



**House
Legislative
Analysis
Section**

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TIFAS: SCHOOL TAX CAPTURE

House Bill 4284 as enrolled
Sponsor: Gregory E. Pitoniak

House Bill 4285 as enrolled
Sponsor: Rep. Bill Bobier

House Bill 4286 as enrolled
Sponsor: Rep. Ken Sikkema

House Committee: Taxation
Senate Committee: Not referred.

Second Analysis (7-14-94)

THE APPARENT PROBLEM:

Michigan's new school finance system, approved by the voters at a March 15 referendum, reduced property taxes significantly for many property owners. The new financing scheme includes a state property tax of 6 mills on all property and a local tax of 18 mills in most school districts on property other than homesteads and agricultural property. In some districts additional local millage can be approved to keep schools at current spending levels, and all districts can seek voter approval of a limited number of "enhancement" mills. Additional taxes, subject to certain limits, are also permitted for intermediate school districts. One issue that arose in the debate over the new school finance plan was the treatment of authorities making use of tax increment financing. This economic development tool allows special local authorities to capture the growth in tax revenue in a designated development area (e.g., a downtown district) for use in a wide variety of improvements to public facilities (e.g. sidewalks, lighting, parking, beautification efforts, recreational facilities). Typically the facilities are paid for through bond issues that are paid off from the tax revenue growth in the development area. Such plans already in place obviously depend on capturing some school property taxes. So the question arose of how to protect TIFA plans from the substantial reduction in property taxes in many communities. Also, a decision had to be made as to whether state and local school taxes levied under the new financing system could be captured by TIFAs in the future. The statutory backup plan that would have gone into effect had the March 15 ballot

proposal been rejected contained a proposal to protect existing TIFA projects, but the ballot plan did not address the subject (although supporters said they assumed existing projects would be protected and pointed to proposed appropriations for that purpose).

THE CONTENT OF THE BILL:

Under the bills, tax increment finance authorities and similar entities could capture non-school revenue as now. Revenue from the new state education property tax and from local and intermediate school district property tax levies (and specific taxes on abated property in lieu of such taxes) could only be captured in a development area to repay eligible advances, eligible obligations, and other protected obligations stemming from TIFA plans approved before August 19, 1993. (This protects certain commitments for ongoing projects and already approved "pipeline" projects.) Revenues from the state education tax, local school district, and intermediate district, respectively, would be captured in proportion to their percentage of the total of school tax revenues. The bills specify that the school taxes would be captured in the amount necessary to repay eligible advances, eligible obligations, and other protected obligations "without regard to" tax revenues from non-school sources. This is said to mean that school taxes would be captured first to protect those commitments and only after that would non-school tax revenue be captured for those purposes.

House Bills 4284-4286 (7-14-94)

The legislature would be required to hold a TIFA harmless when, due to the reduction in school property taxes, it had insufficient revenues to repay an eligible advance or to pay an eligible obligation. The legislature would be required to appropriate and distribute money to an authority based on a formula provided in the three TIFA-related statutes. Generally, the state would make up the difference between the total revenues (from school and non-school sources) that an authority would have received if school millage rates were at 1993 levels and the revenues it actually received. However, the amount distributed could not be greater than the difference between the eligible advances and obligations and the authority's tax increment revenues and other non-TIFA revenues to be used for the payment of those commitments. But, additional amounts could be distributed to cover shortfalls if the state distribution and the authority's revenues still did not cover eligible advances and obligations in a fiscal year and if the payment on those commitments under a TIFA plan anticipated the use of excess prior year increment revenues that the authority had been permitted by law to retain.

Claims would have to be made to the Department of Treasury not less than 30 days before the first day of a fiscal year (except that claims for the 1993-94 fiscal year could be made at any time). Distributions would be made by the state to an authority in two equal payments, on March 1 and September 1 after receipt of a claim. The bills specify what information would have to be contained in a claims report.

Calculations of distributions and required claims reports would be made on the basis of each development area of the authority.

