

Council Comments:

Citizens Research Council of Michigan

625 SHELBY STREET, SUITE 1B, DETROIT, MI 48226-3220

(313) 961-5377 • FAX (313) 961-0648

1502 MICHIGAN NATIONAL TOWER, LANSING, MI 48933-1738

(517) 485-9444 • FAX (517) 485-0423

CITIZENS RESEARCH COUNCIL OF MICHIGAN IS A 501(C)(3) TAX EXEMPT ORGANIZATION

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STATE BALLOT PROPOSALS A AND C - PROPOSED PROPERTY TAX AMENDMENTS

Proposals A and C on the November 3, 1992 ballot would amend Section 3 of Article 9 of the Michigan Constitution. Proposal A was placed on the ballot by the Legislature while Proposal C is the "Cut and Cap" proposal placed on the ballot by initiative petition. Michigan's historical method of uniformly assessing property at 50 percent of its true cash value, a current market-value system, would be changed to a modified acquisition-value system, whereby property is re-assessed up to current market value only when sold.

Both proposals limit annual assessment increases on each parcel of property until it is sold to the lesser of the rate of inflation, or five percent in Proposal A and three percent in Proposal C. The Proposal A cap applies only to homestead property, while Proposal C applies to all classes of property. The state would not reimburse local units for the revenue loss. In addition to the assessment cap, Proposal C provides for a 30 percent reduction in school operating property taxes phased in over the next five years, which would be reimbursed by the state. Proposal A amends the Headlee roll-back provisions of the Constitution.

IMPACTS OF PROPOSALS A AND C

- The cap and reassessment on sale provisions in both proposals would reduce future increases in assessments and property taxes. However, this will be done at the expense of uniformity in assessments with similar properties paying different amounts of property taxes depending on when the property was acquired.
- The reduction in property taxes would be modest under proposal A, but Proposal C would reduce property taxes by 3.1 billion, or 24 percent, by 1997. Michigan now has high property taxes compared to other states.
- Both property taxes and local government (including school districts) revenues would be reduced by \$1.0 billion by 1997 by the three percent cap in Proposal C, which would not be reimbursed by the state. Local units might respond by increasing tax rates which are not limited by the proposals.
- School property taxes would be reduced by \$2.1 billion in 1997 as a result of the 30 percent cut in proposal C which would be reimbursed by the state. All districts including out-of-formula districts would be reimbursed for 30 percent of their operating levies based on current millage rates, not any future millage increases. The reimbursement would vary widely among districts depending on their current tax rates and state equalized values.
- The net cost to the state of this reimbursement would be about \$1.5 billion after "circuit breaker" savings. This would be financed from growth in current revenue sources and would significantly reduce state funds otherwise available for state services and for state aid to schools and other local units.

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Changing The Method of Assessing Property

Proposals A and C amend the Constitution of 1963 which provides that:

The Legislature shall provide for the uniform general ad valorem taxation of real and tangible personal property not exempt by law. The Legislature shall provide for the determination of true cash value of such property; the proportion of true cash value at which such property shall be uniformly assessed, which shall not, after January 1, 1966, exceed 50 percent; and for a system of equalization of assessments.... (Section 3 of Article 9)

The Present Assessing System

The requirements for the uniform taxation of property have been in the Constitution since 1850. Under the uniformity requirement, each parcel of property and all classes of property are to be assessed at the same percentage of true cash value throughout the state. Also, the property tax rate applied to each parcel and class of property is to be uniform throughout each taxing jurisdiction. The Legislature has provided by law that all property is to be assessed annually at 50 percent of its true cash value, or the usual selling price. Michigan has a market-value based system of assessing property.

Michigan has about 1500 local assessing jurisdictions (cities and townships). The Legislature has provided for the equalization of assessments made by local assessors within each county, and for equalization among the 83 counties by the state. This three-step process at the local, county and state levels is designed to ensure that all property is uniformly assessed each year at 50 percent of its true cash or current market value. The state equalized value of property in Michigan is \$154 billion, the statewide average tax rate is about \$57 per \$1,000 of state equalized value, and the total property tax levy is about \$8.8 billion annually.

The Proposed Assessing System

Assessment Caps. The proposed modified acquisition-value system of assessing property in Proposals A and C would be superimposed on the present uniform general ad valorem market-value system by providing exceptions to the present constitutional provisions. Instead of annual assessments of property at 50 percent of current market value, property would be assessed at its December 31, 1991 value, which in most cases is the same as its December 31, 1990 value because assessments were frozen in 1991. Beginning December 31, 1992, annual property assessment increases on individual parcels of existing property would be limited to the lesser of the inflation rate or five percent in Proposal A or three percent in Proposal C. The limit in Proposal A would apply only to homestead property, while Proposal C would apply to all classes of property.

