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"HEADLEE ROLLBACKS" AND THE CONSTITUTIONALITY OF PUBLIC ACT 415 OF 1994

Second in a series of papers on issues raised by Proposal A of 1994.

In Brief

Proposal A, which voters approved in March of 1994, amended the Michigan Constitution to require that annual increases in the "taxable value" of parcels of existing property be limited to the lesser of five percent or inflation, but did not define what was meant by taxable value. Courts long have held that the meaning of a constitutional provision is to be found not in the intent of its drafters, but in the common understanding of the voters who ratified it. Thus, while the Legislature possessed considerable statutory discretion to define taxable value before Proposal A was placed on the statewide ballot, that discretion later was circumscribed by voter ratification. Despite this, the Legislature subsequently defined "taxable value" as being synonymous with a different constitutional term, "assessed value of property as finally equalized" in an attempt to prevent "Headlee rollbacks" of state-equalized values from occurring in concert with the limitations imposed by Proposal A, which would have provided taxpayers with a substantially greater tax reduction than was apparently intended by the Legislature when it drafted Proposal A.

Background

In March of 1994, voters approved Proposal A, a property taxation-school finance proposal which amended several sections of the state Constitution. Among other matters, Proposal A requires that an-nual increases in the taxable value of each parcel of existing property be limited to the lesser of five per-cent or inflation and that such property be reassessed upon a transfer in ownership.

While Proposal A introduced into the state Constitution an entirely new term, that of 'taxable value," the proposal was notably silent with respect to any definition of that term. Thus, it was left to the Legislature to provide a statutory definition. This the Legislature subsequently did by adopting Public Act 415 of 1994, which amended numerous sections of the general property tax act.

Much already has been written regarding the taxable value limitation. However, the question generally considered in other analyses has been the extent to which the limitation will create disparities in assessments among similarly situated parcels of property which either appreciate at different rates or which are sold at different points in time. The question considered here is a different one, which has not yet received much scrutiny: namely, whether the statutory definition of taxable value which the Legislature enacted after Proposal A took effect is consistent with the state Constitution and with the common understanding of the voters who ratified the proposal. The answer to this question requires that the definition be examined within the context of a preexisting state constitutional provision, Section 31 of Article 9.

The Local Property Tax Levy Limitation

At the November 1978 general election, voters ratified a state constitutional amendment which limited state and local government revenues and required voter approval of new taxes. The "Headlee Amendment," added Sections 25 through 33 to Article 9 of the state Constitution and amended Section 6 of Article 9. Section 31 of Article 9 provides in part as follows:

> If the assessed value of property as finally equalized, excluding the value of new construction and improvements, increases by a larger percentage than the increase in the General Price Level from the previous year, the maximum authorized rate applied thereto in each unit of Local Government shall be reduced to yield the same gross revenue from existing property, adjusted for changes in the General Price Level, as could have been collected at the existing authorized rate on the prior assessed value.

The levy of a tax, which is to say the revenue generated by it, is a function of two variables: the tax rate and the tax base to which the rate is applied. That portion of Section 31 of Article 9 recited above has been referred to appropriately as a "levy" limitation, which in this case is achieved by a limitation on the rate. Section 31 requires that, if the existing property tax base in a unit of local government increases faster than the rate of inflation, the maximum authorized rate must be reduced or "rolled back" by a commensurate amount so as to produce the same property tax levy as would have been obtained from the old base.

The Taxable Value Limitation

Section 3 of Article 9 of the state Constitution, as amended by Proposal A, provides in part as follows:

> For taxes levied in 1995 and each year thereafter, the legislature shall provide that the taxable value of each parcel of property adjusted for additions and losses, shall not increase each year by more than the increase in the immediately preceding year in the general price level, as defined in section 33 of this article, or 5 percent, whichever is less until ownership of the property is transferred.

