Legislative Analysis

Phone: (517) 373-8080
http://www.house.mi.gov/hfa

Analysis available at
http://www.legislature.mi.gov

ROAD FUNDING PACKAGE – *ENACTED ANALYSIS*

House Bill 4370 – Public Act 179 of 2015
Sponsor: Rep. Hughes

House Bill 4614 – Public Act 177 of 2015
Sponsor: Rep. LaFontaine

House Bill 4616 – Public Act 178 of 2015
House Bill 4736 – Public Act 174 of 2015
House Bill 4737 – Public Act 175 of 2015
House Bill 4738 – Public Act 176 of 2015
Sponsor: Rep. McCready

Senate Bill 414 – Public Act 180 of 2015
Sponsor: Sen. Schmidt

Complete to 11-16-15

SUMMARY:

Note: This document describes major changes contained in these bills related to transportation financing and other state revenues. It is not a comprehensive description of the changes made by each bill.

House Bill 4738 would amend the Motor Fuel Tax Act to increase motor fuel taxes as follows:

- Increase the tax on diesel motor fuel from 15 cents per gallon and the tax on gasoline motor fuel from 19 cents per gallon to a single rate of 26.3 cent per gallon on all motor fuel effective January 1, 2017
- Annually adjust the tax rates for motor fuels based on consumer inflation (using the U.S. Consumer Price Index), with increases capped at 5% per year, effective January 1, 2022.

The bill would also add provisions to the act related to alternative fuels.

House Bill 4736 would amend the Michigan Vehicle Code to increase certain vehicle registration tax rates. Rates for most passenger cars, vans, light trucks, and large commercial trucks would increase by 20%, beginning January 1, 2017. The current average registration tax for a passenger vehicle is approximately $100; this bill would increase that average by approximately $20. The bill would also create a new registration tax surcharge for electric-powered motor vehicles.

House Bill 4370 would amend the Income Tax Act of 1967 to earmark a portion of income tax revenue currently allocated as General Fund/General Purpose (GF/GP) revenue to the Michigan Transportation Fund (MTF) for distribution to the State Trunkline Fund (STF) and to local road agencies according Section 10(1)(k) of Public Act 51 of 1951 (bypassing the Comprehensive Transportation Fund). The earmarks would be as follows:

- $150 million for FY 2018-19.
- $325 million for FY 2019-20.
- $600 million for FY 2020-21 and subsequent fiscal years.

The bill would also expand the Homestead Property Tax Credit by changing the following parameters:

- Increase the percentage of gross rent paid that can be utilized to calculate the credit from 20% to 23% for tax year 2018 and subsequent tax years.
- Increase the household income phase-out range for claiming the credit by $10,000 for tax year 2018 and subsequent tax years. The current phase-out range is $41,000-$50,000 (the credit is reduced by 10% for each $1,000 of income above $40,000).
- Increase the maximum credit that can be claimed from $1,200 to $1,500 for tax year 2018 and subsequent tax years.
- Lower the percentage of household resources utilized as the threshold for calculating the credit amount from 3.5% to 3.2% for tax year 2018 and subsequent tax years.
- Adjust dollar amounts utilized in calculating the credit amount based on the U.S. Consumer Price Index beginning with tax year 2021.

<u>Senate Bill 414</u> would amend the Income Tax Act of 1967 to create a mechanism that would automatically reduce the individual income tax rate if the increase from one year to the next in total GF/GP revenues exceeded inflation (as calculated using the U.S. Consumer Price Index). This determination would begin with tax year 2023 (based on final FY 2021-22 GF/GP revenue growth) and continue indefinitely on an annual basis.

The income tax rate (currently 4.25%) would be reduced proportionally based on the amount by which GF/GP revenue exceeded FY 2020-21 GF/GP revenue adjusted for inflation times 1.425, divided by total income tax revenue. (Note that in some years, GF/GP revenue growth may exceed inflation but the amount of GF/GP revenue will not be above the adjusted FY 2020-21 base level due to prior revenue declines. Presumably no rate reduction would occur in such a year.)

<u>House Bill 4614</u> and <u>House Bill 4616</u> would amend the Streamlined Sales and Use Tax Revenue Equalization Act, and the Motor Carrier Fuel Tax Act, respectively, to make those acts consistent with the amendments to the Motor Fuel Tax Act made in House Bill 4738.