Reassessment on Sale. Property would be reassessed only when sold under both Proposals A (homestead only) and C. Proposal A does not specify the level at which property should be reassessed when sold, while Proposal C expressly provides that when sold "it shall be assessed at the then applicable proportion of true cash value," which would need to be defined. The actual selling price of a parcel of property is not necessarily its true cash value, according to past Michigan court decisions.

Effects on Assessments. Both the annual assessment cap and the reassessment when sold provisions would create significant disparities in assessments among parcels. Because of the assessment caps, houses that have greater appreciation in price will have relatively lower assessments in relation to current market value. For example, under a three percent assessment cap, property that increases in market value at three percent annually would continue to be assessed at 50 percent of its market value, while property that increases by seven percent annually would be assessed at 41 percent after five years and 34 percent of current market value after ten years.

Similarly, with the three percent cap and reassessment when sold, properties that increase in market value at the same rate would have significantly different assessments, depending on when they were sold. For example, at a seven percent annual increase in market value, a house sold after five years would be assessed at 21 percent more than a comparable house that had not been sold, and a house sold after ten years would be assessed at 46 percent more than a comparable house that had not been sold. These differences in assessments would result in differences in the amount of taxes paid. Thus, the modified acquisition-value system would result in significant disparities among houses of the same market value that receive the same benefits from government services.

Effects on Equalization. Proposals A and C would be superimposed on existing constitutional provisions that require the Legislature to provide for a system of equalization assessments. Since assessments within each assessing jurisdiction would no longer be at 50 percent of true cash or market value, assessments among assessing jurisdictions would also vary from the 50 percent standard depending on their relative rates of increase in property values and their relative rates of turnover from property sales. Equalization is used to equitably distribute among assessing units the tax burdens imposed by overlapping taxing jurisdictions (counties and school districts) as well as to equalize the distribution of state aid among taxing jurisdictions. Thus, the implementing legislation for either Proposal A or C would have to deal with the system of equalization of assessments.

California--Proposition 13. In 1978 the voters of California adopted a constitutional amendment, Proposition 13, which changed the method of assessing and taxing property in California. It placed a cap on property taxes of one percent of its full cash value; limited annual assessment increases to the lesser of the inflation rate or two percent over the 1975 assessed value; and provided that new construction or a change of ownership would trigger a reassessment of property up to its current appraised value.

The U.S. Supreme Court this year upheld Proposition 13 in **Nordlinger v Hahn**, Opinion No. 90-1912, June 18, 1992. While the Supreme Court found that the acquisition-value system had created dramatic disparities in the taxes paid by persons owning similar pieces of property, it ruled that the Proposition 13 acquisition-value system did not violate the Equal Protection clause. The Court held that it did not discriminate between newer and older owners with respect to either the tax rate or the annual rate of adjustment in assessments. New owners and old owners are treated differently with respect to one factor only---the basis on which their property is initially assessed.

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The court also found that a state legitimately can decide to structure its tax system to discourage rapid turnover in ownership of homes and businesses and that a new owner does not have the same reliance interest warranting protection against higher taxes as does an exiting owner.

The Property Tax Burden In Michigan

- Property taxes are relatively high in Michigan compared to other states and in 1990 were about 31 percent higher than the U.S. average:
- Michigan relies on property taxes for 24.3 percent of total state and local revenue compared to the U.S. average of 18.3 percent;
- Property taxes in Michigan are 4.7 percent of personal income compared to the U.S. average of 3.6 percent;
- Property taxes in Michigan are \$820 per capita compared to the U.S. average of \$626.

If property taxes in Michigan were at the U.S. average they would be about \$1.9 billion lower. Property taxes in Michigan have been increasing by 7.4 percent annually over the past 15 years, which is faster than the increase in the consumer price index and faster than the growth in personal income of Michigan residents.

Reducing the Property Tax Burden

Both Proposals A and C would reduce the property tax burden in Michigan by slowing down the rate of increase in property assessments and Proposal C would cut school property taxes.

Assessment Caps. The caps would result in lower property taxes paid by property owners and lower revenues for local units of government. The Senate Fiscal Agency projects that the five percent cap on homestead property assessments in Proposal A would reduce future property taxes by about \$265 million or 2.5 percent in 1997. This would reduce local government property tax revenues and would not be reimbursed by the state. The three percent cap in Proposal C would reduce property taxes paid in 1997 by about \$1.0 billion, a ten percent decrease. The state would not reimburse local units for this loss in revenues. The caps would continue over time to slow the rate of increase in assessments compared to the current market-value system (assuming market values continue to increase by more than the caps). This would provide both a cumulative savings to taxpayers and a cumulative loss in revenues to local units.

