

Legislative Analysis



CITY UTILITY USERS TAX

Mitchell Bean, Director
Phone: (517) 373-8080
<http://www.house.mi.gov/hfa>

House Bill 4737 as passed by the House
Sponsor: Rep. George Cushingberry, Jr.
Committee: Tax Policy

First Analysis (9-29-05)

BRIEF SUMMARY: The bill would amend the City Utility Users Tax Act to eliminate the rate reduction and staffing provisions that apply when revenue exceeds \$45 million. The city would be permitted to use all revenue generated from the tax for the hiring and retention of police officers.

FISCAL IMPACT: The bill would have no impact on state revenue, and would have no mandatory impact on revenue in the city of Detroit if the current statutory provisions are followed.

THE APPARENT PROBLEM:

The City Utility Users Tax Act permits the City of Detroit to impose on city utility users a tax of five percent of the amount paid for utilities.¹ The first \$45 million in revenue generated from the tax must be used to hire and retain police officers. If, in a fiscal year, tax revenue exceeds \$47.25 million, the city must either use the excess revenue above \$45 million to hire and retain police officers above the level of police officers on November 1, 1984 or reduce the rate on October 1 of the following fiscal year by a ¼ of one percent for each \$2.25 million above \$45 million.

In an April 2005 analysis of Mayor Kilpatrick's FY 2006 Executive Budget, the City of Detroit Auditor General noted that the projected utility user tax revenue for FY 2004-2005 was \$53 million (\$8 million above the revenue threshold). This would require the city to use the additional revenue to hire police officers above the 1984 level of 3,530 officers (according to the city's figures) or reduce the rate to 4.25 percent.² After a series of work force reduction through layoffs and attrition, the number of police officers in the city fell below the 1984 level during the last three months of the city's 2005 fiscal year (July 1, 2004 – June 30, 2005), and so the city did not meet the spending and staffing requirements of the act. (This is the first time this has happened since the staffing provision was enacted in 1984.) As a result, a rate reduction is required beginning on

¹ See also Detroit City Code § 18-11-1 et seq.

² According to the City of Detroit Office of the Auditor General, in April, the mayor's budget projected \$56 million in utility user tax revenue for FY 2006. Reducing the rate by three-quarters of one percent, based on FY 2005 revenue projection of \$53 million, would decrease tax revenue by an estimated \$6.3 million to \$49.7 million, assuming the revenue projections hold. Assuming the city doesn't meet the staffing requirements and revenue projections hold, the rate would be further reduced by one-half of one percent on October 1, 2006. Further, the Detroit Police Officers Association asserts the number of police officers as of 11/1/1984 to be 2,756. The Auditor General's analysis cites 3,537 officers. According to committee testimony this includes 7 chiefs and deputies, which should be excluded from the count.

October 1, 2005, and will again be required on October 1, 2006 if the city does not meet the spending and staffing requirements during the 2006 fiscal year.

The city currently faces a potential budget shortfall of about \$187 million, and cannot afford to "lose" any additional utility user tax revenue because of a rate reduction.³ This past week, Mayor Kilpatrick presented the City Council with a plan to balance the budget that relies, in part, on an additional \$6.3 million in utility user tax revenue. The city has suggested that the rate reduction and staffing level provisions in the act be eliminated. This would permit the city to keep the rate at five percent, and use all of the revenue from the tax for the hiring and retention of police officers, without reducing the rate and without any staffing requirement.

THE CONTENT OF THE BILL:

The City Utility Users Tax Act permits the City of Detroit to levy, assess, and collect from city utility users, a tax of up to five percent (in increments of ¼ of one percent) on the amount paid for intrastate telephone communication services, electrical energy, steam, and natural and artificial gas provided by a public utility or a resale customer.

The act provides that the first \$45 million in revenue generated from the tax is to be used to retain or hire police officers, and further provides that if the amount generated in a fiscal year exceeds \$47,250,000 (105 percent of \$45 million), one of the following is to occur:

- The rate shall be reduced in decrements of ¼ of one percent for each \$2.25 million (five percent of \$45 million) collected in excess of \$45 million, beginning on October 1 of the following fiscal year.
- The amount collected in excess of \$45 million shall be used to hire and retain additional police officers above the number of officers employed on November 1, 1984 (3,530 officers according to the city).⁴

House Bill 4737 would delete the above language, and simply provide that all of the revenue generated from the tax shall be used to hire and retain police officers.

