House
Legislative
Analysis
Section

Olds Plaza Building, 10th Floor
Lansing, Michigan 48909
Phone: 517/373-6466

BLT PROPERTY TAX PROPOSAL

House Bills 4278, 4279, 4281-4286
(Substitutes H-2)
House Bill 4280 (Substitute H-3)

Sponsors:
Rep. Bob Emerson (HB 4278)
Rep. William R. Keith (HB 4279)
Rep. H. Lynn Jondahl (HB 4280)
Rep. Michael E. Nye (HB 4281)
Rep. Susan Grimes Munsell (HB 4282)
Rep. Jessie Dalman (HB 4283)
Rep. Gregory E. Pitoniak (HB 4284)
Rep. Bill Bobier (HB 4285)
Rep. Ken Sikkema (HB 4286)

House Joint Resolution G
(Substitute H-1)
Sponsor: Rep. Glenn Oxender

Senate Bill 146 (Substitute H-3)
Sponsor: Sen. Doug Carl

Committee: Taxation
First Analysis (3-17-93)

THE APPARENT PROBLEM:

The cover of the November 20, 1971, issue of Saturday Review magazine announced, "Financing Schools: Property Tax is Obsolete." More than 20 years later, that famous periodical is long gone, but the property tax remains. And school financing continues to be the focus of intense debate. As a recent report by the Citizens Research Council of Michigan noted, there have been 12 proposals dealing with property taxes put before the voters since November of 1972, only one of which passed (the Headlee proposal of 1978). Most were defeated by very large margins. In November of 1992, voters rejected two proposals, one of which would have reduced school operating millages by 30 percent and both of which would have limited annual assessment increases. Innumerable property tax and school finance plans have been before the legislature during the same period. Repeatedly, policymakers have made serious efforts to find better ways to raise and distribute tax dollars for elementary and secondary schools. Time and again, attempts at creating lasting comprehensive school finance reform have been frustrated by the enormous complexity of the task and by the competing and conflicting goals of the parties involved.

By and large, criticism of Michigan's current school financing system focuses on three interrelated elements: the overreliance on the local property tax; the disparities in spending per pupil from school district to school district; and the inability of some districts to raise the funds to provide even a minimally acceptable educational program for their children. People differ over which element deserves most emphasis. For some, the issue is simply the high level of property taxation, and they call for a reduction in that burden as a stimulus to the economy, as well as a reduction in the size of government generally. Others focus on shifting from the local property tax to state taxes, whether the income tax, the sales tax, or a statewide property tax, in order to equalize per pupil spending and provide additional funds to the lowest spending districts. Yet others put less emphasis on equality of spending and instead advocate changes in the tax system that will provide all students with at least an acceptable level of spending while leaving alone those districts that have the resources they need.

At the heart of the school financing problem is the local property tax. Michigan is by most accounts a high property tax state, regularly raising more revenue from that source than from sales and income taxes combined. It is a highly visible, unpopular tax, that is often described as inconsistently administered from community to community. Although an extensive system of credits has eased its impact on low-income and elderly taxpayers, on agriculture, and on some favored businesses, it is widely criticized for bearing insufficient relationship to a taxpayer's ability to pay. Nevertheless, it is the principal means of funding for public schools. School districts collected over 70 percent of all 1991 property tax revenues. The Citizens Research Council said in a recent report that, in 1990, "Michigan property taxes were 31 percent higher than the national average."

Reliance on the property tax, moreover, has produced serious inequality between school districts. The amount of money a student has spent on his or her education depends upon the total amount of property wealth in the district and the willingness of residents to tax themselves. While the state aid formula reduces the disparities somewhat, it is still possible for one district to spend thousands of dollars per pupil more than a neighboring district while levying a much lower millage rate. Students fortunate enough to live in "property-rich" jurisdictions, economically growing areas, or communities with extensive business property have far more dollars behind them than others. Some districts in the state are spending under $3,500 per pupil and others over $8,000 per pupil!

The traditional strength of the property tax as a source of revenue has been its stability. The Citizens Research Council points out that from 1978 to 1991, the property tax brought in additional revenue each year, while each of the major state taxes (the income tax, sales tax, and single business tax) had years when revenues decreased from the previous year. But the strength of the property tax has been diminished in recent years by aggressive assessment protests by large manufacturers, including General Motors and Ford Motors, by plant closings, and by taxpayer resistance to millage increases. And the other side of "stability" of revenues is the perception among taxpayers of steadily increasing tax burdens. The lifting of a one-year assessment freeze for 1992 complicates matters by presenting many taxpayers with large assessment increases for 1993.

Once again there are proposals before the legislature dealing with property taxes (and there is renewed optimism that the time is right for significant change). Governor Engler is proposing an assessment reduction approach that would reduce the percentage of market value on which property tax rates are levied. A bipartisan group of legislators in the House of Representatives has developed a new approach to school financing that would rely less on property taxes and more on either the income tax or sales tax.

