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Senate Joint Resolution K (Substitute S-4 as reported)

Senate Bill 278 (as reported with amendment)

Senate Bill 508 (Substitute S-1 as reported)

Senate Bill 552 (Substitute S-1 as reported)

Senate Bill 553 (as reported without amendment)

Senate Bill 554 (as reported without amendment)

House Bill 4608 (as reported with amendment)

House Bill 4612 (as reported with amendment)

House Bill 4613 (Substitute S-2 as reported)

Sponsor: Senator Rudy J. Nichols (S.J.R. K)

Senator James A. Barcia (S.B. 508)

Senator Dick Posthumus (S.B. 552)

Senator Norman D. Shinkle (S.B. 553, S.B. 278)

Senator Dan L. DeGrow (S.B. 554)

Representative Mary C. Brown (H.B. 4608, H.B. 4612)

Representative Teola Hunter (H.B. 4613)

House Committee: Taxation (H.B. 4608, 4612 & 4613)

Senate Committee: Finance

Date Completed: 12-7-87

RATIONALE

Michigan's property tax system has long been the target of considerable complaint; it has been called the State's most onerous tax by some, an impediment to business and economic development by others. At the same time, there have been continuing calls from educators, parents, taxpayers, and business to reform and improve the financing of our public education system, and to insure quality education for all. While those who pay property taxes are frustrated with their seeming inability to prevent continual tax increases, educators are beset with the problems of balancing budgets in the face of ever-increasing costs and limited revenues.

As demonstrated by two recent reports, the Citizens Property Tax Commission Report (by the Citizens Property Tax Commission) and Educational Quality in the 21st Century (by the Michigan School Finance Commission), the problems of high property taxes and school financing are so linked that the issues cannot be addressed separately. Of the \$5.6 billion generated by the property tax in 1986, over 70% was used to fund public education. These figures show the State's heavy reliance on the property tax to fund education, and imply that, under the current tax structure, significantly lowering property taxes could drastically affect school financing, while increasing needed funding for education would likely only exacerbate the problem of high property taxes.

The studies show that Michigan's property tax burden is relatively high compared with other states. In 1984 property tax revenue in the State was 5.2% of personal income, or nearly 50% above the national average of 3.5%, ranking Michigan as the sixth highest among the states. While property taxes relative to personal income have risen steadily since the early 1970s, the State's share

of total public school revenue dropped from 47.4% in 1967-68 to 32.6% in 1981-82. Even with increased State funding, the figure rose to only 36.6% in 1985-86. This means that local school districts have had to shoulder a greater portion of the financing of schools, and this has resulted in greater reliance on the property tax.

The lessening of the State's share of school financing and the increased role of local districts have worsened the disparity in per-pupil expenditures among school districts, even those that have similar millages and enrollments, that has existed for years. Though total expenditures for education remain high — the State ranked tenth nationally in per capita expenditures in 1983-84 for public education, for example — the way that money is distributed varies widely from district to district, from around \$6,000 per pupil to \$1,800 per pupil. The tax bases of some districts (the state equalized valuation of the property within a district) are extremely high, while in other districts they are very low. The Bridgman School District, for instance, levies 6.3 mills to produce revenue of \$4,423 per pupil, while the average district levies 32.5 mills to produce about \$3,000 per pupil. The school aid formula reduces the disparity between districts somewhat, but does not compensate entirely for the differences between poor districts and wealthy districts throughout the State. Some people feel that properly addressing the problems of school financing and property taxes requires that existing revenues be distributed more equally throughout the State than is currently the case.

Several ideas have been put forth to address the problems of high property taxes and adequate and equitable financing of our education system. Some people feel that a constitutionally set statewide property tax, limits on local

SJR K, S.B. 278, 508, 552-554, HB 4608, 4612 & 4613 (12-7-87)

millage rates, and guaranteed per-pupil funding, combined with increased revenue from other sources dedicated to school aid, could provide the answers.

