

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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WHAT (IF ANYTHING) SHOULD BE DONE REGARDING THE MICHIGAN PROPERTY TAX?

THE ISSUE IN BRIEF

At the November 1992 general election, Michigan voters rejected two statewide ballot proposals to amend the state Constitution to reduce property taxes in Michigan. Since 1972, there have been 12 such proposals on the ballot; only one received voter approval: the tax limitation amendment of 1978. The rejection of the most recent proposals may have been the result of several factors singly or in combination. First, it may be that, contrary to popular perception, a majority of voters do not consider the property tax to be unduly burdensome, at least not when viewed in conjunction with the local services which it finances and to which voters have become accustomed. Second, it may be the voters do consider the property tax to be burdensome, but they concluded that neither of the proposals in question would have provided an appropriate solution. Finally, voters may simply have been of the opinion that it is the responsibility of state policymakers -- the Legislature and the Governor -- and not of themselves to resolve complicated public policy issues such as property taxation.

State policymakers will have to sift through these various considerations when deciding what, if any, alternative to next propose. It is noteworthy that Public Act 15 of 1991, which essentially "froze" 1992 assessments at 1991 levels, will not be in effect during 1993 unless extended by the Legislature. Local assessors are legally required to assess property at 50 percent of true cash Value (the usual selling price). Since 1993 assessments will reflect property value increases over two years instead of one, assessment increases on many parcels of property may exceed taxpayer expectations, thus producing additional dissatisfaction. This Council Comments examines some of the issues which complicate resolution of the property tax question.

Background

The general property tax is one of the oldest taxes in Michigan, originating from a territorial act. Much of the present statute, the general property tax act was adopted by the state Legislature in 1893. While several state agencies have certain responsibilities relative to its administration, the general property tax is assessed, levied, collected and expended entirely at the local level. The Michigan Constitution requires all real and tangible property not exempted by law to be assessed at no more than 50 percent of true cash value (the base) and also imposes specific limitations upon property tax rates although several of the millage limitations may be increased with voter approval.

