

Supplement to The Michigan Economic Outlook for 2024–2025: The State Tax Revenue Outlook¹

Jacob T. Burton, Gabriel M. Ehrlich, and Michael R. McWilliams
University of Michigan

The Consensus Revenue Estimating Conference (CREC) took place on May 17 in Lansing, during which state officials agreed on final revenue forecasts for fiscal years 2024–26. The short version of the story is that after a decline of 3.7 percent in fiscal 2023, state officials expect combined General Fund General Purpose (GFGP) and School Aid Fund (SAF) revenues to nudge down slightly further in fiscal 2024 before returning to moderate growth in fiscal years 2025 and 2026.

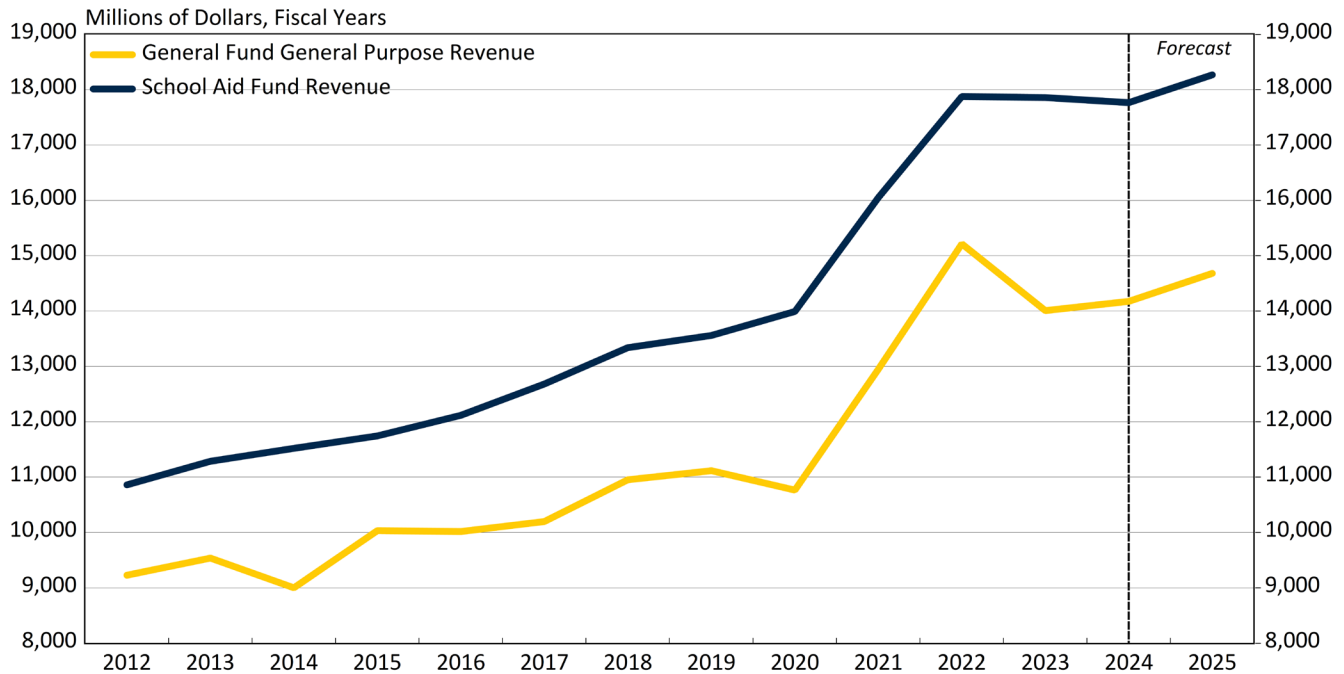
While the performance in fiscal 2023 and the outlook for fiscal 2024 may sound like bad news, there are two reasons we are not currently alarmed. First, combined revenues soared by over \$8.3 billion in fiscal years 2021 and 2022, as shown in Figure 1 below. The dramatic rise in state revenue during that time was due to several features of the pandemic and post-pandemic economy, most notably the emergency federal assistance and the shift in consumer spending from services to goods. Second, the dramatic fall of state tax revenue in fiscal 2023 was due mostly to a combination of factors related to the state’s tax laws rather than to economic factors.² Recent changes to the state’s tax laws will continue to

¹ We changed the format of this May’s forecast report to make our economic outlook for the state of Michigan available contemporaneously with the state’s May Consensus Revenue Estimating Conference on May 17, 2024. This report on the state’s tax revenue outlook serves as a supplement to our economic outlook. Both reports are publicly available on our website at <https://lsa.umich.edu/econ/rsqe/forecasts/michigan-forecast.html>.