<u>House Bill 4737</u> would amend Public Act 51 of 1951 (Act 51) to require the Michigan Department of Transportation (MDOT) to form a Roads Innovation Task Force that would issue a report to the Legislature by March 1, 2016. The report would include, among other things, an evaluation of road materials and construction methods that could allow the department to build high-quality roads that last longer than those typically constructed by the department, with a goal of roads that last at least 50 years, higher quality roads, and reduced maintenance costs.

The bill would also create a *Roads Innovation Fund*. For FY 2016-17 and each subsequent fiscal year, the first $100.0 million of motor fuel tax revenue would be deposited into the fund (rather than into the MTF); this annual deposit is also provided for in House Bill 4738. Money could be expended from this fund only after each house of the Legislature approved a one-time concurrent resolution on a record roll call vote. Approval of the concurrent resolution would release money from the fund for credit to the MTF and distribution according to Section 10 of Act 51. Once money was released from the fund by the concurrent resolution, the fund would no longer receive the annual $100.0 million deposit of motor fuel tax revenue.

The bill would also earmark up to $3.0 million from the MTF each year for a new railroad grade crossing surface account, and would increase a current $43.0 million MTF earmark for STF debt service to $50.0 million.

The bill would also add a number of provisions related to road construction warranties and would lower the current limit on MDOT administrative expenses from 10% to 8% of all funds received by the department.

Finally, the bill would effectively allow, with the approval of the MDOT director, the City of Detroit to use up to 20% of its MTF distribution for public transit purposes.

The seven bills were all tie-barred to one another; all seven bills have been enacted.

FISCAL IMPACTS:

Overall Impact on State Revenues

The attached table presents estimates for the state fiscal impacts of this package over the period of FY 2016-17 to FY 2020-21. For FY 2017-18, when both the motor fuel and vehicle registration tax increases would be effective on a full-year basis, the bills would increase total state revenues by an estimated $617 million. When the expansion of the Homestead Property Tax Credit became effective in FY 2018-19, the estimated net increase in state revenues would be $416 million.

Impacts on Transportation Programs

When fully phased in for FY 2020-21, the bills would increase funds dedicated for transportation purpose via the MTF by an estimated $1.2 billion per year. The $1.2 billion in new transportation funds would be distributed from the MTF as follows:

- Up to $3 million for a new Rail grade crossing surface account.
- $62 million to the Comprehensive Transportation Fund (CTF) for public transportation purposes (10.0% of increased motor fuel and vehicle registration tax revenue but not GF/GP revenue redirected in House Bill 4370).
- $459 million to the State Trunkline Fund (STF) for state highway construction and maintenance (39.1% of the net MTF balance after CTF and other earmarks, plus $7.0 million increase in the current earmark for STF debt service).
- $452 million for distribution to county road commissions (39.1% of the net MTF balance after CTF and other earmarks).

- $252 million for distribution to cities and villages (21.8% of the net MTF balance after CTF and other earmarks).

The above figures, and the "Total Increase in Transportation Funds" figures in the attached table are based on the following assumptions:

- That the Legislature approves a concurrent resolution to release $100.0 million from the Roads Innovation Fund for inclusion in FY 2016-17 MTF distributions.
- That 2% of revenue from the increase in gasoline motor fuel tax revenue made by House Bill 4738 would be credited to the Recreation Improvement Account. [1]
- That the statutory maximum of $3.0 million for the Rail Crossing Surface Account would be appropriated from the MTF each year.

Note – Net Impact on Transportation Revenue: Over the last three fiscal years, FYs 2013-14 through 2015-16, state transportation appropriations have included over $1.1 billion in state GF/GP revenue – an average of $378.7 million. Specifically, FY 2015-16 transportation appropriations include $400.0 million in GF/GP revenue, of which $214.8 million is for credit to the STF. Of the $400.0 million total, $258.0 million is designated as being one-time only.

The Road Funding Package would increase certain dedicated transportation motor fuel and vehicle registration taxes beginning in FY 2016-17, and would permanently redirect state income tax revenue from GF/GP to transportation programs starting in FY 2018-19. These increases are shown in the attached table as increases in transportation revenue – starting at $455 million in in FY 2016-17 and growing to $1.2 billion by FY 2020-21. However, the actual increases in net revenue available for transportation programs will depend on the whether or not the transportation budget continues to use GF/GP revenue in baseline appropriations. If GF/GP revenue is not retained in the FY 2016-17 budget, STF revenue could be less in FY 2016-17 as compared with FY 2015-16.

Impacts on General Fund/General Purpose Revenues

When fully phased in for FY 2020-21, the bills would reduce annual state GF/GP revenues by an estimated $806 million. Based on estimates from the May 2015 consensus revenue estimating conference and trend analysis assuming continued moderate economic growth over the next six years, total GF/GP revenues for FY 2020-21 are estimated to be roughly $11.6 billion. The estimated reduction in GF/GP funds under this package would represent approximately 7% of that total.