Millage Increases. It should be noted that since the proposals limit only assessment increases, not tax rate increases, local units could respond to these limits on assessment growth by increasing their tax rates. Some local units have available to them a considerable amount of additional authority to increase property taxes with voter approval under existing constitutional and statutory millage limitations. Units that are subject to the 50 mill limit (non-charter counties and townships and school districts) could levy statewide about \$1.1 billion more in property taxes within the 50 mill limit with voter approval. Only a few units subject to the 50 mill limit are at the limit and more than 80 percent of the local units have five or more mills available with voter approval within the 50 mill limit. In aggregate, cities statewide are about \$400 million below the

maximum 20 mill charter limit established by state law, although some cities are at the statutory limit.

Thus, there is substantial additional property taxing authority available to many local units statewide that could be used to offset the loss of local revenues resulting from the assessment caps.

Cut in School Taxes. Proposal C provides for a 30 percent exemption for all property from local school operating taxes phased in over five years--ten percent in 1993, increasing by five percentage points a year to 30 percent in 1997. Residential and agricultural property pay 64 percent of all property taxes and business property about 36 percent, and the relief would be proportionate. It is projected that the "cut" provision will reduce school operating taxes paid by all property owners by about \$570 million in 1993, increasing to \$2.1 billion by 1997. The state would reimburse all school districts including out-of-formula districts for this property tax loss based on the 1991 millage rate or the current rate, whichever is less. The exemption would apply to future increases in school millage, but the reimbursement would not.

Cost to the State

While the state would reimburse school districts for the property tax revenue loss from the phased-in exemption, the net cost to the state would be less than the amount reimbursed. The reduction in property taxes resulting from the cut and from the caps would reduce the cost to the state of the homestead property tax relief credits (and reduce the tax savings of those who receive the credits). The net costs to the state of reimbursing local school districts are projected to be about \$400 million in the state fiscal year 1993-1994, rising to over \$1.5 billion in fiscal 1997-98.

While the reimbursement would be required by Proposal C, the method of financing the cost to the state is not specified. Proponents of Proposal C have indicated that the cost would be paid out of the growth in state revenues. The consensus forecast for state general fund and school aid fund revenues for 1992-93 is about \$10 billion. Based on projected future revenue increases of 5.0 percent annually, which has been about the average, the reimbursement could be financed over the five-year phase-in period using about half of the cumulative growth in revenues.

In fiscal 1993-94, however, when a ten percent reimbursement would be made for school taxes levied in 1993, the \$416 million net cost of the reimbursement would use most of the projected \$499 million increase in state revenues, with the remaining revenue increase providing for less than a one percent increase in spending on state programs and state aid to local units. During the phase-in period, when the reimbursement increases by five percentage points annually to the 30 percent maximum, the projected five percent annual increase in revenues would cover the cost of the reimbursement and permit about a 2.7 percent annual increase in state spending. This would significantly reduce the rate of increase in state spending, which has averaged over five percent.

State spending on both state programs and state aid to local units could be impacted. The 1978 Headlee Amendment to the Constitution (Section 30 of Article 9) requires that 41.6 percent of total state spending be paid to local units of government. Since the state property tax reimbursement to school districts would be counted as state aid, the state could reduce, if necessary, other state aid to local units as well as state services.

Other Provisions

Headlee Roll-Backs. Michigan, by statute, froze property assessments for this year at the December 31, 1990 level. That freeze ends this year and December 31, 1992 assessments will be based on current market values reflecting two years of price increases. This will have two significant consequences: first, many taxpayers will experience double-digit increases in assessments, reflecting two years of increases in property values; and, second, many local units will experience large Headlee roll-backs in their millage rates as their state equalized values on existing property increase faster than the one-year increase in the consumer price index. Some formula school districts could lose significant amounts of state aid under current law because state aid is based on the rolled-back millage rate, unless the voters approve a Headlee override.

Proposal A was placed on the ballot by the Legislature as a companion to the assessment freeze and provides for use of the two-year increase in the consumer price index in calculating the millage roll-back for 1993. By limiting annual assessment increases to three percent, Proposal C would also negate the roll-back problem. If assessments on existing property rise three percent or less in any year and the inflation rate exceeds three percent, Headlee roll-ups would be possible. Proposal A also changes Headlee millage-roll-backs from one roll-back factor for all classes of property to two roll-back factors--one for residential-agricultural property and one for business property.

Tax Increment Financing. Proposal C requires the state to reimburse local units of government amounts necessary to ensure that tax increment financing contractual obligations entered into before September 1, 1991, are not impaired due to the reduction in school operating taxes.

Approval of Both Proposals. Since Proposals A and C amend the same section of the Constitution and conflict with respect to the allowable increase in annual assessments and the classes of property affected, it appears that if both were approved, the one receiving the higher number of "yes" votes would prevail as provided in the Constitution (Section 2 of Article 12).