House Bill 4284 would amend the downtown development authority act (MCL 125.1651 et al.). House Bill 4285 would amend the Tax Increment Finance Authority Act (MCL 125.1801 et al.). House Bill 4286 would amend the Local Development Finance Act (MCL 125.2152 et al.).

Under the bills, an "eligible advance" would mean an advance made before August 19, 1993. An "eligible obligation" would mean an obligation issued or incurred by an authority or municipality on behalf of an authority before August 19, 1993. The term "other protected obligation" would apply to 1)

an obligation to refund a bond or note that was an eligible obligation; 2) an obligation issued or incurred after August 19, 1993, but before December 31, 1994, to finance a project described in a plan approved before August 19, 1993 (or for a downtown development authority, before December 31, 1993) and for which a contract for final design had been entered into before March 1, 1994; and 3) an obligation incurred after August 19, 1993, to reimburse a party to a development agreement entered into before that date for a project described in a plan approved before August 19, 1993, and undertaken and installed by that party in accordance with a development agreement. House Bill 4284, which deals with downtown development districts, would add to the term "other protected obligation", an obligation incurred by the authority evidenced by or to finance a contract to purchase real property within a development area, or both, if all of the following requirements were met: 1) the authority purchased the property in 1993; 2) before June 30, 1995, the authority entered a contract for the development of the property; and 3) in 1993, the municipality on behalf of the authority received approval for a grant from both the Department of Natural Resources (for site reclamation) and the Department of Commerce (for development).

FISCAL IMPLICATIONS:

According to the Senate Fiscal Agency, TIFAs will capture about \$108 million in school property taxes in fiscal year 1994-95. Of this \$104 million will come from the state education tax, local school taxes on non-homestead property, and specific taxes on abated properties (e.g., industrial facilities under Public Act 198 of 1974). This loss, says the SFA, will be made up to the schools by the state through higher state school aid payments. In addition, "hold harmless" mills (to bring higher spending districts up to current spending levels) and enhancement mills will also be captured. This means, the SFA says, that schools with hold harmless mills will need to have slightly higher millage rates to generate the same amount of money, and schools levying enhancement mills will generate less money from the tax. The SFA also points out that \$40 million was appropriated in 1993-94 and \$22 million in 1994-95 to allow the state to cover TIFA shortfalls. (7-1-94)

ARGUMENTS:

TIFA debts with school tax revenue to be captured only after that.

For:

The bills would allow tax increment financing to continue, although at reduced levels. They permit the capture of school taxes to cover obligations from certain existing and pipeline TIFA projects and require state reimbursement to cover some obligations if they cannot be met due to the reduction in property taxes that resulted from the enactment of a new school financing system. Other local tax revenues would continue to be subject to capture for any purpose. The bills as passed by both House and Senate would require the capture of school-related property taxes first for the payment of eligible advances and obligations and other protected obligations. Then other local tax revenues could be captured if needed for those obligations. Finally, if those two sources were not sufficient for that purpose, there would be a contribution from the state. The bills ensure that TIFAs will not be left without a means of meeting their obligations. The fiscal health of local units of government with TIFAs should not be threatened due a change in tax policy made at the state level. It should be noted that over time, as existing obligations are paid off, there will be less need to capture school taxes. For local units without a great deal of debt currently, these bills would permit new economic development activities by TIFAs by allowing the capture of non-school tax revenues for new projects.

Against:

Concerns have been raised throughout the discussion on the TIFA bills about the loss of revenues intended for the schools. The new school tax system has yet to be fully tested, and school supporters are concerned about its ability to generate sufficient funding. Allowing school tax revenues to be captured, even if for limited purposes, is not encouraging to those who fear the new financing system will not fully fund the schools. The loss of school aid dollars to TIFA capture will require additional general fund spending on schools. Plus, allowing capture of school mills will require some districts that need extra mills to stay at current spending levels to raise taxes even higher than would otherwise have been the case. Other alternative proposals would have allowed the capture of school revenues only if needed to meet existing TIFA commitments after non-school revenues had been captured, or would have required the use of a state appropriation to cover certain