Council Comments

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STATE BALLOT ISSUES – PROPOSAL D

THE GRADUATED INCOME TAX

Proposal D on the November 2 ballot is a proposed constitutional amendment that would eliminate the present constitutional prohibition against graduated income taxes, require a graduated state income tax in 1977, and beginning in 1978 authorize the legislature to impose either a graduated or flat rate income tax. The proposed amendment to Article IX, Section 7 of the Michigan Constitution, which was placed on the ballot by initiative petition would:

- remove the present constitutional prohibition against graduated state or local income taxes;
- require that for calendar 1977 the legislature impose a graduated income tax at a maximum rate of 3.9 percent on the first $20,000 of the taxable income of individuals after allowing personal exemptions of at least $1,500 for each taxpayer and dependent and require that the rate on taxable incomes over $20,000 be increased to the rate needed to make up for the revenue loss. It is estimated that the rate on taxable income in excess of $20,000 would be 8.5 – 9.0 percent;
- establish the present statutory $1,500 personal exemption as a constitutional minimum exemption and authorize the legislature to allow other exemptions, credits and deductions;
- authorize the legislature to impose after January 1, 1978, either a graduated or a flat rate state personal income tax;
- permit the legislature to impose a graduated corporate income tax; and
- permit the legislature to authorize graduated local income taxes.

Background

The present constitution (Article IX, Section 7) provides: "No income tax graduated as to rate or base shall be imposed by the state or any of its subdivisions." This prohibition was incorporated in the Constitution of 1963 as an express limitation on the power of the state legislature and political subdivisions of the state to impose graduated income taxes. In both 1968 and 1972 proposed constitutional amendments were placed on the ballot to repeal this prohibition and to authorize graduated income taxes, but such proposals were rejected by the voters.

The Michigan state income tax is currently imposed at a rate of 4.6 percent on the taxable income of individuals (federal adjusted gross income with certain adjustments minus a $1,500 personal exemption for the taxpayer and each dependent). Under present law the tax rate is scheduled to be reduced to 4.4 percent on July 1, 1977, although legislative revenue estimates for the fiscal year 1976-77 indicate an intent to repeal the scheduled decrease in rate and continue the 4.6 percent rate.

The state has adopted a uniform city income tax act which authorizes cities to impose a flat rate tax of one-half of one percent on the income of non-residents earned in the city and of one percent (two percent in Detroit) on the income of resident individuals and corporations. Sixteen cities are currently imposing the tax.

The Proposed Graduated State Income Tax for 1977

Proposal D requires that during calendar 1977 any state tax on the income of "natural persons" shall be imposed at a rate not to exceed 3.9 percent on taxable income of $20,000 after allowing personal exemptions of $1,500 for each taxpayer and dependent. This would reduce the tax rate on such income from the present 4.6 percent to a maximum of 3.9 percent, a reduction of about 15 percent. Based on income projections for 1977 a 15 percent reduction in the tax rate on the first $20,000 of taxable income would reduce gross state income collections by about $200 million.

The proposed amendment requires that any revenues lost during 1977 by reducing the tax on the first $20,000 of taxable income be raised by increasing the tax rate on that portion of taxable income in excess of $2,000. Based on projections of 1977 income levels, the tax rate on taxable income in excess of $20,000 would be at an estimated rate of 8.5 – 9.0 percent. Thus, in order to provide a 15 percent reduction in the taxes paid on the first $20,000 of taxable income (from 4.6 to 3.9 percent), the rate on taxable income over $20,000 would have to be increased by about 90 percent (from 4.6 to 8.5-9.0 percent).

Under the proposed two-bracket graduated state income tax for 1977 the break-even point would be at about $23,500 of taxable income after the $1,500 personal exemption for the taxpayer and each dependent. Taxpayers with taxable incomes under $23,500 would pay less state income tax in 1977 while those with taxable incomes in excess of $23,500 would paymore state inome tax. Under present Michigan law taxpayers who file joint returns for federal income tax purposes must also file joint returns for state income tax purposes. In 1977 an estimated 80-85 percent of Michigan state income tax returns will report taxable income of less than the $23,500 break-even point and 15-20 percent of returns will report taxable income in excess of the $23,500 break-even point.

