Legislative Analysis

ROAD FUNDING PACKAGE – *PRELIMINARY ANALYSIS*

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Note: All bills are as passed by the Senate.

House Bill 4370 (S-3)
Sponsor: Rep. Hughes

House Bill 4614 (S-5)
Sponsor: Rep. LaFontaine

House Bill 4616 (S-6)
House Bill 4736 (S-4)
House Bill 4737 (S-4)
House Bill 4738 (S-5)
Sponsor: Rep. McCready

Senate Bill 414 (S-4)
Sponsor: Sen. Schmidt

Complete to 11-3-15

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 vehicle registration tax rates. Rates for passenger cars, vans, light trucks, and large commercial trucks would all be increased by approximately 20% across the board, effective 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.

<u>House Bill 4370</u> 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 for distribution to state and local road agencies (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 General Fund/General Purpose (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> would amend the Streamlined Sales and Use Tax Revenue Equalization Act and <u>House Bill 4616</u> would amend the Motor Carrier Fuel Tax Act to make complementary amendments to those in House Bill 4738.

<u>House Bill 4737</u> would amend Public Act 51 of 1951 to require the Department of Transportation to form a Roads Innovation Task Force that would issue a report to the Legislature by March 1, 2016 that 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 last at least 50 years, higher quality roads, and reduced maintenance costs.

The bill would also create a Roads Innovation Fund. 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. For FY 2016-17 and subsequent years, the first $100 million of motor fuel tax revenue would be deposited into the fund (rather than into the Michigan Transportation Fund); this annual deposit is also provided for in House Bill 4738. Once the Legislature approved the concurrent resolution releasing money in the fund, the deposits would no longer be made into the fund.

The bill would also add a number of provisions related to road construction warranties.

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

The seven bills are all tie-barred to one another; that is, no bill would become law unless all seven bills became law.

FISCAL IMPACT:

<u>House Bills 4370, 4736, and 4738</u>
The attached table presents preliminary 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 sets of tax increases would be effective on a full-year basis, the bills would increase total state revenues by an estimated $608 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 $407 million.

More specifically, when fully phased in the bills would increase funds dedicated for transportation purpose via the Michigan Transportation Fund by an estimated $1.2 billion per year while reducing available state GF/GP funds by an estimated $806 million per year.

The $1.2 billion in new transportation funds would be distributed from the Michigan Transportation Fund as follows:

- $62 million to the Comprehensive Transportation Fund (CTF) for public transportation purposes (10.0% of new revenue but not diverted GF/GP funds).
- $454 million to the State Trunkline Fund for state highway construction and maintenance (39.1% of the remaining funds after the CTF earmark).
- $454 million to county road agencies (39.1% of the remaining funds).
- $253 million to cities and villages (21.8% of the remaining funds).

Those amounts include the $100 million per year that would be held in the Road Innovation Fund pending legislative approval of a concurrent resolution.

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

$806 million reduction in GF/GP funds under this package would represent approximately 7% of that total.

Senate Bill 414
The income tax rate reduction trigger created by this bill would reduce state GF/GP revenues in years in which prior-year GF/GP revenue growth exceeds the rate of inflation 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 a GF/GP revenue limit equal to FY 2020-21 revenues adjusted for inflation since FY 2020-21 times 1.425.

In contrast to the House-passed version of this bill, which would utilize a year-over-year measure of revenue growth to trigger income tax rate cuts, this version of the bill effectively uses a cumulative measure of inflation to trigger rate cuts. 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: Jim Stansell
William E. Hamilton
Kyle I. Jen

Summary: Road Funding Package Fiscal Impacts (As Passed by the Senate)
PRELIMINARY 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)	147	202	208	214	221	C
Expand Homestead Property Tax Credit (HB 4370)	0	0	(206)	(206)	(206)	D
Total Net Increase/(Decrease) in State Revenues	**452**	**608**	**407**	**413**	**419**	E=A+B+C+D
Revenue Diversion						
Divert income tax revenue from GF/GP to transportation (HB 4370)	0	0	150	325	600	F
Total Increase in Transporation Funds*	**452**	**608**	**763**	**944**	**1,225**	G=A+B+C+F
Distribution to:						
Comprehensive Transportation Fund	45	61	61	62	62	
State Trunkline Fund	159	214	274	345	454	
County Road Commissions	159	214	274	345	454	
City and Villages	89	119	153	192	253	
Total Reduction in GF/GP Funds	**0**	**0**	**(356)**	**(531)**	**(806)**	H = D - F

*Includes $100 million per year to be held in the Road Innovation Fund pending legislative approval of a concurrent resolution.

Note: 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.