

State Notes

TOPICS OF LEGISLATIVE INTEREST

March/April 2008



Federal Economic Stimulus Act of 2008

By Jay Wortley, Senior Economist, and David Zin, Economist

The Federal Economic Stimulus Act of 2008 was passed by Congress on February 7, 2008, and signed into law by President Bush on February 13, 2008. The purpose of this Act is to provide a fiscal stimulus to the slumping U.S. economy. Under this Act, the Federal government will inject \$151.7 billion into the economy in fiscal year (FY) 2007-08 and another \$16.3 billion in FY 2008-09, for a total of \$168.0 billion over the two fiscal years, as estimated by the Congressional Joint Committee on Taxation. The major features of this stimulus package are income tax rebates to individuals and a tax reduction for businesses, which the Act achieves by accelerating the depreciation they may claim. Each of these major components of the Federal Economic Stimulus Act of 2008 is described below, and the estimated direct impact of this stimulus on Michigan's State government taxes and other revenue also is presented.

Federal Income Tax Rebates to Individuals

The Federal income tax rebates consist of a basic credit and a child credit. It is estimated that these rebates will be paid to individuals beginning in May 2008. These rebates will inject \$106.7 billion into the U.S. economy in FY 2007-08 and another \$10.0 billion in FY 2008-09, according to the Congressional Joint Committee on Taxation.

Basic Credit. Qualifying individuals will receive an income tax credit of at least \$300 and up to \$1,200. Qualifying individuals and their respective credit amounts fall into the following three categories:

1. Single taxpayers who have a net income tax liability of at least \$600 will receive a basic credit of \$600 and joint taxpayers who have a net income tax liability of at least \$1,200 will receive a basic credit of \$1,200; however, the amount of the total credit is phased down at certain income levels, as explained below.
2. Taxpayers who have 1) a net income tax liability of at least \$1 but less than \$600 for single taxpayers and less than \$1,200 for joint taxpayers, and 2) gross income greater than the sum of the applicable basic standard deduction plus one personal exemption for single filers and two personal exemptions for joint filers, will receive a basic credit equal to their income tax liability or \$300 for single taxpayers and \$600 for joint taxpayers, whichever is greater. The minimum income level is \$8,750 for a single taxpayer and \$17,500 for joint filers.
3. Individuals with income of at least \$3,000, which includes earned income, Social Security benefits, and veteran's payments, who do not qualify for a credit under the other two categories, will receive a basic credit of \$300 for single individuals and \$600 for married couples. These individuals do not have to have an income tax liability in order to qualify for this credit.



Child Credit. Individuals who qualify for a basic credit and have a qualifying child, also will qualify for a child credit equal to \$300 per child. A qualifying child must be under 17 years old, must have the same principal residence as the taxpayer for more than half of the tax year, and must be related to the taxpayer.

Income Limitation on Rebate. The amount of the rebate (basic credit plus child credit) will be reduced for taxpayers whose income is above a certain level. The rebate for single people will be reduced by an amount equal to 5.0% of the amount by which their adjusted gross income exceeds \$75,000 and the rebate for married couples filing jointly will be reduced by an amount equal to 5.0% of the amount by which their adjusted gross income exceeds \$150,000.

Rebate Checks and Credit Reconciliation. The U.S. Department of Treasury will calculate the basic credit and child credits based on the information contained in taxpayers' 2007 Federal income tax returns, which were due April 15, 2008. This amount then will be sent to taxpayers via a check beginning in May 2008. In 2009, when taxpayers complete their 2008 Federal tax return, they will recalculate the credits based on actual data for 2008. If the recalculated credits are greater than the amount of the rebate taxpayers received in 2008, they will be able to claim the difference as an additional refundable credit in 2009. If the recalculated credits are less than the amount of taxpayers' 2008 rebate check, they will *not* be required to repay the difference.

Examples of the rebate amounts that hypothetical taxpayers would receive are presented in [Table 1](#).