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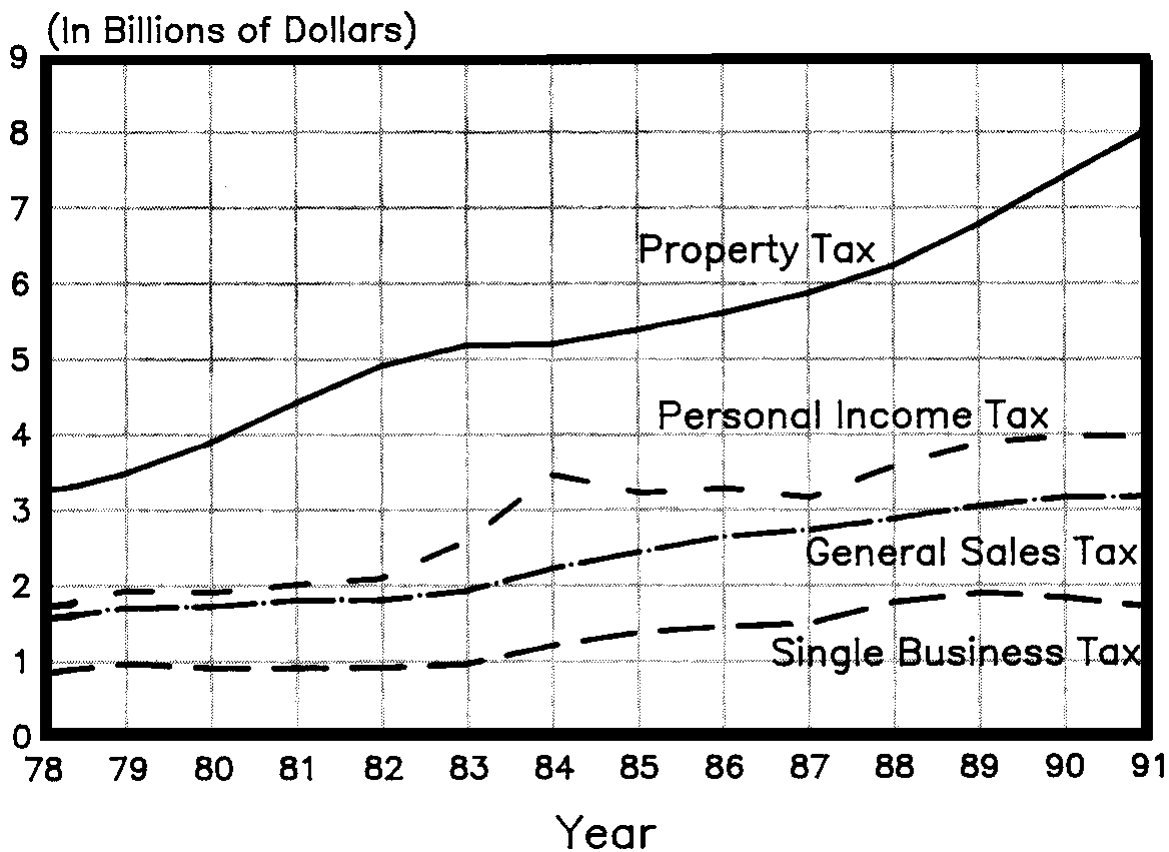
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Chart 1 illustrates several notable features of the property tax: its capacity to generate vast sums of revenue its continuing growths and its relative stability as a revenue source throughout business cycles. The data compare annual collections from the property taxes during the 14-year period 1978-1991, with collections from the three largest taxes imposed by the state: the personal income tax the single business tax and the general sales tax (including its statutory complement, the use tax). In particular, the sales tax is often mentioned as a replacement revenue source to finance local services now financed by property taxes. However it is noteworthy that the \$3.1 billion in combined sales and use tax collections in 1991 were only 39 percent of the \$8.0 billion property tax levy that year. In fact for six of the 14 years, property tax collections exceeded incomes sales, and use tax collections combined.

Chart 1

**Local Property, Personal Income, General Sales,*
and Single Business Tax Collections, 1978-1991**



Source: State Tax Commission, 1991 Ad Valorem Tax Levy Report; Annual Reports of the State Treasurer, 1978-1991. *Also includes use tax.

Second, in each year during the period shown, the property tax generated more revenue than in the previous year, even in those years when the statewide average property tax rate decreased. For example, property tax collections grew by 49 percent from 1979 through 1983, from \$3.5 billion to \$5.2 billions even as the statewide average property tax rate decreased each year. Over

the 14-year period, the base of the property tax grew by 135 percent (from \$59.5 billion to \$139.9 billion) while the rate grew by only 6.1 percent (from 53.89 mills to 57.17 mills).

By contrast, revenues from both the single business and sales taxes decreased from the previous year on two occasions and income tax revenues decreased four times (although two of the four decreases in income tax revenues resulted, at least partially, from statutory rate reductions). Clearly, state taxes are far more susceptible to economic fluctuations than the property tax and this fact together with the magnitude of the yield of the property tax, complicates efforts to reduce property taxes by shifting to other revenue sources.

Distribution of the Local Property Tax

The Michigan Legislature has enacted more than 20 individual taxes to fund the operations of state government. Because revenue at the state level is derived from a number of sources, neither the capacity to raise revenue nor the likelihood of taxpayer dissatisfaction becomes linked to a single tax. However at the local level, the property tax is the principal revenue source and approximately 2,500 units of local government heavily depend upon it to finance local services. Thus taxpayer attention does tend to focus on the local property tax.

Table 1 presents data on the distribution of the property tax during the 1991-92 fiscal year (1991 levy). Over 70 percent of the property tax (\$6.2 billion) was levied for local education purposes by kindergarten-12th grade school districts intermediate school districts and community colleges.

