SFA BILL ANALYSIS

Senate Fiscal Agency • Lansing, Michigan 48909 • (517) 373-5383

Senate Joint Resolution K (Substitute S-7 as reported)
Senate Bill 508 (as reported without amendment)
Senate Bill 553 (as reported without amendment)
Senate Bill 554 (as reported with amendment)
Senate Bill 714 (as reported with amendment)
Senate Bill 715 (as reported with amendment)
House Bill 4613 (Substitute S-4 as reported)

Sponsor: Senator Rudy J. Nichols (S.J.R. K)
Senator James A. Barcia (S.B. 508)
Senator Norman D. Shinkle (S.B. 553)
Senator Dan L. DeGrow (S.B. 554, 715)
Senator John J. H. Schwarz, M.D. (S.B. 714)
Representative Teola Hunter (H.B. 4613)

House Committee: Taxation (H.B. 4613)
Senate Committee: Finance

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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.

According to 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 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, which 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 Bridgeman 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 millage rates, and guaranteed per-pupil funding, combined with increased revenue from an increase in the sales tax and 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 except Senate Bills 714 and 715 are tie-barred to Senate Joint Resolution K. Following is a detailed description of the joint resolution and each bill.

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Senate Joint Resolution K (Substitute S-7)

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

- Increasing the State's sales and use taxes from 4% to 5%.
- Levying a statewide property tax of up to eight mills for school operating purposes.
- Allowing up to seven mills to be levied by a school district without the approval of the voters, up to seven mills with the approval of the voters, and, in some cases, further additional millage with approval of a school board.
- Providing that each school district that levies at least seven mills would receive each year at least $2,750 per pupil or 110% of the amount the district received per pupil in the prior year, whichever was less, minus an amount equal to the school district's State equalized valuation per pupil multiplied by seven mills.
- Dedicating to the State School Aid Fund 100% of the statewide property tax and the revenue from the 1% sales and use tax increase, and 25% of the State's "growth revenue".

The joint resolution provides that beginning in 1989 there would be a statewide property tax of up to eight mills. A school district could levy up to seven mills without approval of the voters, and could levy an additional seven mills with voter approval. If a school district, combining State school aid and a 14-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, additional millage but not more than an amount that increased per pupil spending to 104% of the 1988-89 level through the 1991-92 school year. After the 1991-92 school year, a district could levy, with voter approval, an amount up to that year's millage plus two mills. 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 also require that each school district that levied at least seven mills receive from the State School Aid Fund at least $2,750 per pupil per year, or 115% of the amount the district received per pupil in the prior year, whichever was less, minus an amount equal to the school district's State equalized valuation per pupil multiplied by seven mills. The amount would be adjusted annually to reflect any change in the State's General Fund/General Purpose revenues.

The State School Aid Fund would receive all of the revenue from the statewide property tax and the 1% increase in the sales and use taxes. The Fund would also receive 25% 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 and the 1% increase in the sales and use taxes could not be included in the calculations required by the tax limitation amendments to the Constitution, which restrict the total amount of taxes that may be 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

The bill would amend the McCauley-Traxler-Law-Bowman-McNeely Lottery Act to provide that 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 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 eight 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 require 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

Senate Bill 714

The bill would amend the General Sales Tax Act to raise the sales tax from 4% to 5% as of January 1, 1989, and to dedicate the 1% increase to the State School Aid Fund. Currently, 60% of the revenue collected under the Act is dedicated to the State School Aid Fund. Under the bill, after the 1% increase in the sales tax was deposited in the Fund, 60% of the remaining sales tax collections also would have to be deposited in the Fund.

The bill would phase-out the sales tax on public utility services to residential dwellings. Beginning in 1989 the levy would be 4%; it would be reduced to 3% in 1990, 2% in 1991, and 1% in 1992, and would be eliminated in years after 1992.

MCL 205.52 et al.

Senate Bill 715

The bill would amend the Use Tax Act to raise the use tax from 4% to 5%, and dedicate 20% of the revenue collected under the use tax to the State School Aid Fund.

