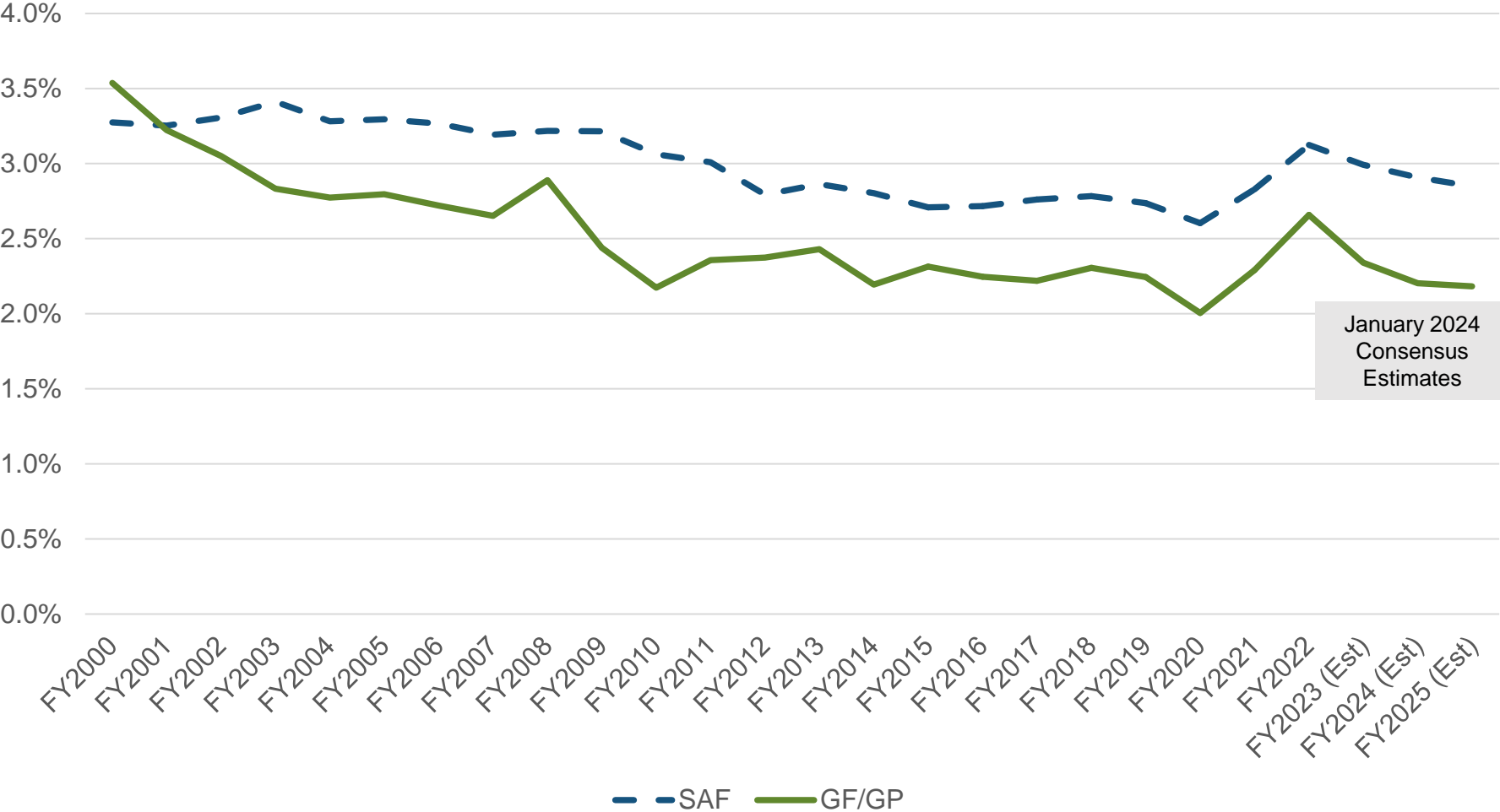
GF/GP Revenue

Nominal GF/GP revenue reached an a high of \$15.2 billion in FY 2021-22, but recent tax changes will reduce estimated collections. When adjusted for inflation, GF/GP revenue for FY 2022-23 is estimated to be 21.7% below the FY 1999-00 level with continued declines over the forecast horizon.



SAF and GF/GP Revenue as a Percent of Michigan Personal Income

As a percent of Michigan personal income, both SAF and GF/GP revenue have been generally declining since FY 2000-01. The recent two-year uptick represents temporary pandemic related activity, after which both SAF and GF/GP are expected to again decline as personal income gains outpace revenue growth.



January 2024
Consensus
Estimates

House Fiscal Agency Economics Roles

- **Economic Forecasting and Revenue Estimating**
 - Prepare economic forecasts for both the U.S. and Michigan as well as a detailed revenue forecast for Michigan in preparation for the Consensus Revenue Estimating Conference held in February and May. The HFA forecast is typically published shortly before the conference date.
 - Monitor revenues to ensure that the consensus estimates remain viable. An HFA revenue update is published monthly.
- **Tax and Revenue Analysis**
 - Prepare fiscal analyses of bills with revenue implications which receive hearings in various subcommittees.
- **Legislative Assistance**
 - Provide assistance to members and staff about potential or introduced legislation that might have tax and revenue implications.
 - Assist legislators and staff in addressing constituent questions on tax and revenue related issues.
- **All tasks are completed in compliance with statutory requirements for nonpartisanship and confidentiality.**

For more information about the state revenue:

HFA website

<http://www.house.mi.gov/hfa/>

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