Table 1

Taxpayer Examples of Tax Rebate under Economic Stimulus Act of 2008						
Type of Filer	Adjusted Gross Income	Income Tax Liability	Number of Children <17	Total Credit/Rebate		
				Basic Credit	Child Credit	Total
Single	\$14,000	\$0	0	\$300	\$0	\$300
Single	50,000	6,700	0	600	0	600
Single	25,000	450	0	450	0	450
Head of Household	35,000	2,500	2	600	600	1,200
Joint	35,000	1,100	2	1,100	600	1,700
Joint	80,000	7,600	3	1,200	900	2,100
Joint	150,000	20,700	2	1,200	600	1,800
Joint	200,000	36,800	2	0	0	0

Source: Senate Fiscal Agency

Federal Income Tax Reduction for Businesses

The Economic Stimulus Act of 2008 also will provide a tax reduction to businesses to help stimulate economic activity. The Act provides this business tax reduction by changing the way new purchases of property are depreciated or expensed. Under current law, businesses are allowed to deduct a certain percentage of the cost of buildings and equipment from their business income. The amount of the deduction and the number of years for which a deduction may be claimed vary depending on the type of property and its cost. The Economic Stimulus Act of



2008 accelerates the depreciation that businesses will claim for new capital purchased and put in service in 2008, by providing a 50.0% depreciation bonus and an increase in the Section 179 capital expenditure deduction (described below).

50% Bonus Depreciation Deduction. Businesses that purchase new capital assets in 2008 will be able to claim 50.0% of their cost as depreciation in 2008, plus the amount they otherwise would be able to claim on the remaining 50.0% of the property's value. For example, a business that in 2008 pays \$1,000 for new equipment that is depreciated over five years would have been able to deduct \$200 in depreciation before this law change, but now will be able to deduct \$600 for the 2008 tax year, an increase of \$400. This increase in their depreciation deduction will lower businesses' taxable income and reduce their income tax liability for their 2008 tax year; however, this acceleration in their depreciation deduction in 2008 will reduce the depreciation that will be available for them to claim in future years; thus, the reduction in taxes realized in 2008 will be offset by higher taxes in future years.

Increase in Section 179 Expensing of Depreciable Assets. Section 179 of the Internal Revenue Code allows some businesses to forego depreciation and instead deduct or expense all or a portion of the amount spent on newly purchased capital equipment during the tax year, instead of depreciating it over several years. If the total cost of qualifying property exceeds a certain level, this deduction is phased out. Prior to the Economic Stimulus Act of 2008, the maximum amount that a business taxpayer could have deducted under this provision in 2008 was \$128,000, and it would have been reduced by the amount by which the total cost of the qualifying property exceeded \$510,000. Under the Economic Stimulus Act of 2008, this special deduction will increase to \$250,000 in 2008 and it will not be reduced unless the cost of the qualifying property is in excess of \$800,000.

Impact on Michigan State Government Revenue

The Federal Economic Stimulus Act of 2008 will have a direct impact on Michigan's tax revenue in two major ways: 1) The Federal rebates spent by individuals in Michigan will help boost sales tax, casino tax, and lottery revenue, and 2) the acceleration in depreciation that businesses will be able to claim will reduce Michigan business tax revenue. As shown in Table 2, it is estimated that the net fiscal impact on Michigan State government revenue will be a gain of \$32.4 million in FY 2007-08 and a loss of \$94.4 million in FY 2008-09; then, for several years, the State will realize gains in revenue, including increases of \$16.2 million in FY 2009-10 and \$32.7 million in FY 2010-11.

