

Citizens Research Council of Michigan

625 SHELBY STREET, SUITE 1B, DETROIT, MI 48226,3220 • (313) 961-5377 • FAX (313) 9614)648
1502 MICHIGAN NATIONAL TOWER, LANSING, MI 48933-1738 • (517) 485-9444 • FAX (547) 485-0423

Michigan Constitutional Issues

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

Report No. 313-10

Last in a series on revising the Michigan Constitution

October 1994

FINANCE AND TAXATION

THE ISSUE IN BRIEF

At the November 8, 1994 general election, the voters of Michigan will decide whether to call a constitutional convention to revise the Michigan Constitution of 1963. The question appears on the statewide ballot automatically every 16 years as required by the Constitution.

The power to tax and the disposition of the revenues derived therefrom involve two of the essential characteristics of civil government. This analysis examines several provisions in Article 9, "Finance and Taxation," of the Michigan Constitution and Issues related to them that a constitutional convention might consider: state and local property taxes; a graduated income tax; local sales taxes; and the effectiveness of the 1978 (Headlee) tax limitation amendment.

Introduction

It was noted in the first of this series on revising the Michigan Constitution that the principal purpose of a state constitution is to serve as a limitation upon the governmental power of the state. Perhaps in no area is the foregoing principle more often illustrated than with respect to the power of the government to tax and the interest of the people to limit that power. Thus, Article 9, "Finance and Taxation," of the Michigan Constitution contains various limitations upon the otherwise plenary power of the Legislature. These limitations range from prescribing the proportion of value at which property may be taxed, to requiring voter approval before units of local government may increase certain taxes and indebtedness, to specifying how the revenues from certain taxes are to be expended. Many of these provisions were contained in the state Constitution when it was adopted, while others were added subsequently by voters.

Constitutional Convention Issues

If the people of Michigan decide at the general election this November to call a constitutional convention, there are several provisions of Article 9 of the Constitution upon which the convention might wish to focus its attention.

Property Taxation

Section 3 of Article 9 requires that general ad valorem property taxes be uniformly imposed upon all nonexempt property; that property be uniformly assessed at the same proportion of market value (not to exceed 50 percent); and that the Legislature provide for a system of equalization of assessments. In March of 1994, voters amended several provisions of Article 9. Section 3 was

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amended to exclude school operating taxes from the uniformity requirement and to limit annual increases in the taxable value of individual parcels of property to the lesser of five percent or inflation. Beginning with 1995 taxes, property will be reassessed at the proper percentage of true cash value when sold. The taxable value cap had the effect of grafting a modified, acquisition-value system of assessing property onto what had been a market-value based system. However, the requirements of uniformity (except for school operating taxes) and equalization were not altered. One result has been to complicate administration of the property tax. A constitutional convention might rethink the wisdom of excluding school operating taxes from the uniformity requirement and of superimposing a modified acquisition-value system upon a market-value based system.

Property Tax Limits Section 6 of Article 9 imposes an aggregate limit of 15 or 18 mills on nonchartered counties, nonchartered townships, and school districts for operating purposes. These limits may be increased up to 50 mills for up to 20 years by voters. The principal shortcoming of the 50 mill limit is that so much millage is excluded from it (resulting from both its own terms and judicial fiat) that the limit has been rendered virtually meaningless. For example, the statewide average millage rate has not been below 50 mills since 1972. Furthermore, there is no effective enforcement mechanism with respect to that millage that is subject to the limit. As a result, the limit was exceeded on six occasions during the late 1980s and early 1990s. Given the history of the 50 mill limit, a constitutional convention might wish to weigh the general efficacy of property tax limits and (if continued efficacy is deemed to exist) the method by which to establish a limit that is truly effective rather than a mere parchment barrier.

Graduated Income Taxes

Section 7 of Article 9 prohibits the imposition of an income tax, graduated as to rate or base, by the state or any of its subdivisions. While this prohibition once was a contentious issue -- proposals to allow graduated income taxes were defeated in 1968, 1972 and 1976 -- the issue has receded in recent years. (Forty-one states levy a personal income tax, of which eight states, including Michigan, do so at a uniform rate upon all income levels.) However, it might be argued that the use of federal adjusted gross income, together with various credits and exemptions, has had the practical effect of graduating the Michigan income tax base. The "Address to the People" which accompanied the present Constitution did note that income calculated for federal tax purposes could be used and that the Legislature could prescribe reasonable exemptions. Furthermore, the courts of Michigan have upheld the use of exemptions, exclusions and credits, but on grounds that they apply to all taxpayers without regard to income. However, it is noteworthy that the Legislature also has enacted exemptions which are based upon income. For example, the homestead property tax credit produces what amounts to a graduated income tax (or a nonuniform property tax, if the homestead property tax credit is looked upon as property tax relief). A constitutional convention would have an opportunity to revisit the prohibition on graduated income taxes and to consider factors that affect uniformity of the tax base.