CONTENT

The bills and the joint resolution would amend various acts, and propose an amendment to the State Constitution, to restructure the State's public education financing system. All of the bills are tie-barred to Senate Joint Resolution K. Following is a detailed description of the joint resolution and each bill.

Senate Joint Resolution K (Substitute S-4)

The joint resolution proposes an amendment to Michigan's Constitution "to provide for school financing reform" by doing the following:

- Levying a statewide property tax of up to 20 mills for school operating purposes.
- Allowing up to four additional mills to be levied by a school district, with voter approval, and, in some cases, further additional millage with approval of a school board.
- Providing that each school district would receive each year at least \$3,000 per pupil or 115% of the amount the district received per pupil in the prior year, whichever was less, from the State School Aid Fund.
- Dedicating to the State School Aid Fund 100% of the statewide property tax, and 33% of the State's "growth revenue".

The joint resolution provides that beginning in 1989 there would be a statewide property tax of up to 20 mills. A school district could levy up to four additional mills with the approval of a majority of the electors voting on the question. If a school district, combining State School Aid and the four-mill levy, received less per pupil than it spent in the 1988-89 school year, it could levy, with the approval of the school board, an additional millage to make up the difference, but not to exceed the amount spent per pupil in the 1988-89 school year. The additional millage approved by the school board could not apply after the 1991 school year. If the ratio of the assessed valuation of property to the number of pupils in the State increased, by a percentage greater than the increase in the U.S. Consumer Price Index from the previous year, the maximum rate of the statewide property tax levy would have to be reduced to a rate that yielded the same gross revenue per pupil that could have been collected during the prior year.

The joint resolution would require that each school district receive from the State School Aid Fund at least \$3,000 per pupil per year, or 115% of the amount the district received per pupil in the prior year, whichever was less. The amount would be adjusted each year to reflect changes in the U.S. Consumer Price Index.

The State School Aid Fund would receive all of the revenue from the statewide property tax. The Fund would also receive 33% of each year's "growth revenue", defined as the amount of State revenue collected each fiscal year, not including revenue dedicated to transportation purposes under the Constitution, that exceeded revenue collected in the prior fiscal year. A new State tax, or increase in an existing tax, would be excluded from the growth revenue calculation in the year it took effect and the following year.

The joint resolution provides that revenue generated by the statewide millage could not be included in the calculations required by the tax limitation amendments to the Constitution, which restrict the total amount of taxes that maybe imposed on taxpayers in any one year, and require that a level of State spending to local governments be maintained.

If adopted by the Legislature, the resolution would be submitted to the people of the State at the next general election.

Senate Bill 508 (Substitute S-1)

The bill would amend the McCauley-Traxler-Law-Bowman-McNeely Lottery Act to provide that effective January 1, 1989, a prize awarded by the State Lottery would be subject to the State income tax. Currently, no State or local taxes can be imposed upon lottery prizes.

MCL 432.34

Senate Bill 552 (Substitute S-1)

The bill would amend the Single Business Tax Act to limit the excess compensation reduction that a business currently can use to reduce its adjusted tax base in calculating tax liability under the Act.

The adjusted tax base of a business as calculated under the Act, multiplied by 2.35%, produces its tax liability before certain credits and adjustments are allowed. Currently, after calculating its adjusted tax base, a business may reduce the base by calculating its excess compensation reduction. To do this, a business divides its compensation (labor costs) by its tax base. The resulting percentage that exceeds 63% is then multiplied by the business' adjusted tax base, and this amount is subtracted from the adjusted tax base. The bill provides that only that percentage exceeding 70% of the compensation/tax base ratio could be used to reduce the adjusted tax base, thus limiting the excess compensation reduction. (Example: If a business' compensation/tax base ratio is 73%, it currently can multiply its adjusted tax base by 10% (73% - 63% = 10%) and subtract the result from its adjusted tax base. Under the bill, however, because its compensation/tax base ratio exceeded 70% by 3%, the business could reduce its adjusted tax base by only 3%.)