² First, [Public Act 4 of 2023](#), adopted in March 2023, expanded exemptions for certain retirement income as well as the state’s earned income tax credit and adopted new earmarks to Michigan’s corporate income tax rate. Second, Michigan’s individual income tax rate was lowered from 4.25 percent to 4.05 percent for calendar year 2023 due to a provision associated with the state’s 2015 road funding law. Third, Public Acts 20, 21, and 29 of 2023 provided new sales and use tax exemptions for most delivery and installation charges in Michigan. Fourth, the state’s “flow-through entity tax”, adopted in December 2021, experienced a one-time outsized level of returns in fiscal 2022 and has subsequently fallen to a more sustainable level. Altogether, these factors are estimated to have reduced combined fiscal 2023 revenues by over \$1.8 billion in fiscal 2023, and they are expected to reduce fiscal 2024 and 2025 revenues by nearly \$2 billion and \$1.4 billion, respectively.

influence state tax revenues throughout our forecast period, as will the ongoing shifts in spending as consumers deplete any remaining excess savings from the pandemic era and continue to rotate their consumption bundles away from goods and back to services.

Figure 1
Michigan Tax Revenues, General and School Aid Funds



State officials expect combined GFGP and SAF revenues to decline by 0.3 percent in fiscal 2024, as the recent legislative changes continue to phase in. The State, however, anticipates growth to rebound to a middling pace of 2.1 percent in fiscal 2025. RSQE's forecast has a similar flavor but is slightly more optimistic over the next two years. We project growth in both years, with combined revenues increasing by 0.2 percent this fiscal year and then climbing 3.2 percent in fiscal 2025. The state's expanding labor market elicits healthy gains from personal income tax withholding in both years, driving a 1.2 percent increase in total GFGP revenue in fiscal 2024 and 3.6 percent in fiscal 2025. Sales and use tax revenue growth, on the other hand, is mixed. The ongoing shift in consumption patterns leads to a drop in combined sales and use tax revenue in fiscal 2024, before rebounding in fiscal 2025. Total SAF revenue mirrors this pattern and falls by 0.5 percent in fiscal 2024 before increasing by 2.8 percent in fiscal 2025.

We now describe our forecast of state revenues in more detail. Table 1 breaks down the recent history as well as our forecast for fiscal years 2024–25. The upper portion details GFGP revenues, and the lower portion summarizes SAF revenues.

Net Personal Income Tax Revenue

- Following two years of extraordinary growth during the pandemic, net personal income tax revenue declined by 11.5 percent in fiscal 2023 due to an increase in refunds and substantial reductions in annual, quarterly, and flow-through entity tax revenue. The reduction in flow-through entity tax revenue accounted for over half the decline. That decline was expected—the tax was introduced during fiscal 2022 and experienced outsized returns in its first year of existence due to incentives related to the timing of payments. The decline in fiscal 2023 represented an adjustment to a more sustainable level.
- Personal income tax withholding, on the other hand, saw a gain of 1.5 percent in fiscal 2023, despite the tax rate adjustment to 4.05 percent, bolstered by the ongoing jobs recovery and wage growth in the state.
- We forecast another year of declining revenue from annual, quarterly, and flow-through returns, but withholding more than makes up for that loss despite moderating job growth. Altogether, net personal income tax revenue rises 2.2 percent in fiscal 2024.
- We expect all components of personal income tax revenue to improve in fiscal 2025 as the new tax legislation is mostly phased in and the economy continues to expand. Net personal income tax revenue grows by 7.7 percent.

Consumption Tax Revenue

- GFGP consumption tax revenue in Michigan is driven by distributions from the sales and use taxes, with smaller contributions from excise taxes on cigarettes and alcohol.
- In fiscal 2021 and fiscal 2022, gross sales and use tax revenue showed remarkable growth due to the combination of resilient consumer demand during the pandemic, a shift in spending away from services to taxable goods, and inflationary pressures in goods markets.
- Sales tax revenue pulled back slightly in fiscal 2023 as economic growth softened, consumers felt the pinch of inflation, and spending began to shift back to services. Use tax revenue, on the other hand, grew rapidly in fiscal 2023, which may partly reflect increased consumer spending in the accommodations sector. Gross sales and use tax revenue ticked up 0.5 percent as a result.
- The ongoing transition of consumer spending back to services has led to a decline in sales tax revenue to-date in fiscal 2024. We project gross sales and use tax revenue to retract by 0.9 percent for the fiscal year.
- As the state economy continues to expand in fiscal 2025, we project gross sales and use tax revenue to pick back up, with growth of 1.7 percent.
- Combining the General Fund’s share of gross sales and use tax revenue with the excise taxes on cigarettes and alcohol, we forecast GFGP consumption tax revenue to fall by 1.6 percent in fiscal 2024 before nudging up by 0.8 percent in fiscal 2025.