THE CONTENT OF THE BILLS:

The following is a brief description of the main provisions of the so-called bipartisan legislative team (BLT) school finance/property tax proposal. The proposal would:

** Replace local school operating property taxes on residential and agricultural property with a statewide property tax of 16 mills to be levied by an education finance authority. (The average school operating millage rate is said to be 34.6 mills) There would be no change in the taxation of commercial and industrial property, but millage rates could not be increased beyond current levels. The statewide millage would be subject to Headlee rollback requirements (if revenue increased at a faster rate than inflation), but there could be no override.

** Raise the state income tax from 4.6 percent to 6.0 percent with the additional revenue dedicated to the school aid fund.

** Increase the personal exemption in the state income tax from $2,100 to $2,775 for 1993 and $3,000 after that.

** Increase the percentage of rent that can be used in calculating a renter's homestead property tax credit from 17 percent to 20 percent. (That figure is the amount of rent assumed to be spent for property taxes in calculating the credit.)

** Allow the income tax increase to be replaced by a two-cent sales tax increase if approved by voters at a statewide referendum in November 1994.

** Provide a statewide basic per pupil grant to school districts of $4,700 in fiscal year 1992-93 and adjusted annually thereafter based on changes in revenues and pupil counts (an estimated $4,850 for fiscal year 1993-94). School districts spending below the basic grant level currently would be limited to a 10 percent annual increase in per pupil revenue. For two years, districts spending above the basic grant amount would get a grant equal to their 1992-93 total revenues. (In other words, they would be "held harmless" and not see revenue reductions for two years.) The basic grant would be reduced by $100 per pupil for districts that did not comply with Public Act 25 of 1990 (which requires school improvement plans, core curriculums, and accreditation).

** Allow certain high millage, low income districts to retain some extra property taxes locally until 1998-99. The amount of money provided to a district by the state would be calculated by subtracting from the basic grant the funds raised by local property taxes on business property. In a district where the average gross income was less than 90 percent of the state average (as certified by the Department of Treasury), only the revenue from the first 38 mills levied would be subtracted from the grant. (This means the district could retain the mills above that number levied on business property.) The amount of the reduction from the grant, however, would be increased by 20 percent in 1994-95; 40 percent in 1995-96; 60 percent in 1996-97; 80 percent in 1997-98; and 100 percent in 1998-99.

** Eliminate categorical grants except for special education and bilingual education. The state would continue to pay retirement system contributions for the schools. Moneys that currently go to schools through categorical grants would be part of the basic grant to each local district.

** Permit a local school district income tax to be approved by the voters for up to ten years (with renewals possible) in order to maintain per pupil spending above the basic grant amount after 1994-95. If voters approved an income tax levy that, combined with the basic grant, resulted in per pupil spending more than twice the basic grant in any year, the basic grant to the district would be reduced by one-half the excess amount.

House Bill 4278 would amend the School Aid Act (MCL 388.1611 et al.) to provide for the determination of the basic grant and continuing categoricals. House Bill 4279 would amend the School Code (MCL 380.1204a et al.) to authorize continued millages for community colleges operated by school districts, to penalize districts that fail to meet Public Act 25 requirements, and to repeal tax base growth sharing. House Bill 4280 would create the Education Finance Authority Act, under which the 16-mill statewide property tax would be levied. House Bill 4281 would amend the Income Tax Act (MCL 206.30 et al.) to raise the rate to six percent, increase the personal exemption, increase circuit breaker credits for renters, and hold harmless local units from the reduction in income tax revenue resulting from the increased personal exemption. House Bill 4282 would create the Local School District Income Tax Act. House Bill 4283 would amend the Property Tax Limitation Act (MCL 211.201 et al.) to prevent a county from allocating fewer mills to a school district than those allocated in 1993. House Bills 4284-4286 would amend three acts dealing with tax increment finance authorities to protect arrangements entered into prior to February 1, 1993. Senate Bill 146 would amend the General Property Tax Act (MCL 211.2b) to exempt residential and agricultural property from local school operating taxes. House Joint Resolution G would put the two percent sales tax increase (in the constitution) before the voters in November of 1994 to replace the income tax increase. The bills are all tie-barred to one another.

HOUSE COMMITTEE ACTION:

Senate Bill 146 as it passed the Senate contained Governor Engler's proposal to reduce assessment ratios from the current 50 percent of market value to 45 percent in 1993; 42.5 percent in 1994; and 40 percent in 1995 and thereafter. The House Taxation Committee adopted a substitute that incorporated Senate Bill 146 into the BLT proposal.