MCL 141.1152

³ See articles in the *Detroit Free Press* on 9/28/05 detailing these problems and the mayor's solutions at, www.freep.com/news/locway/budget28e_20050928.htm and www.freep.com/news/locway/budget-box128e_20050928.htm. Additionally, a September 9, 2005 memo from the City Council's Fiscal Analyst to the council discusses the city's budget problems, and projects a budget gap of at least \$215 million. The memo is available on the council's website at www.ci.detroit.mi.us/legislative/CouncilDivisions/FiscalAnalysis/Reports/FIRSTBUDMON%20RPTFINAL.pdf

⁴ If revenue is between \$45 million and \$47.25 million, there is no language currently in the act requiring how the excess revenue above \$45 million is to be spent, nor would a rate reduction be required. Moreover, if revenue is more than \$47.25 million and the city does not meet the spending and staffing requirements, it can use the excess revenue above \$45 million for any purpose, although a rate reduction would be required the following year.

BACKGROUND INFORMATION:

Utility User Tax Revenue

In April, the mayor's proposed executive budget projected \$56 million in utility user tax revenue. The adopted budget projects \$49.7 million, which accounts for approximately 1.8 percent of total city revenue. However, according to one representative of the city, ongoing budget negotiations between the administration and the city council have resulted in a revised revenue projection of \$56 million. The chart below, adapted from a report on the mayor's budget by the city's Auditor General, shows budgeted and actual utility user tax revenue since FY 1995.

Fiscal Year	Budgeted Revenue (millions)	Actual Revenue (millions)	Δ% in Actual Revenue from Prior Year
1995	52.5	49.6	(7.5)
1996	56.3	53.9	8.7
1997	54.7	54.6	1.3
1998	57.4	50.1	(8.2)
1999	54.7	50.9	1.6
2000	54.6	54.5	7.1
2001	54.6	54.3	(0.4)
2002	54.6	52.1	(4.1)
2003	54.6	55.3	6.1
2004	55.2	50.5	(8.7)
2005	55.0	53.0	5.0
2006	56.0	N/A	N/A

Source: Office of the Auditor General, City of Detroit

Detroit Police Department Restructuring

In mid-April, Mayor Kilpatrick presented a proposed FY 2006 budget to the city council that, among other things, called for the layoff of an unspecified number of commanders and inspectors within the police department, and the layoff of the 91 student police officers. (The layoff affecting the student police officers is being challenged by the Detroit Police Officers Association and is currently pending before the state Court of Appeals.)

In June, the city council adopted a budget cutting the department's budget by \$54 million, which the police chief and city officials said would have led to the lay off of 584 police officers. (This would be in addition to the loss of 721 sworn positions over the last two years through attrition and unfilled vacancies.) In response, the chief assembled a committee to restructure the department and, in late August, announced a restructuring plan that proposed the following changes:

- Merge the city's 12 police precincts into six larger police districts.
- Layoff 150 police officers.

- Reassign 250 of the 426 officers working in non-patrol positions, placing them on the street. (When combined with the layoffs, there would be an increase of 100 officers on street patrols.)
- Reduce command staff through attrition and demotions.
- Increase departmental efficiency and effectiveness through the elimination and consolidation of various police units and divisions.

Overall savings realized through these changes were projected to be about \$20 million (\$34 million short of total required cuts). However, any savings will be delayed, as the layoffs and demotions are currently being challenged in court. In early September, a Wayne County Circuit Court judge stayed the demotion of 14 inspectors and four commanders. The judge extended a prior order that held that the city could not unilaterally reduce the pay or rank of police commanders. The department had projected that the demotions would have saved about 30 to 40 patrol positions. The Detroit Police Officers Association also filed suit in Wayne County Circuit Court challenging the layoff of 150 officers.

A more detailed description of the department's restructuring plan is available through the city's website at www.ci.detroit.mi.us/HomePage/Police%20Report.pdf. See also articles in the *Detroit Free Press* (www.freep.com/news/locway/police30e_20050830.htm) and *Detroit News* (www.detnews.com/2005/metro/0508/30/A01-297330.htm).

Legislative History

The city utility users tax dates to the enactment of Public Act 198 of 1970. (For technical reasons, it was re-enacted by Public Act 100 of 1990). At the time, the city's financial difficulties prompted then-Mayor Roman Gribbs to push for the utility tax and an increase in the city's income tax. (The legislature did not increase the city's income tax rate, but authorized the utility users tax and provided the city with a one-time grant of \$5 million.) Initially, Public Act 198 provided that all of the revenue generated from the tax had to be used exclusively for "public safety" purposes, which included both police and fire protection. A *Detroit News* editorial from August 1970 noted that, "the new money will enable the mayor to reinstate a fire cadet program and fill vacancies in the Police Department" and "could not be used to restore other city services that have been curtailed." The tax was expected to raise approximately \$18.5 million on an annual basis.

Public Act 34 of 1979 added the rate reduction provision, with a revenue threshold of \$37 million (the estimated revenue for FY 1979), which was later increased to \$45 million with the enactment of Public Act 108 of 1981.