The bill would take effect January 1, 1989.

MCL 208.31 et al.

Senate Bill 553

The bill would amend the General Property Tax Act to provide that the State would be considered a property tax levying unit under the Act, and that all of the Act's provisions regarding the powers and duties of local levying units would apply to the State.

The bill specifies that the Act's provisions regarding the treatment of delinquent property taxes would apply to the State.

The bill would take effect January 1, 1989.

Proposed MCL 211.1b

Senate Bill 554

The bill would amend the School Code to provide that there would be a statewide property tax levy of 20 mills, and that the millage would be collected at the same time and in the same way as other property taxes. The revenue would be deposited in the State School Aid Fund.

The bill would allow a local governmental unit that collected the statewide levy to charge taxpayers a tax administration fee of up to 1%, to offset any additional costs incurred in assessing property and collecting taxes for the statewide levy, and for participating in the review and appeal process.

The bill would take effect January 1, 1989.

Proposed MCL 380.1852

MORE

SJR K S B 27R 50R 552 553 554 NR 500R 510R 520R 530R 540R 550R 560R 570R 580R 590R 600R 610R 620R 630R 640R 650R 660R 670R 680R 690R 700R 710R 720R 730R 740R 750R 760R 770R 780R 790R 800R 810R 820R 830R 840R 850R 860R 870R 880R 890R 900R 910R 920R 930R 940R 950R 960R 970R 980R 990R 1000R

Senate Bill 278

The bill would amend Public Act 198 of 1974 to provide that an industrial facilities exemption certificate could not be granted after December 31, 1987. Exemption certificates in effect on that date would continue until the expiration of the certificates (up to 12 years).

Currently, the Act allows local units to establish plant rehabilitation districts and issue industrial facilities exemption certificates to exempt from property taxes qualified facilities within a district.

Proposed MCL 207.572

House Bills 4608 and 4612

House Bill 4608 would amend the General Sales Tax Act to specify that computer software was subject to the State sales tax, and House Bill 4612 would amend the Use Tax Act to make computer software subject to the use tax. In each bill, computer software would be defined as a set of statements or instructions that when incorporated in a machine-usable medium was capable of causing a machine or device having information processing capabilities to indicate, perform, or achieve a particular function, task, or result.

The taxes would be on computer software offered for general sale to the public (or general use by the public) and software modified or adapted to the user's needs or equipment only if it were available on an as-is basis or as an end product without modification or adaptation. Not included under the taxes would be software originally designed for the exclusive and special needs of the purchaser and specific, separately identified, charges for technical support or for adapting or modifying software programs for the purchaser.

MCL 205.51 (House Bill 4608)
205.92 (House Bill 4612)

House Bill 4613 (Substitute S-2)

The bill would amend the Income Tax Act to limit the homestead property tax credit to claimants, other than senior citizens, whose household income was less than \$29,000. The credit would be reduced by 10% for a claimant who had household income over \$20,000, and by an additional 10% for each \$1,000 of household income in excess of \$20,000.

Currently, the homestead property tax credit can be claimed by taxpayers, if they qualify, on household income of up to \$73,650 before the credit begins to be reduced by 10% for each \$1,000 of income. This provision would still apply to senior citizens under the bill.

Under the Act, taxpayers can claim a credit against State income tax liability equal to 60% of the amount by which their property tax, or 17% of rent, exceeds 3.5% of total household income, up to a maximum credit of \$1,200.

The bill would take effect January 1, 1989.

MCL 206.520

SENATE COMMITTEE ACTION

As passed by the House, House Bill 4613 (H-1) would have amended the Income Tax Act to do the following:

- Create the 10/20 homeowner tax credit, a credit equal to the first 10 mills on the first \$20,000 of market value for taxpayers with an adjusted gross income of \$50,000 or less.
- Tax certain military pay.
- Tax lottery winnings.