FISCAL IMPLICATIONS:

According to information by the staff to the House Taxation Committee, the proposal contains a $330 million tax cut through the increase in the income tax personal exemption.(2-4-93) Critics in the Department of Treasury have said that the proposal will mean overall higher taxes if school districts currently spending above the basic grant amount maintain current spending through a local income tax. (3-10-93) How the proposal affects individual districts and individual property owners varies widely based on circumstances. The House Fiscal Agency has prepared information on the proposal's effect on school districts.(3-5-93)

ARGUMENTS:

For:

The BLT proposal represents a major overhaul of the state's property tax/school finance system. It recognizes that the issues of reducing property taxes and funding schools cannot be dealt with separately. It addresses the major problems of the current system by reducing the reliance on the local property tax; making funding for school districts more equal; and increasing the financial resources of the lowest spending districts. On average, school operating property taxes on residential and agricultural property would be reduced by more than half. Property taxes on such property would be collected by a state authority and shared statewide. (Business property taxes would remain with the local district at current rates, but the rates would be frozen.) A basic grant from the state would be established that contributes roughly the same amount of dollars to each student's education, no matter where he or she lives. The basic grant is expected to be about $4,850 in 1993-94. Lower spending districts would see their funding increased 10 percent a year until they reached the grant level. At the same time, school districts would not be prevented from spending more than the basic grant; there would be no cap on spending. There would be a two-year "hold harmless" period, and then a district could levy, with voter approval, a local income tax to maintain current spending levels or even to increase spending.

One of the advantages of the basic grant approach is that it provides school districts with a more predictable revenue stream. Districts will not be dependent on annual legislative appropriations and school aid formula calculations. School administrators will be able to concentrate on educational issues rather than expending energies on endless millage election drives.

The BLT proposal would increase the state income tax, which is more closely tied to the ability to pay, to cover the property tax cut. Voters could decide in 1994 whether to replace the income tax (or perhaps replace remaining property taxes) through an increase in the sales tax. However, the proposal would provide a tax cut by increasing the personal exemption in the income tax. This benefits all taxpayers, not just property owners, and particularly benefits large families. Similarly, the amount renters can claim for a homestead property tax reduction would be increased, to ensure that they benefit along with residential property owners.

Although the proposal contemplates funding schools through a statewide property tax, it would actually increase local control of school budgets. This is because many categoricals (earmarked state funds) are eliminated and the dollars put into the basic grant to school districts. Local districts, not state policymakers, will decide how these dollars are spent.

Against:

The following criticisms have been made of the proposal.

-- The proposal represents at best a tax shift and probably an overall tax increase when what the state needs is a tax cut. An across-the-board property tax reduction is the best approach. This proposal does nothing for the state's businesses, the job-creators, which are overburdened with property taxes. Taxing business property at a higher rate than residential and agricultural property is obviously discriminatory and may be unconstitutional. It will undoubtedly be challenged in court. The state's economy, and its ability to create new jobs, would be better served with a straightforward assessment reduction plan.

-- Some school districts could suffer a significant loss of revenue under this proposal. Districts spending above the basic grant level will only be able to maintain or enhance current spending by getting voter approval of a local income tax. Some districts that have been able to get millage increases approved, particularly where commercial and industrial property bears a significant portion of the burden, may find local income tax increases impossible. Some districts will need to levy income taxes of two or three percent to stay at current spending levels. This would be on top of the increase in the state income tax (and possibly federal income tax increases)! Without approval of the local income tax, some districts will be forced to cut educational programs dramatically.

-- While providing equal funding for each child sounds fair, the reality is that some districts need more dollars than others, that costs differ in different parts of the state, that some children cost more to educate than others, that a "one size fits all" funding approach is not practical. Some allowance needs to be made for this.

-- Some people complain that the funding increases some school districts will receive under this plan are not tied in any way to improved performance. If the additional dollars simply go into higher salaries without educational improvements, what has been gained? Similarly, there are benefits to having the legislature examine each year spending needs of districts through the budget process rather than permitting automatic increases. This proposal assumes that what is wrong with schools is a lack of funding, whereas the relationship between school quality and funding levels is a shaky one at best.

-- Some programs operated now by intermediate school districts through categorical grants could disappear if the dollars are sent straight to local school districts as part of the basic grant. This has been the experience with professional development programs, say ISD representatives. Categoricals have been a means for the state to emphasize its educational priorities and introduce needed change into the educational system. They are the main source of ISD program funds. ISD leaders fear that valuable programs, such as regional media centers, accreditation assistance, school improvement planning, and professional development, will be lost as local districts use dollars that once were part of categoricals to deal with inflationary needs and contract negotiations. In states where local districts decide whether to purchase ISD-type services, there is a lot of discontinuity in programming, say ISD advocates. Similar problems could arise with the elimination of local district categoricals, such as those for gifted-and-talented programs.

-- Some people are opposed to any increase in sales taxes, which they consider regressive, as an alternative to income or property taxes. There are those who support the proposal in general who opposed HJR G as a result.

POSITIONS:

The following are among those who have indicated supported for the Bipartisan Legislative Team proposal: The League of Women Voters, the Michigan Education Association, the Michigan Federation of Teachers, and the Michigan Municipal League.

Among those who have expressed opposition to the proposal are the Michigan State Chamber of Commerce, the Michigan Townships Association, Taxpayers United for the Michigan Constitution, and the state treasurer.