In 1984, a federal district court ordered the city to recall about 724 police officers who were laid off during city budget cutbacks in 1979 and 1980. The recall was to be phased in during the first six months of 1985. The city estimated that the court order would cost about \$60 million over the next four years, an amount which the city could not afford. Also, at that time, the utility user tax rate was lowered from five percent to four percent on October 1, 1984, as required by statute, after the tax generated about \$54.4 million in revenue in FY 1983. In response, then-Detroit Mayor Coleman A. Young urged the

legislature to let the city increase the rate back to five percent and use the additional revenue – expected to be about \$68 million over the next four years – to recall the laid off officers. The legislature and governor responded by enacting Public Act 349 of 1984, which required that the first \$45 million in tax revenue be used for the hiring and retention of police officers (apparently conforming state law to then-city policy), and required that additional revenue above \$45 million be used to hire and retain police officers above the number employed as of November 1, 1984.

ARGUMENTS:

For:

The bill permits the City of Detroit to retain an estimated additional \$6.3 million (see footnote 2) in utility user tax revenue in FY 2006 that otherwise could be lost. The Detroit police chief testified that without this money, additional layoffs will be necessary.

The Detroit City Council unanimously passed a resolution in support of the bill, stating that, "The prospective loss of funding for the Detroit Police Department would prompt steep cuts in police personnel at a time when the City of Detroit is preparing to host several world-class events, including the 2005 Major League Baseball All-Star Game and the 2006 Super Bowl."

Against:

Representatives of the Detroit Police Officers Association have argued that doing away with the staffing requirements will result in many more layoffs than those projected by the department, as the city could simply reduce General Fund support to the department, offsetting the additional utility user tax money. The 1984 staffing level served to provide assurances that the police department will be appropriately staffed. While the city has been well above this level for the past 20 years, the number of officers has been whittled away through layoffs and attrition. Without any staffing requirement, police ranks could be reduced even further. This ultimately could result in fewer officers on the street and place the safety and well-being of city residents, business owners, visitors, and remaining police officers at great risk.

Response:

Fungibility will always be an issue when the department's budget includes a mix of utility user tax revenue, general fund revenue, and other revenue sources. To the extent that the city reduces General Fund support for the department because of the utility users tax revenue, it averts deep cuts in other departments and other city services (which have also had their share of cuts in recent years). If the city is to reverse its fortunes, it must find the resources to provide water, lighting, and transportation services, as well as the police protection. Moreover, if the police department's budget must be cut, it's not clear where cuts could come from other than through layoffs (and/or wage reductions), given that, according to committee testimony provided by the Detroit police chief, nearly 90 percent of the department's budget is in personnel costs.

While the staffing level in the act may have once made sense, it appears to have little relevance to today. In 1984, the city wanted to use the excess revenue to recall recently laid-off police officers. The date was placed in statute to provide assurances that the city would use the extra money for those officers. (In the 21 years since, the city has

routinely met the spending and staffing requirements.) As time passes the staffing number becomes ever more arbitrary, particularly given the precipitous decline in the city's population over the last 20 years.

Against:

Rather than eliminating the rate reduction and staffing level provisions altogether, the bill should be updated to more accurately reflect the current structure of the Detroit Police Department and the city's financial situation. The revenue threshold has been in place for nearly 25 years and perhaps should be increased. The staffing level was set in 1984. That number should be updated to reflect the current staffing levels of the department. Perhaps, moreover, a target number should be established in the act, to avoid the kind of situation that exists today, where city officials and police officer representatives cannot agree over the number represented by the 1984 staffing-level guideline. Putting a precise number in statute could protect utility user tax revenues and guard against future layoffs.

Response:

Ultimately, the number of police officers is a matter that should be addressed by city officials and the police unions through the collective bargaining process. Moreover, by eliminating the rate reduction and staffing level provisions, the bill largely returns to the language as provided for in the original act of 1970. This provides the department and the city with greater flexibility in determining how to use the city's financial resources.

Against:

The rate reduction should be allowed to continue, for several reasons. First, taxes in the city are already very high, and lowering the tax burden on city residents and businesses would encourage much-needed investment in the city. Second, the tax is highly regressive; that is, more burdensome on lower-income residents. Finally, the tax is added on to home heating costs, which are expected to increase dramatically this winter.

As an alternative, perhaps the act should contain a sunset date, so that state and city officials could review the city's financial picture and the need for continuing the tax. The original 1970 act included a sunset date of December 31, 1972, which was subsequently extended for the next 20 years, until the act was re-enacted in 1990. The tax appears to have been transformed from a temporary, stop-gap measure intended to shore up the city's finances during a few lean years in the 1970's and 1980's, to a permanent revenue source.

POSITIONS:

The City of Detroit supports the bill. (9-22-05)

The Detroit Police Officers Association opposes the bill. (9-22-05)

Legislative Analyst: Mark Wolf
Fiscal Analyst: Jim Stansell

■ This analysis was prepared by nonpartisan House staff for use by House members in their deliberations, and does not constitute an official statement of legislative intent.