The bill would phase-out the use tax on public utility services to residential dwellings. Beginning in 1989 the levy would be 4%; it would be reduced to 3% in 1990, 2% in 1991,

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and 1% in 1992, and would be eliminated in years after 1992.

MCL 205.93 and 205.111

House Bill 4613 (Substitute S-4)

The bill would amend the Income Tax Act to limit the homestead property tax credit to claimants whose household income was less than $59,000. The credit would be reduced by 10% for a claimant who had household income over $50,000, and by an additional 10% for each $1,000 of household income in excess of $50,000.

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. 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 also make permanent a requirement that property tax credits claimed by persons receiving Aid to Families with Dependent Children (AFDC) or General Assistance (GA) be reduced by the proportion of their income represented by assistance payments. (Beginning with returns for 1980, and continuing with yearly extensions, the Act has required that property tax credits claimed by people receiving AFDC or GA be reduced by the proportion of their income represented by assistance payments.)

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 $59,000 or less. The substitute also contains a provision to make permanent a requirement that property tax credits claimed by persons receiving AFDC or GA be reduced by the proportion of their income represented by assistance payments.

The substitute also contains a provision to tie-bar it to Senate Joint Resolution K.

FISCAL IMPACT

Senate Joint Resolution K

An eight-mill statewide property tax and a seven-mill local property tax would generate $1,805 million in the 1989 tax year. A one-cent increase in both the sales and use taxes would increase dedicated revenues by $740.3 million in FY 1989-90. Earmarking 25% of State revenue growth would increase School Aid funding by approximately $60.0 million in FY 1989-90. (For a full fiscal impact estimate of S.J.R. K and accompanying bills, see the Senate Fiscal Agency memoranda of February 8 and February 19, 1988.)

Senate Bill 508

Taxing lottery winnings as ordinary income would generate approximately $10.0 million per year in GF/GP revenues.

Senate Bill 553

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

Senate Bill 554

An eight-mill statewide property tax would generate approximately $962.7 million in the 1989 tax year.

Senate Bill 714

The bill would increase dedicated State revenues by approximately $584.2 million in FY 1989-90.

Senate Bill 715

The bill would increase dedicated State revenues by approximately $112.1 million in FY 1989-90.

House Bill 4613

Phasing out the homestead property tax credit for households whose income is in excess of $50,000 would increase GF/GP revenue by approximately $19.2 million in FY 1989-90.

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 by dedicating a 1% sales and use tax increase to the School Aid Fund, and dedicating one-quarter of the State's future revenue growth to education, the proposal would 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

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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 the property tax 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 income 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. By placing in the Constitution a statewide millage not to exceed eight mills and allowing only a 14-mill levy by the school districts (more if required, but only through 1992), Senate Joint Resolution K 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: if the assessed valuation of a parcel compared to pupil count in a district increased 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 $2,750 per pupil (or 110% of a district's per-pupil expenditure in the prior year if it were less than $2,750) and requiring yearly adjustments to reflect inflation, Senate Joint Resolution K would help to correct a number of vexing problems, most prominent among them being 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 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 the revenue from a statewide property tax of eight mills and 20% of sales and use taxes 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 would, in effect, pool the resources of all school districts. By capping the amount of millage that local districts can levy and thus limiting per-pupil expenditures, 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-quarter of the State's annual revenue growth to the School Aid Fund, meaning that 25% 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

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substantial amounts of revenue were simply not available. It is likely that the 25% 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 per-pupil expenditure to inflation would ignore 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 avenue 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 reduce the ability of persons to claim the homestead property tax credit by making ineligible for the credit those with household income above $59,000, and reducing by 10% for each $1,000 over $50,000 the credit eligible claimants could take. Thus, a 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.

Opposing Argument

The proposal would cap the statewide millage levy at eight mills, but allow a school district to levy seven mills, allow seven additional mills with voter approval, and under certain circumstances, allow 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 school board wanted more on top of that. The proposal could cause severe credibility problems for local districts.

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