Business Tax Revenue

- Business tax revenue comes primarily from the state's corporate income tax (CIT), insurance company premiums, and oil and gas severance tax payments. Certain businesses continue to pay taxes and claim credits under the previously used Michigan Business Tax (MBT) instead of the CIT. Variability in the timing of when MBT refunds are claimed can lead to swings in the state's overall business tax revenue. All business tax revenue accrues to the General Fund.
- Business tax revenue saw impressive growth during the pandemic, primarily due to sharp rises in CIT payments in fiscal 2021 and fiscal 2022.
- Gross CIT collections remained strong in fiscal 2023. The new earmarks adopted last year, though, subtracted from the share accruing to the General Fund, leading GFGP business tax revenue to drop 16.4 percent for the fiscal year.
- We expect GFGP business tax revenue to eke out growth of 0.8 percent in fiscal 2024 before falling by 1.1 percent in fiscal 2025.

Total General Fund Revenue

- Most of the GFGP's revenue sources declined in fiscal 2023, resulting in an overall loss of \$1.2 billion, or 7.9 percent, as shown in Figure 1. The decline came after two years of exceptional growth during the pandemic. Although some softening was expected, the decline in fiscal 2023 was due mostly to a combination of factors related to the state's tax laws as discussed above.
- Based on our projections of the individual components, we expect total GFGP revenue to grow by 1.2 percent in fiscal 2024 before accelerating to growth of 3.6 percent in fiscal 2025. This growth comes despite the ongoing phase-in of the new tax legislation and is largely attributable to the growth of personal income tax withholding in fiscal 2024 and overall personal income tax revenue in fiscal 2025.
- Our forecast puts total GFGP revenue almost \$3.6 billion, or 32.1 percent, higher in fiscal 2025 than in fiscal 2019. After adjusting for inflation, however, the growth of General Fund revenues from fiscal 2019–25 is only 4.1 percent, resulting in average real growth of just 0.7 percent per year.

Total School Aid Fund Revenue

- About half of total SAF revenue comes from sales and use tax collections, while one-fifth derives from the personal income tax, and about one-seventh comes from the state education property tax. Other taxes, such as the real estate transfer tax, liquor tax, casino tax, and tobacco tax, as well as lottery transfers, all contribute smaller amounts.
- Despite a sizeable loss in GFGP revenue, total SAF revenue managed to hold flat in fiscal 2023, as its allocations are generally based off gross revenue and are largely protected from the tax law changes that were adopted last year. That said, SAF growth in fiscal 2023 was held back by the drop in flow-through entity tax revenue and the overall decline in gross personal income tax revenue.

- Revenues related to the housing market also limited SAF growth in fiscal 2023. State education property tax revenue (SEP) grew by 4.8 percent, but real estate transfer tax revenue fell by 28.8 percent as mortgage rates soared and home sales cooled.
- We forecast total SAF revenue to decrease by 0.5 percent in fiscal 2024 as contributions from the sales, use, and personal income taxes all slide.
- We expect SAF revenue to expand by 2.8 percent in fiscal 2025, with growth from most major revenue components.
- Total SAF revenue is forecast to finish fiscal 2025 over \$4.7 billion, or 34.7 percent, higher than in fiscal 2019. After adjusting for inflation, that growth is reduced to 6.2 percent, translating to average real growth of just 1.0 percent per year from fiscal 2019 to 2025.

Table 1
State Revenues by Fiscal Year
(Millions of dollars, except as noted)

	Actual		RSQE Forecast	
	2022	2023	2024	2025
<u>General Fund General Purpose</u>				
Personal income tax	9,212	7,764	8,105	8,860
(% change)	(19.3)	(-15.7)	(4.4)	(9.3)
Consumption taxes	3,173	3,207	3,155	3,182
(% change)	(4.1)	(1.1)	(-1.6)	(0.8)
Sales	1,702	1,674	1,642	1,700
Use	1,192	1,272	1,256	1,228
Other consumption	279	261	257	254
Business taxes	1,993	1,665	1,678	1,660
(% change)	(25.7)	(-16.4)	(0.8)	(-1.1)
MBT/SBT/Corporate income	1,531	1,172	1,130	1,095
Other business	462	493	548	565
Other GFGP taxes	182	177	191	202
GFGP tax revenue	14,560	12,813	13,130	13,904
(% change)	(16.3)	(-12.0)	(2.5)	(5.9)
Nontax revenue	656	1,198	1,048	778
GFGP revenue	15,216	14,011	14,178	14,682
(% change)	(17.5)	(-7.9)	(1.2)	(3.6)
<u>School Aid Fund</u>				
SAF taxes	16,628	16,505	16,496	17,000
(% change)	(13.6)	(-0.7)	(-0.1)	(3.1)
Lottery transfer	1,248	1,352	1,270	1,270
(% change)	(-12.1)	(8.3)	(-6.1)	(0.0)
Earmarked state SAF revenue	17,876	17,857	17,766	18,270
(% change)	(11.4)	(-0.1)	(-0.5)	(2.8)
<u>Addendum</u>				
Combined GFGP and SAF revenue	33,093	31,868	31,944	32,952
(% change)	(14.1)	(-3.7)	(0.2)	(3.2)
Gross sales and use taxes	13,358	13,419	13,301	13,523
(% change)	(11.0)	(0.5)	(-0.9)	(1.7)

RSQE: May 2024