Table 1

**Distribution of Local Property Tax
by Unit of Local Government, Levy of 1991
(In Millions)**

Unit of Local Government	Dollar Amount	Percent of Total Levy
Schools	\$6,170.8	71.43%
Cities	1,207.1	13.98
Counties	961.8	11.13
Townships	251.7	2.91
Villages	<u>47.2</u>	<u>0.55</u>
Total Levy	\$8,638.6	100.00%

Source: State Tax Commission, 1991 Ad Valorem Tax Levy Report.

Property taxes in Michigan are relatively high compared to other states. For examples in 1990 property taxes in Michigan were approximately \$820 per capita compared to \$626 per capita nationally. Michigan property taxes were 31 percent higher than the national average.

General Considerations

As with school finance reform, there is no magic solution to the property tax question. Rather the choices are essentially limited to either of two broad options: reduce the property tax and shift to another revenue source such that the level of existing local services will be undiminished, or reduce property taxes without replacement revenue and accept some reduction in local services. Despite their sometimes complicated nuances, the various property tax proposals that policymakers have heretofore advanced have been but variations upon one of these two themes. Unfortunately both options have aspects which render them unpalatable.

It should also be noted that a reduction in property taxes could be effected either by reducing the rate or the base of the tax. (While occasionally there has been significant disagreement with respect to which component of the property tax was more worthy of reductions the result in either case would be the same mathematically since rate times base equals levy.) Likewise, a property tax reduction could be made either retroactive such as a reduction in existing assessment or rate levels, or prospective -- for example, in the form of a limitation upon future annual assessment or rate increases.

A Tax Reduction Without Reimbursement

That having been said the state Legislature could reduce the property tax by a given amount or percentage without reimbursing units of local government for revenue foregone. Such an approach would have several considerations in its favor. First, it would be simple and straightforward, in contrast to many proposals which are often rendered incomprehensible by provisions that attempt to achieve often incompatible goals such as reducing property taxes while "holding harmless" all parties that might be adversely affected. Second, taxpayers would be provided with genuine tax relief since there would be no necessity to shift to some other revenue source. Nor would state policymakers be required to confront budgetary Hobson's choices in order to redirect resources to units of local government.

Of course, this approach would cause a reduction in local services financed by the property tax, thereby forcing difficult choices upon local units. For this reason alone, any proposal to reduce the property tax which did not also reimburse units of local government for lost revenue would encounter considerable opposition, if not from taxpayers themselves, then from a wide array of interest groups whose programs are financed by property tax revenues.

A Tax Reduction With Reimbursement

Alternatively, the Legislature could reduce the property tax by a given amount and reimburse units of local government for revenue foregone, or authorize alternative local taxes. Reimbursement might derive either from state general revenues, or from some other tax earmarked to that purpose by the Legislature. While a property tax reduction proposal requiring reimbursement would likely engender less political opposition than one without such a requirement, such a proposal would still face some opposition for at least two reasons.

First, as already noted the property tax generates significant revenue. As a result, reimbursing units of local government for even a modest property tax reduction would require considerable replacement revenues, causing either substantial reductions in existing state government services

or increases in other taxes that voters might find unacceptable. For example, had the state elected to replace local school operating property taxes in 1991, the cost would have been \$4.8 billion. Assuming the state had chosen to allocate that amount proportionately among each of the four state taxes examined on **Page 2**, the single business tax rate would have increased from 2.35 percent to 3.60 percent; the individual income tax rate from 4.6 percent to 6.62 percent; and the sales and use tax rates from 4 percent to 6.18 percent.