The income tax rate reduction trigger created by Senate Bill 414 would reduce state GF/GP revenues in years in which prior-year GF/GP revenue growth exceeds the rate of inflation

[1] There is a presumption in current law that 2% of revenue from the motor fuel tax on gasoline is used for watercraft, snowmobiles, and off-road vehicles. As a result, Article IX, Section 40 of the Michigan Constitution dedicates 2% of all tax revenue derived from the sale of gasoline for consumption in internal combustion engines to the Recreation Improvement Account within the Michigan Conservation and Recreation Legacy Fund. This constitutional dedication is reflected in Part 711 of the Michigan Natural Resources and Environmental Protection Act (1994 PA 451).

beginning with FY 2022-23, assuming GF/GP revenues were above the adjusted FY 2020-21 level. Those revenue reductions would continue in subsequent years.

The frequency and magnitude of such revenue reductions would depend on future levels of inflation and economic growth, as well as potential non-economic factors affecting state revenues. (An example of such a non-economic factor is the increase in capital gain and dividend income tax revenue associated with the fiscal cliff in tax year 2011. While this one-time revenue increase was largely offset the following year, the trigger mechanism would have resulted in a permanent reduction in the income tax rate.)

Based on FY 2013-14 and FY 2014-15 GF/GP revenue estimates from the May 2015 consensus revenue estimating conference, if these provisions were currently in effect (with FY 2013-14 as the base year), the income tax rate for tax year 2016 would drop from the current level of 4.25% to approximately 3.96%, resulting in a revenue reduction of $593 million.

The bill would effectively create an ongoing GF/GP revenue limit equal to FY 2020-21 revenues adjusted for cumulative inflation times 1.425. This would allow future revenue growth to offset a decline in revenues occurring for economic or other reasons prior to the trigger taking effect. It would not, however, preclude a revenue decline occurring in a year immediately following a triggered rate reduction.

Fiscal Analysts: William E. Hamilton
Jim Stansell
Kyle I. Jen

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

Summary: Road Funding Package Fiscal Impacts (As Enacted)
FINAL ESTIMATES
Millions of Dollars

	FY 2016-17	FY 2017-18	FY 2018-19	FY 2019-20	FY 2020-21	
Revenue Changes						
Increase gasoline fuel tax (HB 4738)	236	313	311	310	308	A
Increase diesel fuel tax (HB 4738)	69	93	94	95	96	B
Increase vehicle registrations taxes (HB 4736)	155	211	217	224	230	C
Expand Homestead Property Tax Credit (HB 4370)	0	0	(206)	(206)	(206)	D
Total Net Increase/(Decrease) in State Revenues	**$ 460**	**$ 617**	**$ 416**	**$ 423**	**$ 428**	E=A+B+C+D
Revenue Diversion						
Divert income tax revenue from GF/GP to transportation (HB 4370)	0	0	150	325	600	F
Other Revenue Earmark						
Increase in Recreation Improvement Account (1)	5	6	6	6	6	G
Total Increase in Transportation Funds (2)	**$ 455**	**$ 611**	**$ 766**	**$ 948**	**$ 1,228**	H=A+B+C+F-G
Distribution (HB 4737) to:						
Rail Grade Surface Account (3)	3	3	3	3	3	
Comprehensive Transportation Fund	45	60	61	61	62	
State Trunkline Fund (4)	163	219	279	350	459	
County Road Commissions	157	211	272	343	452	
City and Villages	87	118	151	191	252	
Total Reduction in GF/GP Funds (5)	**$ 0**	**$ 0**	**$ (356)**	**$ (531)**	**$ (806)**	H = D - F

Notes:
(1) 2% of the motor fuel tax on gasoline is dedicated to the Recreation Improvement Account within the Michigan Conservation and Recreation Legacy Fund.
(2) Assumes that $100 million held in the Road Innovation Fund would be released by the Legislature for inclusion in FY 2016-17 MTF distribution.
(3) Assumes full $3.0 million approrpriation for the rail grade surface account each year.
(4) STF includes $7.0 million increase in the MTF earmark for STF debt service.
(5) Does not reflect potential fiscal impacts from automatic income tax rate cut trigger (SB 414) beginning in FY 2022-23 and inflationary adjustments to the motor fuel tax rate (HB 4738) and Homestead Property Tax Credit parameters (HB 4370) beginning in FY 2021-22.