The table on the next page shows the estimated tax liability before credits for a family of four at various income levels under the present flat rate tax and the projected graduated rate tax for 1977.

The Proposed State Income Tax Beginning in 1978

The proposed amendment provides that prior to January 1, 1978, the 3.9 percent rate shall not be increased and that the $20,000 taxable income base shall not be decreased. It appears that beginning in 1978 the legislature would have discretion to impose any kind of state income tax it chooses—it could return to a flat rate tax, continue the two-bracket graduated rate provided for in the amendment for 1977, or adopt a multi-bracket graduated income tax and the legislature would have discretion to establish the rate(s).

Present and Proposed Tax Liability for a Family of Four
Before Credits in 1977

Adjusted Gross Income[1]	Taxable Income Before Credits	Present Flat Rate Income Tax[2]	Proposed Graduated Income Tax[3]	Tax Reduction (-) Increase (+)
$ 7,500	$ 1,500	$ 69	$ 58	$ - 11
10,000	4,000	184	156	- 28
15,000	9,000	414	351	- 63
20,000	14,000	644	546	- 98
25,000	19,000	874	741	-133
30,000	24,000	1,104	1,130	+ 26
50,000	44,000	2,024	2,880	+856

[1] Adjusted Gross Income minus $6,000 ($1,500 x 4) in personal exemptions.

[2] Present 4.6 percent rate.

[3] Tax rate of 3.9 percent on first $20,000 and projected 8.75 percent rate on excess.

The amendment provides that "During September of each year the State Revenue Commissioner shall adjust the $20,000.00 taxable income figure for the following calendar year by applying to it an inflation factor for the purpose of maintaining approximate stability in terms of January 1, 1977, dollars." The effect of this section is not entirely clear. While it would appear to require the state revenue commissioner to make the necessary calculation (e.g., an inflation factor of five percent would increase the $20,000 figure to $21,000), it does not appear to delegate to the revenue commissioner the authority to establish the base of the state income tax. The proposed amendment taken as a whole does not require the state legislature to impose either a graduated state income tax or one with a bracket system that breaks at $20,000. Since inflation is known to push increasing numbers of taxpayers into higher tax brackets under a graduated income tax, the section may merely direct the state revenue commissioner to make such a calculation for consideration by the legislature in its determination of the rate and base of the state income tax following January 1, 1978.

Other Provisions in the Proposed Amendment

Since the proposed amendment repeals the present constitutional prohibition against graduated income taxes, it would give the legislature the power: (1) to impose a graduated corporate income tax and, (2) to authorize local units of government to impose graduated local income taxes.

The proposed amendment requires that "In defining state taxable income, the legislature shall allow an exemption of at least $1,500.00 for each taxpayer and dependent." This would establish the present statutory $1,500 exemption as a constitutional minimum deduction.

The amendment also specifically authorizes the legislature to allow other exemptions, credits and deductions. This does not provide any additional authority to the legislature since it currently has such power.

The proposed amendment refers to any state-wide tax on the income of "natural persons." Although estates and trusts as well as "natural persons" are currently subject to tax under the state personal income tax, the amendment does not apply specifically to estates and trusts. Since the proposed amendment repeals the present prohibition against graduated income taxes, it appears that estates and trusts could continue to be taxed the same as natural persons or in some different manner.

State Income Taxes

Forty-one states currently impose broad-based personal income taxes. Graduated personal income taxes are imposed in 36 states and five states, including Michigan, impose flat rate taxes.

The degree of graduation or the progressivity of an income tax is not determined by the rate schedule alone. The progressivity of a tax is influenced by amounts allowed for personal exemptions, deductions and credits as well as by the rate schedule.

The present Michigan personal income tax is a progressive tax, despite the fact that it is imposed at a flat rate. The table below shows the progressivity of the Michigan income tax in 1975 based on preliminary data from 1975 tax returns. The table shows the effective tax rate as a percent of income after allowance has been made for personal exemptions, homestead property tax credits and city income tax credits.

Adjusted Gross Income Class	Effective Tax Rate in 1975
$ 4,000- 5,999	0.5
6,000- 7,999	1.2
10,000- 11,999	2.0
14,000- 15,999	2.4
20,000- 21,999	2.8
24,000- 25,999	3.0
30,000- & over	3.4