A POLICY GUIDE TO

TAX CUTS

IN MICHIGAN

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POLICY PRIMER

Background

The state economy has lost more than 200,000 jobs since the COVID-19 pandemic began, the 10th worst recovery in the nation. Lawmakers can to do more to encourage economic growth and get people back to work. One of the important policy options open to them is to reduce the state's tax burdens. This is why lawmakers ought to reduce the state's individual income and corporate income tax rates.

Tax rates have an impact on economic growth. Business managers want to be profitable, and taxes on their profits discourage investment and job creation. Taxing income at lower rates creates long-term benefits: It encourages business managers to invest in Michigan, and this improves income and job growth. This happens not just in the year when lawmakers lower taxes, but also in the years that follow.

A business can earn more after taxes in some states than in others, so states compete over tax policy. It's not the only thing that matters, but if a state lowers its tax rates, that gives businesses a powerful incentive to expand there.

Other states have lowered their rates recently, and Michigan is falling behind. According to the Tax Foundation, 14 states have cut their tax rates since the pandemic began. This includes Ohio, which now assesses lower taxes on income than Michigan.

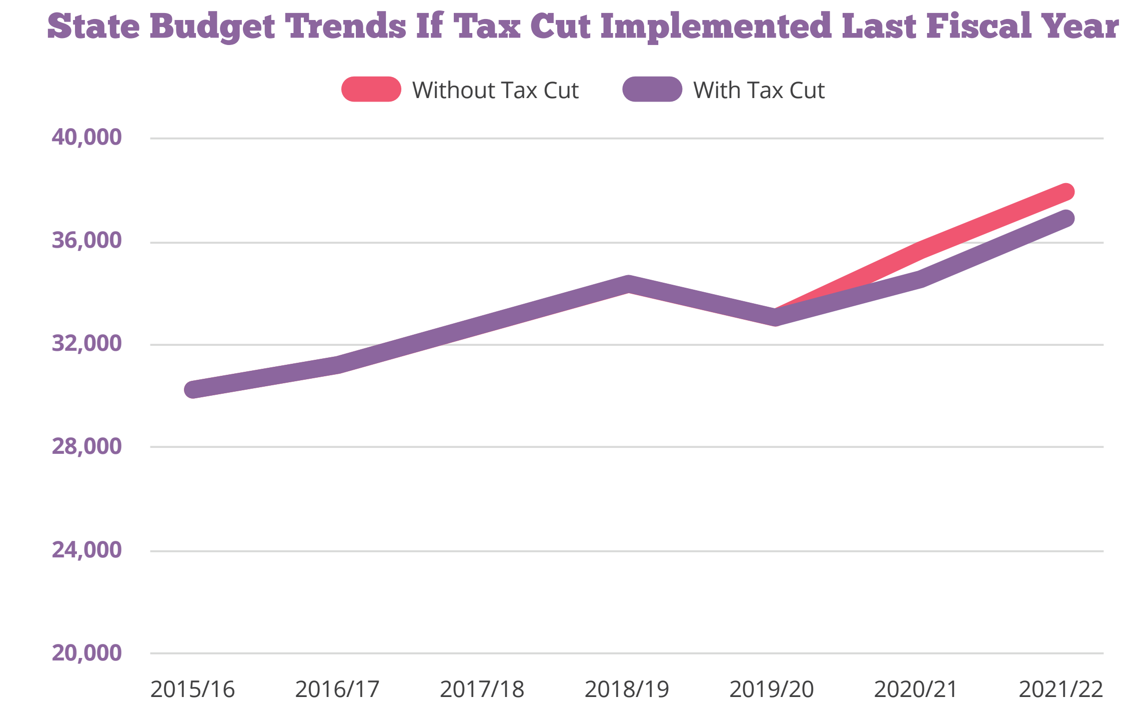
Lawmakers need to act. Specifically, they ought to lower the personal income tax rate from 4.25% to 3.9% and the corporate income tax rate from 6% to 3.9%. Doing so would improve the state's tax competitiveness and improve the state business climate. It would encourage long-term economic growth in the state, which would make Michigan more prosperous.

