



Michigan League FOR Human Services

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It's Time for the Flat Tax to Go

For many years, Michigan has attempted to balance the state budget with one-time fixes, and budget cuts, which are limiting public safety, road repairs and other vital services. These one-time fixes, however, are not aimed at fixing the problem Michigan has faced for many years—the state's revenues are failing to keep pace with the cost of services, creating a structural deficit, which is getting worse each year. One piece of a potential solution to this long-standing problem that is beginning to receive some attention from policymakers, is changing Michigan's income tax from a flat tax to a graduated income tax.

Michigan is one of only seven states that have a flat rate individual income tax structure that taxes all residents at a single rate. The remaining 34 states with an income tax, the District of Columbia, and the federal government have graduated marginal tax rates.

In a graduated income tax structure, those with higher levels of personal income are in a higher tax bracket and are taxed at a higher rate and those with lower incomes pay a lower rate. Under such a tax structure, taxpayers in similar economic circumstances pay similar amounts of income tax.

One example of a graduated income tax system is the federal income tax. The federal government has six personal income tax brackets

in which the more an individual or couple earns, the more that is paid in federal income tax.

Michigan is facing a structural deficit because of aggressive tax cuts, a deep national recession, and a state revenue system that is antiquated and has not kept pace with the economy. In particular, since Michigan taxes all residents' personal income at the same rate, Michigan has not been capturing the growth in income that has been occurring among the state's higher income taxpayers. Under a graduated income tax system, revenue growth would occur at a higher rate as income growth has been concentrated among groups earning higher incomes, thus creating a more stable and adequate source of revenue for the state to provide necessary services to its residents.

In addition, a graduated income tax would be fairer than a flat tax. Currently, Michigan taxes all personal income at a flat 4.35 percent. This rate will decline by 0.1 percent starting on October 1, 2011 and each October 1 for five years. By October 1, 2015, the income tax rate will be 3.9 percent.

While everyone pays the same percentage of their income under Michigan's flat tax, that percentage represents a greater share of disposable income for low- to middle-income individuals and families and, therefore, results in a higher tax burden. For example, a married couple, filing

jointly in Michigan with an income of \$40,000 pays a flat income tax of 4.35 percent, or \$2,175 a year. A married couple filing jointly in Michigan with an income of \$1,000,000 also pays 4.35 percent of their income in taxes as well, or \$43,500, which represents a much smaller share of their disposable income.

To move to a graduated income tax in Michigan, a majority of voters must vote to amend the state Constitution, as it currently prohibits a graduated income tax system. The question has been put to voters on multiple occasions (1968, 1972 and 1976) and has failed. One reason for resistance to a graduated income tax is the fear that individual tax filer's will pay more. However, a graduated structure could be crafted that would either benefit or hold harmless, a significant share of taxpayers. For example, drawing from the three-bracket table below, it is possible to craft a graduated tax structure that would advance at least 90 percent of filers.

Further, such a structure would yield an additional \$600 million in revenue, and more in the future in response to income growth. The top bracket at 6.9 percent would put Michigan in about the middle of states with a graduated income

tax-below California and Vermont at 10.3 and 9.5 respectively, and above Arizona and Mississippi at 4.54 and 5 percent.

Recent polling suggests that public attitudes about a graduated income tax could be changing. A Detroit News/WXYZ poll conducted in June, 2007 by EPIC-MRA found that 57 percent of those polled favored a graduated income tax; a Detroit Free Press/Channel 4 poll conducted in July and August 2007 by Iowa-based Selser & Co. found that 53 percent favored a graduated structure; and Michigan State University's 2008 State of the State Survey also confirmed public support for a graduated income tax, with 57.2 percent of those polled in favor.

As the size of Michigan's deficits continue to grow and essential services are threatened, a graduated income tax offers a reasonable revenue alternative that can ensure adequacy and fairness in the future. However, the income tax is only one component in Michigan's revenue structure and is not the sole solution to Michigan's structural problem. Comprehensive reform that also addresses the sales tax is also needed if Michigan is to modernize its tax structure in a way that can meet the needs of a 21st century competitive state.

Tax Bracket	Taxable Income—Single	Taxable Income—Married, filing jointly
3.9%	\$0-\$20,000	\$0-\$40,000
4.35%	\$20,001-\$60,000	\$40,001-\$120,000
6.9%	\$60,001 and above	\$120,001 and above