Legislative Analysis

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DETROIT CITY INCOME TAX

House Bill 5105 without amendment
Sponsor: Rep. Steve Tobocman
Committee: Tax Policy

First Analysis (9-25-07)

BRIEF SUMMARY: The bill would amend the City Income Tax Act to: (1) to establish the maximum allowable income tax rate in the City of Detroit at 2.50 percent for resident individuals and 1.25 percent for nonresident individuals (the rates that have been in place since 2004); and (2) to eliminate provisions requiring that the city's individual income tax rate be lowered incrementally each year until it reaches the level of 2 percent for residents and 1 percent for nonresidents.

FISCAL IMPACT: This bill would have no state fiscal impact. The City of Detroit imposes a local income tax on residents and nonresidents. Each 0.1 percentage point for residents (and 0.05 percentage point for nonresidents) equates to approximately $11 million on a full year basis.

THE APPARENT PROBLEM:

The City Income Tax Act permits cities to levy an income tax. Special separate provisions govern cities with a population of over 750,000 (Detroit), which can impose an income tax on corporations, city residents, and nonresidents working in the city. Under these provisions, the maximum rate imposed on corporations is two percent. (The current corporation rate is one percent.) Before July 1, 1999 the maximum allowable rate imposed on individuals was three percent for residents and 1.5 percent for nonresidents, and Detroit residents had voted to adopt the maximum level of income taxation. Public Act 500 of 1998 began reducing the maximum allowable individual income tax rates, beginning July 1, 1999 by 0.1 percentage point each year until the resident rate was reduced to two percent.

(Although the rate reductions were to occur on July 1, presumably to coincide with the beginning of the city's fiscal year, the city testified that where two different rates occurred during a single calendar year, they were combined into a single rate. For instance, the first adjustment reduced the income tax rate from 3 percent to 2.90 percent on July 1. This reduction was put in place by establishing a rate of 2.95 percent for that entire calendar year.)

The scheduled rate reductions have been suspended in recent years, however. The act allows a suspension of the rate reduction if the city applies to the State Administrative Board and demonstrates that three of the following conditions are present:

- Funds from the city's rainy day fund have been withdrawn during the previous two fiscal years or the fund has a balance of zero.
- The city's income tax revenue growth rate is 0.95 or less.
- The local tax base growth rate is 80 percent or less of the statewide tax base growth rate.
- The city's unemployment rate is 10 percent or higher according to the most recent available statistics from the Michigan Jobs Commission.

City representatives say Detroit will not continue to be eligible for a suspension of a rollback from the current level of 2.5/1.0 (resident individual/nonresident individual) because it will not be able meet the requirement that it meet at least three of those listed statutory conditions. But given the state of city finances, a reduction of the city income tax could lead to layoffs of 200 to 300 city employees, including firefighters and police officers. Legislation has been introduced to halt future rate reductions and freeze the maximum rate at its current levels.

THE CONTENT OF THE BILL:

The bill would amend the City Income Tax Act to specify that, beginning July 1, 2007, the income tax rate in the City of Detroit would be 2.5 percent on resident individuals and 1.25 percent on nonresident individuals. Under the bill, the process that requires the individual tax rate to be lowered each year (with an exception described below) would no longer apply after June 30, 2007.

(The rates specified in the bill are the current city income tax rates in Detroit that have been in place since 2004.)

Under House Bill 5105, the provisions dealing with the conditions that allow a halt in rate reductions would be eliminated and the maximum rates as of July 1, 2007 (2.50 percent on resident individuals and 1.25 on nonresident individuals) would be fixed.

MCL 141.503

ARGUMENTS:

For:

Why should the City of Detroit not be able to establish its own city income tax rate (subject to a statutory maximum) with more independence from the Legislature? Currently, Detroit is subject to state-mandated city income tax reductions and must use a state-mandated appeals process if it seeks to suspend a scheduled rate reduction. The bill would, instead, leave a cap on Detroit's individual income tax rate at 2.5/1.25 percent (resident individual/nonresident individual)—the rate that has been in place since 2004—but eliminate further mandated reductions. This bill would give the City of Detroit more independence in setting its income tax rate.

The income tax rollback otherwise scheduled to go into effect in 2008 would have a serious negative impact on city finances, reducing 2008 revenue by approximately $11 million. City representatives say Detroit will not be eligible for a suspension of a rollback from the current level of 2.5/1.0 (resident individual/nonresident individual) because it will not be able meet the requirement that it meet at least three statutory conditions before appealing for a suspension of rate reductions. Given the state of city finances, a reduction of the city income tax could lead to layoffs of 200 to 300 city employees, including firefighters and police officers.

Proponents also contend that it is especially unfair for the city to be required by the Legislature to lower its income tax rate given that the bill that required a reduction in Detroit income tax rates (Public Act 500 of 1998) was tie-barred to Public Act 532 which specified that for the period October 1, 1998 through September 30, 2007, the City of Detroit would receive $333.9 million in total (constitutional plus statutory) revenue sharing payments. According to city representatives, the City of Detroit has not received this amount since 2002, when revenue sharing payments to all Michigan cities, including Detroit, began to be reduced. Given that the city has not received the revenue sharing payments promised by Public Act 532, it should not be required to lower its city income tax as required by Public Act 500. To require taxes to be cut at the same time that revenue sharing payments have been reduced from promised levels would put the city's finances in a precarious position.

This should not be considered a "tax increase" because City of Detroit's 2007 income tax level is 2.5 percent, and it has been at this level since 2004 due to decisions by the State Administrative Board in a series of appeals filed by the City of Detroit. City representatives say that because of these determinations no reduction has gone into effect since 2004. The bill will simply freeze the statutory maximum at current levels and relieve Detroit of the obligation to make further reductions in its income tax rates.

Against:

Detroit has historically had the highest city income tax levels in Michigan and while its rates have been lowered from the 3.0/1.5 levels that were in place when Public Act 500 was adopted, Detroit's income tax levels remain the highest in the state. A high individual income tax rate could be viewed as a disincentive for people to live or work in Detroit.

While the bill would not increase Detroit city income tax rates from current levels, the bill *would* eliminate the mandate that Detroit continue to reduce its income tax rate by another 0.5 percent in .10 annual increments. Some persons might characterize eliminating the Legislature's mandate that the City of Detroit lower its future tax rates as a "tax increase."

Detroit residents have been promised that their city income taxes would be lowered incrementally until they reached the level of 2 percent for residents and 1 percent for non-residents. Some may have made important financial decisions based on this promise, which should be kept.

POSITIONS:

The City of Detroit supports the bill. (9-5-07)

The Department of Treasury is neutral. (9-5-07)

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