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Sales Tax Revenue Not Growing With Income

The state is seeing an increasing gap between the growth rate in people's incomes and growth in state's the primary consumption tax, the sales tax. That gap has revenue experts looking at the state's overall tax structure.

"This is a question that has come up over the last couple of years as a gap has opened up between income growth and sales and use tax revenue," explained Gabriel **EHRLICH**, the new director of the Research Seminar on Quantitative Economics (RSQE) at the University of Michigan.

Ehrlich explained to this morning's Consensus Revenue Estimating Conference that disposable income in Michigan last year (2016) grew at a rate of 4.1 percent. By contrast, the state's sales and use tax collections only grew by 1.3 percent. So why the 2.8 percent difference in growth?

He sees three primary culprits.

Of that difference, 0.3 percent is because people are saving more. A dollar saved is not a dollar spent. Another 1.6 percent of the difference is due dropping gasoline taxes.

"Spending on gas went down, quite a bit," Ehrlich explained. "Because gasoline is subject to the sales tax, when people spend less on gas, the state collects less in sales tax."

The third factor is just economic change.

People are spending more in the virtual world, which is by and large, free of taxation. Ehrlich said he believes that 0.9 percent of the so-called sales tax-income growth gap is due to a changing mix of things consumers buy that aren't subject to the state's 6 percent sales tax.

In 2000, the percent of personal consumption in Michigan that was subject to the Michigan sales tax was just below 37 percent. Today that percent is just above 31 percent.

According to State Treasurer Nick **KHOURI**, it is up to state public policy leaders to make sure the state's tax system evolves with the economy.

"We need to make a decision about how our tax system responds to that," Khouri told *MIRS*. "At the end of the day, it comes down to simple math. As part of reform, generally at the state level, we should look to make sure our tax system is keeping up with the evolving economy. What the specific answer is, I think it's a discussion we should have."

So does that mean treading back into the tough political waters of 2007 when lawmakers tepidly stuck the state's fiscal toe into the pool of applying sales taxes to services, a move that was quickly repealed?

Khouri said if that were pursued, it doesn't have to mean the legislature would be hiking taxes.

"In the aggregate, it doesn't have to be a tax increase," he told *MIRS*. "I'm not arguing that it has to be a tax increase. You could decide that through the rates. I'm just talking about what is the right tax base as the economy changes."

Khouri said any rise in revenue that would come from taxing services could be offset by a lower sales tax rate, or by lowering other taxes. In the end, he notes, however, the state has only three major taxes from which to make its revenue -- sales, income and property taxes.

"I look at it as two separate questions," Khouri said. "One, what is the right amount of revenue we should raise? Should it be higher or lower? That's separate from what's the best way to raise that revenue? What I'm talking about is the latter one. What's the best way to structure the tax system regardless of how much you want to raise?"

Incoming State Budget Director Al **PSCHOLKA** said he believes the taxation of services could be part of the overall tax discussion the legislature is going to have early in the 99th Legislature. He did note, however, that the internet tax passed by lawmakers that applies the sales tax to more internet-based sales is bringing in the projected $60 million anticipated when the measure was taken up.