Michigan League FOR Human Services

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Tax Changes Hit Low-Income Families the Hardest

EXECUTIVE SUMMARY

by **Joanne Bump**
Senior Policy Analyst

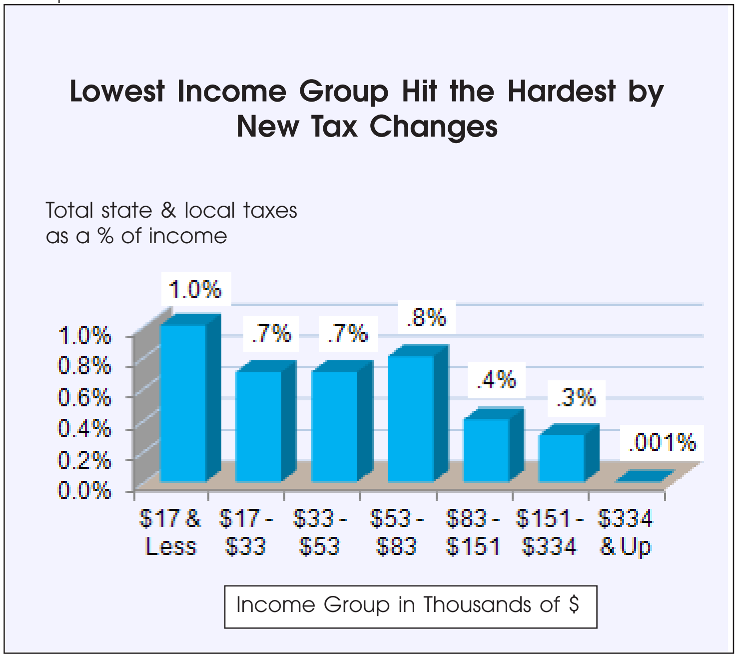
The tax package adopted by Gov. Rick Snyder and the Legislature last year will begin to take effect in 2012. Michigan's business taxes will be reduced by $1.6 billion, while individual income taxes will increase by $1.4 billion, when fully implemented. Fifty-one percent of all Michigan taxpayers will pay more in individual income taxes. The new tax changes cut business income tax revenues by 83 percent and will increase individual taxes by 23 percent. These tax changes make Michigan's tax structure more regressive. Reforming the tax structure could have softened the blow of poverty and provided greater economic security for low-income people. What was implemented, however, does the exact opposite.

Taxes should be equitable and based on a person's ability to pay. The Michigan Earned Income Tax Credit made the state's flat tax far more equitable. However, the new tax law eliminated most of the major credits. An analysis by the Institute on Taxation and Economic Policy, using the prior law tax rate of 4.35 percent, found that Michigan's existing tax system was regressive. The lowest 20 percent income group paid 9.1 percent of income in state and local taxes, while the top 1 percent income group paid only 5.6 percent. Low-income families were all ready paying more in taxes than higher income groups.

Low-Income Families Pay More

The Institute on Taxation and Economic Policy prepared a distributional analysis of Michigan's new personal income tax changes. Tax increases on individuals result primarily from the reduction or elimination of tax credits, exemptions and deductions to the state individual income tax.

All income groups received an average tax increase. The amount ranged from $101 for the lowest income group to $636 for the next to the highest income group.



Source: Data from ITEP,
Chart by the Michigan League for Human Services.

The lowest 20 percent income group, with incomes of less than $17,000, will pay the largest tax increase as a percent of their income, up 1 percent. This group will pay an average of $101 more in tax liability.

The income group of $334,000 or more will have an increase of 0.001 percent, a significantly lower percentage of their incomes than those with lower incomes. This group will pay an average of $7 more in taxes.

The governor's budget proposed the elimination of the state EITC, estimated at $338 million in 2009. In the end, the EITC was reduced from 20 percent of the federal credit to 6 percent, at $112.1 million. The average payment is estimated to fall from $432 per family to $143 for 782,600 filers. Low-income families will pay $261.6 million more in taxes.

The proposed elimination of the EITC ran counter to the governor's MiDashboard, which uses a reduction in child poverty as an indicator of the state's economic strength. It was estimated that 14,000 children would fall into poverty with the elimination of the EITC. Although the EITC was not completely eliminated, the 70 percent reduction in the tax rate will hurt low-income working families.

Recommendations

Policymakers should restore some of the tax provisions that reduced the regressiveness of the personal income tax. These include restoring the EITC back to 20 percent. The reduction to the credit will not impact low-income families until they submit their tax returns in 2013 so there is time to return it to the prior level. Revenues are available through either the state rainy day fund with a balance of $256 million or the estimated FY 11 surplus of $457 million. In addition, revenues are coming in stronger than predicted for FY 12 and FY 13.

Tax reform that provides adequate revenues to fund important government structures and helps to fuel economic recovery could be adopted. One option is to change Michigan's income tax from a flat tax to a graduated income tax, joining most other states. Comprehensive reform could also include a sales tax on services, modernizing Michigan's tax structure in a way that can meet the needs of a competitive 21st century state.