Second, because the property tax is less susceptible to economic fluctuations than taxes levied by the state, it is unlikely that units of local government would warmly embrace an effort to shift from the property tax to another revenue source even if accompanied by a reimbursement requirement. For example, decreased state revenues caused by an economic downturn in the early 1980s reduced state appropriations to school aid from \$1.4 billion in fiscal year 1980 to \$1.1 billion in fiscal year 1983, a reduction of more than 20 percent. During the same period property tax revenues for schools increased from \$2.1 billion to \$3 billion, an increase of over 40 percent. This increase in property tax revenues resulted partly from increases in school operating millages, but mostly from explosive growth in state-equalized valuations.

Previous Proposals

Beginning with the November 1972 general election and ending with the November 1992 general election, 12 proposals to amend the 1963 Michigan Constitution in respect to the local property tax have been placed on the statewide ballot and are summarized below. Any nonproperty tax features of the proposals are noted only to the extent here relevant.

- 1972 -- Proposal C**, an Initiative petition was sponsored by the Governor and the Michigan Education Association. Proposal C would have prohibited levying property taxes for school operating purposes; reduced the 50 mill limitation to 26 mills; authorized with voter approval property taxes for enrichment programs, and for vocational education and special education. Rejected, 58 percent to 42 percent.

- 1976 -- Proposal C**, an initiative petition, would have prohibited local units from levying without voter approval, a tax not already authorized by law or charter, or increasing the rate of an existing tax above that then authorized. Rejected, 57 percent to 43 percent.

- 1978 -- Proposal E, (Headlee)**, an initiative petition, prohibits local units from levying, without voter approval, a tax not authorized by law or charter when Proposal E took effect or increasing the rate of an existing tax above that then authorized; requires voter approval of now general obligation debt issued by local units; and requires that maximum authorized rates be “rolled back” when SEV increases exceed inflation. Approved, 52 percent to 48 percent.

- **Proposal H, (Voucher Plan)**, an initiative petition, would have prohibited levying property taxes for school operating purposes, for intermediate school districts and for vocational education and special education. Rejected, 74 percent to 26 percent.

- **Proposal J, (Tisch)**, an initiative petition, would have reduced the assessment ratio from 50 percent to 25 percent and limited assessment increases to 2.5 percent yearly. Rejected, 63 percent to 37 percent.

- 1980** -- **Proposal A, (Smith-Bullard)**, an initiative petition, would have reduced the 50 mill limitation to 24.5 mills; authorized a statewide tax of up to 30.5 mills on property other than homesteads and farms; and required roll backs by class. Rejected 79 percent to 21 percent.
- **Proposal C, (Coalition Plan)**, a legislative proposal, would have eliminated property taxes on the first \$7,000 of homestead SEV; increased the sales and use tax rates to 5.5 percent from 4 percent. Rejected, 74 percent to 26 percent.
- **Proposal D, (Tisch)** an initiative petition would have rolled back 1981 assessments to 1977 levels; reduced the assessment ratio from 50 percent to 25 percent; permitted assessment by class; and limited annual assessment increases on homesteads and farms to two percent. Rejected, 56 percent to 44 percent.
- 1981** -- **Proposal A**, a legislative proposals would have exempted homesteads from half of property taxes for operating purposes; increased sales and use tax rates to 5.5 percent; and limited to six percent annually the growth in the levy from any class of property. Rejected, 72 percent to 28 percent.
- 1989** -- **Proposal B**, a legislative proposal, would have levied a statewide tax of nine mills on nonbusiness property and 14 mills on business property; required foundation millage for schools; and increased sales and use tax rates to six percent. Rejected 76 percent to 24 percent. 1992 **Proposal A**, a legislative proposals would have limited annual assessment increases on homestead property to the lesser of five percent or inflation; and provided for reassessment upon sale. Rejected, 63 percent to 37 percent.
- **Proposal C, (Cut and Cap)**, an initiative petition, would have reduced school operating millage by 30 percent over five years; limited annual assessment increases to the lesser of three percent or inflation; and provided for reassessment upon sale. Rejected, 59 percent to 41 percent.