The rebates that will be paid to individuals under the Economic Stimulus Act of 2008 will give individuals in Michigan a boost in their disposable income of an estimated \$3.6 billion, which will increase total disposable income in Michigan by about 1.0% in 2008. This extra cash in the hands of consumers in Michigan will be used in three major ways: 1) They will spend it on goods and services, 2) they will use it to pay down existing consumer debt, or 3) they will save it. It is estimated that about 60.0% of the rebates will be spent in Michigan and of this amount about 60.0% will be spent on taxable items. It is assumed that approximately two-thirds of the amount that taxpayers will spend will be spent before the end of FY 2007-08, and the remaining one-third will be spent in FY 2008-09. In FY 2007-08, this increased spending by consumers in Michigan will generate an estimated \$53.8 million in sales tax revenue, \$10.6 million in lottery



revenue, and \$4.5 million in casino tax revenue, for a total of \$68.9 million. In FY 2008-09, an additional \$26.0 million in new revenue will be generated primarily from the sales tax.

Table 2

Estimated Fiscal Impact of Economic Stimulus Act of 2008 on Michigan State Government Revenue FY 2007-08 to FY 2010-11 (Millions of Dollars)					
Provision	Tax Base Impact 2008 Tax Year	Revenue Impact			
		FY 2007-08	FY 2008-09	FY 2009-10	FY 2010-11
Federal Tax Rebates to Individuals					
Rebates to Individuals in MI	\$3,629.4				
Increase in Taxable Spending in MI	\$1,306.6				
<u>Estimated Tax/Revenue Impact:</u>					
Sales Tax.....	---	\$53.8	\$24.6	\$0.0	\$0.0
Lottery.....	---	10.6	1.0	0.0	0.0
Casino Tax	---	4.5	0.4	0.0	0.0
Subtotal New Revenue from Rebates	---	\$68.9	\$26.0	\$0.0	\$0.0
Acceleration of Business Depreciation/Expensing					
50% Bonus Depreciation:					
Change in Depreciation Deducted by MI Businesses	\$4,158.0				
<u>Estimated Tax/Revenue Impact:</u>					
Michigan Business Tax.....	---	(32.2)	(112.8)	14.4	30.8
Individual Income Tax.....	---	(3.2)	(4.0)	1.0	0.8
50% Bonus Depreciation Revenue Impact	---	(\$35.4)	(\$116.8)	\$15.4	\$31.6
Section 179 Expensing Increase:					
Change in Expensing Deducted by Michigan Businesses	\$126.0				
Section 179 Expensing Revenue Impact...	---	(1.0)	(3.6)	0.9	1.2
Subtotal Business Depreciation/ Expensing Changes	---	(\$36.5)	(\$120.4)	\$16.2	\$32.7
Estimated Net Impact on Michigan Government Revenue					
Impact by Fund:	---	\$32.4	(\$94.4)	\$16.2	\$32.7
General Fund/General Purpose	---	(\$22.3)	(\$114.2)	\$16.2	\$32.7
School Aid Fund	---	\$54.0	\$19.4	\$0.0	\$0.0
Other.....	---	\$0.8	\$0.3	\$0.0	\$0.0

Source: Senate Fiscal Agency

The Federal acceleration in the depreciation and expensing deductions for 2008 capital acquisitions initially will have a negative impact on the business income tax portion of the new Michigan business tax. The business income tax is based on business income as defined by the Internal Revenue Code, which includes the Federal deductions for depreciation and Section 179 expensing. Therefore, as the allowable deductions for Federal depreciation and expensing of capital goods increase for the 2008 tax year, the deductions for depreciation and expensing

State Notes

TOPICS OF LEGISLATIVE INTEREST

March/April 2008



under Michigan's business income tax also will increase, which will reduce businesses' 2008 tax liability. It is estimated that the Federal changes in depreciation and Section 179 expensing will reduce Michigan business tax revenue \$36.5 million in FY 2007-08 and \$120.4 million in FY 2008-09. The acceleration in the amount of depreciation that businesses will be able to claim in the 2008 tax year will reduce the amount of depreciation that will be available for them to claim beginning in the 2009 tax year. As a result, it is estimated that these Federal business tax changes will boost Michigan business tax revenue \$16.2 million in FY 2009-10 and \$32.7 million in FY 2010-11.