Some lawmakers hesitate to lower taxes out of concern that lower rates will generate less money for the state budget, and Michigan operates with a balanced budget requirement. Over the long term, a tax cut can pay for itself through encouraging greater economic growth — and therefore larger tax receipts — but lawmakers need to consider short-term effects, too. So they need to find money within the budget if they want to lower tax rates. This is easier to do right now than in years past because state revenues are up. Even though Michigan has lost jobs since the pandemic began, state tax collections have increased. The most recent state budget spends $3.6 billion more than the one from the year before COVID hit — 10.4% more. Lawmakers may have even more money than that, since more taxes are coming in than expected. Plus, lawmakers have billions in unallocated money sitting in their funds, due to strong revenue growth.

And finally, Michigan lawmakers increased the personal income tax from 3.9% to 4.35% in 2007, and the tax rate was supposed to return to 3.9% after a few years. That didn't happen, as lawmakers made a modest cut in 2011 but never completely repealed the rate increase. Now that tax cuts are manageable, lawmakers ought to revisit the idea of what was promised to be a temporary increase.

The details of the reform:

Tax cuts are a simple but important policy; they can be implemented by approving two simple bills. One reduces the state's personal income tax rate from 4.25% to 3.9%. Another reduces the state's corporate income tax rate from 6% to 4.5%.


State Budget Trends If Tax Cut Implemented Last Fiscal Year
Without Tax Cut
With Tax Cut
40,000
36,000
32,000
28,000
24,000
20,000
2015/16
2016/17
2017/18
2018/19
2019/20
2020/21
2021/22


Corporate Income Tax Rates
$ in millions
12
10
8
6
4
2
0
Minnesota
Illinois
Wisconsin
Michigan before
Indiana
Michigan after

Frequently Asked Questions

Would lawmakers have to cut the budget if they lower tax rates?

The state has a balanced budget requirement, which means that reduced revenue has to be paired with lower state spending. The good news, however, is that state revenue is also growing, thanks to a growing economy. This means that lawmakers can afford to lower tax rates without having to lower spending. They can pass a tax cut and increase the state budget simultaneously, provided there is enough revenue growth. And administrators expect sufficient revenue growth.

How much would taxpayers save with this proposed tax cut?

People in a household earning the state median income of $59,600 a year would save a little more than $200 annually. Cutting the corporate income tax rate tends to increase wages and company earnings, and reduce prices, but it is unclear how much of each would happen.

While taxpayer savings would be modest, these rate cuts would improve the state business climate. This would bring more long-term benefits to people than even cutting personal income taxes.

How much would this proposal improve Michigan's tax competitiveness?

According to the Tax Foundation, Michigan's tax structure ranks 14th-best among the states. Under the proposal, it would improve to 11th-best. In the region, Michigan would have the best-ranked corporate income tax.

Wisconsin and Ohio recently reduced their income tax rates in response to the pandemic. Ohio now assesses lower rates than Michigan, and this proposal puts Michigan's flat tax rate below Ohio's highest tax rate in its tiered tax system.

Have lawmakers considered cutting tax rates recently?

While lawmakers often talk about reducing state tax rates and often introduce bills to do so, they have not voted on such a bill since 2017. That bill proposed a small reduction in income tax rates, but it was rejected by House members 55-52. The majority of Republicans and two Democrats voted for it, while the majority of Democrats and 12 Republicans voted against it.

What are the economic effects of this proposal?

Letting people keep more of what they earn has a number of benefits. It encourages more business development and job growth over the long term. That's because investing becomes more lucrative when governments take less income from households and businesses. A rate cut allows people to spend more of their resources on the things they want. And it makes Michigan a more attractive place to add jobs compared to its competitors. Over the short term, residents can expect the income tax reductions to generate 15,000 jobs. There would also be long-term gains, as competitiveness grows over time. Consider that Michigan creates and loses more than 800,000 jobs each year, a turnover of one out of 16 jobs every three months. Tax cuts offer all businesses an incentive to add more jobs and cut fewer jobs.

Individuals and Businesses: Who Benefits and Why

Some lawmakers think that they only can get credit for economic news if they are directly involved in it. This is a mistake. The economic growth that drives opportunity and prosperity does not come from subsidizing the right business. It comes through the bottom-up decisions made by entrepreneurs, small business owners, and large companies, all using their knowledge and resources to serve customers better. State lawmakers' role is to protect property rights, establish justice, and offer quality public services. They also ought to keep the costs of doing that low.

Reducing the burdens of government helps people thrive. It allows them to make free decisions about how to do things best, without shouldering the costs imposed by unnecessarily expensive government. A series of good events then unfolds.

A worker decides to start his own business.

A manager decides to hire more people.

A big company decides to invest in its Michigan businesses rather than in Ohio.

These are all more likely when governments reduce tax rates.

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