- Eliminate certain single business tax credits for utilities.
- Increase the personal exemption.
- Limit the Homestead Property Tax Credit to households with an income under \$50,000.

The Senate committee substituted the bill to eliminate all of these provisions and instead insert a provision to limit the Homestead Property Tax Credit to households with an income of \$29,000 or less. The substitute also contains a provision to tie-bar it to Senate Joint Resolution K.

The Senate committee also adopted amendments to House Bills 4608 and 4612, which would amend the General Sales Tax Act and the Use Tax Act respectively, to tax computer software. The amendments would tie-bar the two bills to Senate Joint Resolution K.

FISCAL IMPACT

Senate Bill 508 (Substitute S-1)

If all lottery prizes had been taxed as ordinary income, State General Fund/General Purpose revenues would have increased approximately \$18.5 million in FY 1986-87.

Senate Bill 552 (Substitute S-1)

Using a sample of 1983 tax returns, the Department of Treasury estimates that raising the excess compensation deduction from 63% to 70% would have increased Single Business Tax collections by \$60 million in FY 1982-83. Applying the growth rate in overall Single Business Tax revenues between 1983 and 1988 would result in a FY 1987-88 revenue increase of \$90 to \$95 million under Senate Bill 552.

Senate Bill 553

The bill would have no fiscal impact on State or local government.

Senate Bill 554

A 20-mill statewide property tax would generate approximately \$2,406.6 million in the 1989 tax year.

Senate Bill 278

The fiscal impact of eliminating Public Act 198 tax abatements would depend on whether abatements are effective in encouraging additional State investment. According to a recent Senate Fiscal Agency report, if one assumes that the new investment would have taken place without the tax abatement, Public Act 198 resulted in a revenue loss for State and local government for all outstanding abatements of approximately \$250 million in 1986. In contrast, assuming none of the investment would have taken place without the abatements, the estimated revenue increase for State and local governments was approximately \$185.8 million. Finally, new abatements granted in 1986 resulted in a loss of State and local revenue of \$41.3 million (assuming the investment would have taken place without the tax incentive).

House Bill 4608, 4612 and 4613 (S-2)

House Bill 4608 and House Bill 4612 together would increase State GF/GP revenues by approximately \$10 million per year.

Fiscal information is not available on House Bill 4613 (S-2) at this time.

ARGUMENTS

Supporting Argument

School districts should have the financial resources to offer a proper quality education to every student. There is strong evidence that the public in Michigan is willing to continue its long and proud tradition of providing that education; however, the current method of financing this most worthy expenditure has placed the system in jeopardy. Local districts rely heavily on the property tax to finance their schools, and in recent years have seen their percentage of the total cost of funding education rise dramatically, while the State's share has fallen. Greater reliance on the property tax for school funding has placed tremendous pressure on the schools because their alternatives to increasing revenues are limited. On one hand, schools must pay for ever-increasing operating costs and salaries while answering the public's demand that students be prepared for an increasingly technological and complicated society. On the other hand, to generate the revenue needed to operate the schools properly, the majority of the schools' revenue must come from sometimes reluctant, sometimes resistant, property owners and the good faith of the voters. By capping property tax levies for schools, increasing revenues to the School Aid Fund, and dedicating one-third of the State's future revenue growth to education, increase the State's burden of providing funding and thus increase the State's percentage of funding. This would eliminate the continual pressure on school boards and school administrators to ask the voters to provide more property tax revenue, and would thus allow schools to devote a greater portion of their efforts toward developing and providing quality educational programs and the administration of those programs.