Local Sales Taxation

Section 8 of Article 9 limits the rate of the sales tax on gross taxable sales of tangible personal property to four percent, plus an additional two percent of gross taxable sales recently adopted for school aid purposes. Whether the limitation was intended to apply only to a state sales tax or

also to a local sales tax is unclear. According to a 1970 state Attorney General opinion, the Legislature can only authorize a local sales tax by amending the state Constitution, since the voters who ratified the Constitution intended to preempt the sales tax “as a state sales tax.” However, the wording of Section 8 stands in contrast to that of Section 7 which prohibits “the state or any of its subdivisions” from imposing a graduated income tax. These two sections, when read together, suggest that when the drafters of the state Constitution intended to limit not only legislative authority, but also the authority of units of local government, they clearly expressed that intent. In 1991, the Legislature authorized certain municipalities to impose several taxes, including the equivalent of a local sales tax upon restaurant meals, to finance professional sport stadia and convention facilities. To date, none of the eligible municipalities has sought voter approval to impose the taxes authorized. A constitutional convention likely would address the question of whether the state Constitution does, or should, prohibit local sales taxation.

Degree of Constitutional Detail

One of the continuing areas of disagreement at the 1961 Constitutional Convention was the level of detail which the Constitution should contain in the area of taxation. Many delegates were of the opinion that the Legislature should be free to determine the level and type of taxation as circumstances arose, while other delegates expressed the view that the Legislature should not be allowed an unfettered discretion. The fact that the sales tax rate could be increased only if voters amended the state Constitution, while the income tax rate could be increased by the Legislature alone, played a significant role in the adoption of Proposal A of 1994. Similar differences of opinion arose concerning the extent to which constitutional provisions should dedicate revenues to specific purposes. For example, in recent years about 25 percent of total state tax revenues have been constitutionally earmarked to specific funds, an amount that will increase to about 33 percent in 1995, when the recent school finance changes are fully implemented. If a constitutional convention is called, the extent to which legislative discretion concerning taxation and the disposition of revenues should be limited will, again, likely be an issue.

The 1978 Tax Limitation Amendment (Headlee)

At the November 1978 general election, Michigan voters approved a tax limitation proposal which amended Section 6 of Article 9 and added ten new Sections (Sections 25 through 34) to Article 9. The tax limitation amendment: limited state revenues to a fixed percent (9.49 percent) of state personal income; required the state to maintain at least the proportion of spending paid to local units in 1978; prohibited the state from imposing unfunded mandates upon local units; prohibited local units from imposing new taxes, raising existing taxes, or issuing new unlimited-tax, general-obligation debt without voter approval; and limited local property tax revenue growth by requiring local units to reduce maximum authorized tax rates to offset real growth in assessed valuation. In 1993 the Governor appointed a 12-member commission to review the tax limitation amendment and various implementing statutes. The recently issued report of the commission concluded that many of the foregoing provisions have proven to be quite effective and recommended changes to increase the effectiveness of other provisions. The latter are summarized below.

State Revenue Limit The Section 26 revenue limit generally has been effective and noncontroversial, chiefly because it was imposed when state revenues as a percentage of personal income

were at a peak. It should be noted that Section 26 authorizes an adjustment in the revenue limit when programs are transferred between governmental levels by constitutional amendment. A recent example was Proposal A of 1994, which had the effect of transferring a substantial amount of school finance responsibility from the local level to the state. However, Proposal A did not specify that an adjustment in the revenue limit was authorized. A constitutional convention might wish to determine whether a proposed constitutional amendment which transfers governmental programs between levels of government must specify whether the revenue limit is to be adjusted.

Voter Approval of Local Taxes Section 31, to the extent here relevant, prohibits units of local government from levying new taxes or increasing existing taxes without voter approval. The foregoing requirement has not been applied to special assessments or to numerous fees adopted by many communities. While there are recognized legal distinctions between taxes and special assessments or fees, the practical distinctions often are not readily apparent other than that the latter may be imposed without voter approval. A constitutional convention might wish to define the term “tax,” or in the alternative, to require voter approval of all governmental “exactions,” regardless of nomenclature.

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This is the last in a ten-part series on Michigan Constitutional Issues regarding specific issues which a constitutional convention might consider. This series was funded in part by a grant from the Matilda R. Wilson Fund and consists of:

- 313-01 The Nature and Purpose of a State Constitution
- 313-02 The November 1994 Ballot Question and a Brief Michigan Constitutional History
- 313-03 The Declaration of Rights of the Michigan Constitution
- 313-04 Elections and Term Limitation Provisions in the Michigan Constitution
- 313-05 The Executive Branch
- 313-06 The Legislative Branch
- 313-07 Education
- 313-08 The Judicial Branch
- 313-09 System of Local Government
- 313-10 Finance and Taxation