Supporting Argument

The problems of high taxes and adequate funding for all of the State's schools have been the subjects of lengthy and continuing debate for many years. Within the past decade, there have been major proposals, some of them drastic, to alter the State's property tax system and the State and local financing system. Three proposals were placed on the 1978 ballot and three were placed on the 1980 ballot to alter, most notably through property taxes, the State's tax structure. All of the ballot questions were defeated except the Tax Limitation Amendment (Proposal E, or the Headlee Amendment) in 1978. After those defeats, the emphasis in the battles over tax policy switched from property taxes to the income tax, which was raised for six months in 1982 and again from 1983 through a portion of 1986. The property tax issue, though not the headline grabber it once was, has not disappeared and, because of the heavy reliance of school districts and local governments on the property tax, is no less important than in the past.

Michigan's property tax burden relative to other states rates as the sixth highest, and, as a percentage of personal income, is 50% higher than the national average. The strongest complaints about property taxes understandably come from homeowners and businesses owners who find their property values and property taxes rising at the same time that their incomes and ability to pay the taxes are not. High property tax rates are often cited as a deterrent to businesses looking to locate in Michigan, and as an incentive for existing businesses to locate elsewhere.

Currently, the average school district in the State levies 32.5 mills. Senate Joint Resolution K, by placing in the Constitution a statewide millage not to exceed 20 mills and allowing only a four-mill levy by the school districts (more if required, but only through 1991), would provide significant property tax relief in those areas where the school millage rate is near or above the average. The resolution also would provide a buffer against rising

property tax values: it provides that if the assessed valuation of a property compared to pupil count in a district increases at a rate greater than the increase in inflation, the statewide millage would have to be reduced to a rate that yielded the same revenue per pupil as in the previous year. By placing a constitutional limitation on school district property taxes, the resolution would lower the property tax burden for vast numbers of individuals and businesses, would stimulate business growth and economic expansion, and would ease the State's debilitating dependency on the property tax.

Supporting Argument

By guaranteeing \$3,000 per pupil (or 115% of a district's per-pupil expenditure in the prior year if it were less than \$3,000) and requiring yearly adjustments to reflect inflation, Senate Joint Resolution K would help to correct a number of vexing problems, most prominent among them the current disparity that exists in per-pupil spending throughout the State. While districts rich in industrial, commercial, and residential properties with high values can generate a high level of per-pupil funding with relatively modest millage rates, many districts with depressed or declining property values find themselves with inadequate funding even though millage rates are high.

Though the current school aid formula attempts to equalize statewide per-pupil funding by directing State funding toward lower-revenue districts, there still exists a wide disparity in funding levels. This is evidenced by the fact that per-pupil expenditures range from nearly \$6,000 per student to \$1,800 per student, and nearly one-fourth of the State's school districts are out-of-formula (meaning that they receive no money from the State School Aid Fund because the high value of their property tax base relative to their low millage rate effort disqualifies them from receiving funds under the formula). Per-pupil expenditure is based in great part, therefore, on the relative wealth of a school district. Though it would be unfair to assume that students in poorly funded schools automatically receive a poor education, while those in rich districts receive a superior education, it is also unfair to expect that the educational opportunity offered at a price of \$1,800 per student will be the same as an opportunity offered at \$6,000 per student. It is the State's responsibility to provide an education to all its residents, but a system that allows for such an unequal distribution of funds to its citizens based on the wealth of a location encourages the development and continuation of a dual system of educational elitism and educational deprivation. The joint resolution, by requiring a statewide per-pupil expenditure rate, dedicating 20 mills to the State School Aid Fund, and allowing local millage efforts, would reduce considerably the range of spending throughout the State, enrich many poorer districts, and require those districts that currently have high per-pupil funding to make an effort to maintain that funding.

Placing a statewide property tax of 20 mills in the School Aid Fund, and guaranteeing a level of per-pupil expenditure, would have the overall effect of school districts' sharing their tax bases. This would be particularly important in those instances in which a district's total property value was threatened because of a failed industry or a large commercial development gone bankrupt, as such an event would not cause the financial disruption that it can under current conditions. In effect, school districts would no longer be faced with the choice of begging the voters for more millage or reducing programs.

Opposing Argument

The proposal contains a number of disturbing elements. Instituting a statewide property tax and dedicating that revenue to the School Aid Fund, in effect, would pool the resources of all school districts. By capping the amount of millage that local districts can levy and limiting the per-pupil expenditure in districts after 1991, the joint resolution would penalize those districts that have supported their schools and currently spend far greater amounts per pupil. Further, it would penalize those persons and employers who have chosen to live and do business in an area based upon the area's school district and the education that the district provides. Though it may be that current funding methods create disparity in per-pupil funding among districts, it hardly seems appropriate that the funding levels of the fortunate should be dragged down to benefit the unfortunate. The answer to unequal per-pupil expenditure should be greater State funding for poorer districts through other revenue sources or reduced State expenditures in areas other than education.

The joint resolution, in addition to ensuring a statewide property tax in the Constitution, inappropriately would dedicate one-third of the State's annual revenue growth to the School Aid Fund, meaning that 33% of all new revenue would be earmarked for education. This provision would take a great deal of the appropriations decision-making process away from the Legislature, creating potentially troublesome future scenarios. What if the number of students in the State, for instance, dropped dramatically in relation to property values? The State would still be collecting the statewide millage that would be placed in the School Aid Fund, plus the annual revenue growth, but would have considerably less need to do so. In the meantime, a critical State need (more prisons, for instance) could go unmet or underfunded because substantial amounts of revenue were simply not available. It is likely that the 33% provision would cause harm to local units of government in years when there was little or no growth, as revenue sharing had to be cut since a set amount of money for education was constitutionally determined.

Further, guaranteeing levels of funding and indexing for pupil expenditure to inflation ignores the premise that funding should be based on need. The proposal assumes that the level of per-pupil expenditure has a direct bearing on educational quality. Educational quality is determined by a number of factors (teachers, setting, parent involvement, peers, class size, etc.) one of which is funding. Additionally, can it be said with certainty that a 3% rise in inflation should be met with a corresponding 3% rise in expenditures per pupil? The Legislature should be allowed the discretion of deciding where limited revenues are most needed rather than having its hands tied by a continual funding plan.

Opposing Argument

What the people of Michigan want and need is real property tax relief, not a tax shift. Tax cuts and assurances and validations that current revenues are being used efficiently are the real answer to property tax reform. The bills would put money in one hand of the taxpayer while taking it from the other. While the proposal supposedly would cap the number of mills a school district could levy, thus purporting to lower property taxes, it would substantially reduce the ability of persons to claim the homestead property tax credit by making ineligible for the credit those with household income above \$29,000, and reducing by 10% for each \$1,000 over \$20,000 the credit eligible claimants could take. Thus, a healthy portion of the revenue generating part of the school finance reform

plan would be paid for through a reduction in the current property tax credit. Further, the State Constitution currently places a 50-mill limitation (with certain exceptions) on taxes imposed on property for all purposes.

Senate Joint Resolution K would reduce the 50-mill figure to 30, but would apply the limitation to property taxes for all purposes other than for school district operation. By levying a statewide 20-mill tax, allowing voters to approve four additional mills for schools, and allowing school boards to add further mills under certain conditions, the proposal could possibly, with voter approval, exceed the current 50-mill limitation.

Opposing Argument

The proposal would cap the statewide millage levy at 20 mills, but allow an additional four mills with voter approval, and under certain circumstances, additional millage with local school board approval. The proposal would likely anger voters who think that they voted to cap property tax millage rates, only to discover that their local district wanted four more mills, and their local school board wanted more on top of that. The proposal could cause severe credibility problems for local districts.

The proposal would also cause great consternation in those areas of the State that currently levy less than 20 mills for school operating purposes.

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This analysis was prepared by nonpartisan Senate staff for use by the Senate in its deliberations and does not constitute an official statement of legislative intent.