The Statutory Definition

Proposal A introduced the term "taxable value" into Section 3 of Article 9 of the state Constitution without benefit of definition. After the Legislature drafted Proposal A, but before voters ratified it, the view was expressed by some that the proposal essentially would eliminate further Headlee rollbacks on the grounds that Headlee rollbacks were triggered by tax base increases in excess of inflation and Proposal A would limit such increases upon parcels of property to the lesser of five percent or inflation. In short, Proposal A would eliminate Headlee rollbacks by eliminating property tax base increases in excess of inflation. [1]

Apparently, it was not until after voter ratification of Proposal A that policymakers realized the significance of having used in Section 3 of Article 9 a term different from that already contained in Section 31 of Article 9. Plainly stated, if Proposal A were read literally, the *taxable value* limitation of Section 3 would have no effect upon Headlee rollbacks because Section 31 required that such rollbacks be calculated on the basis of *assessed value* of property as finally equalized.

The legislative solution to this dilemma was simply to define "taxable value" and "assessed value" as synonymous terms. Section 34d of the general property tax act, as amended by Public Act 415 of 1994, provides that "'assessed valuation of property as finally equalized' means taxable value." The significance of this legislative maneuver reaches beyond the niceties of constitutional law. There is a practical impact as well: Had the Legislature statutorily implemented the taxable value limitation as it was presented to and ratified by voters, property taxpayers would receive a greater reduction in local property taxes than otherwise will occur under the terms of Public Act 415 because whether Headlee rollbacks were or were not required would have no relationship to the growth in the taxable value of property.

[1] It was recognized, of course, that some minimum number of rollbacks still would occur because over time sufficient turnover in the housing stock within a given unit of local government would require the reassessment of transferred parcels at the then applicable proportion of current true cash value.

Constitutional Niceties

Proposal A was conceived and drafted, not by the voters, but by the Legislature. This fact is significant for two reasons. First, the Legislature had ample opportunity and reasonable latitude before placing the proposal on the statewide ballot to define "taxable value," particularly since the term was a new one, the meaning of which was not established. Second, because the Legislature was proposing a constitutional amendment, it could have included therein a proposed amendment to Section 31 of Article 9 to require that the property tax base for Headlee rollback purposes be the same as was being proposed for limitation in Section 3 of Article 9. The Legislature pursued neither course, choosing instead to provide a statutory definition after voters had ratified the proposal.[2]

It may be presumed that most voters were aware of these considerations. Likewise, voters were aware that the then-existing constitutional phrase, "assessed value of property as finally equalized" had a settled meaning in the realm of property taxation. It referred to the end result of the annual process of uniformly assessing nonexempt real and tangible personal property at no more than 50 percent of its true cash value and then equalizing such assessments. Because Michigan has approximately 1,500 local assessing jurisdictions, equalization is necessary to equitably distribute the local property tax burden among the assessing jurisdictions within as well as among the counties.

Given the foregoing, voters reasonably could have presumed that the Legislature drafted Proposal A with a working knowledge of existing state law, including a working knowledge of the state Constitution. Furthermore, voters reasonably could have arrived at the common understanding that the Legislature would not have employed an entirely novel constitutional term (taxable value) to convey the same meaning as an existing term (assessed value of property as finally equalized). And that common understanding of the voters, expressed through the ratification process, circumscribed subsequent legislative discretion to provide a statutory definition.

Countervailing Arguments

The argument that it was constitutional to statutorily define "taxable value" and "assessed value of property as finally equalized" as synonymous terms is quite straightforward, as is its rejoinder. Simply put, the argument is that Headlee rollbacks and the taxable value limitation achieve the same basic result, albeit by different means: both limit the growth of the local property tax levy; the former by restricting the rate of the tax and the latter by restricting its base. This being the case, proponents of this view contend that the Legislature could not have intended to provide what would amount to compounded property tax relief by allowing Headlee rollbacks

Legislative Intent vs. Voter Understanding

The Michigan Supreme Court has held that while the Legislature may adopt a statute to implement a provision of the state Constitution, it may not do so in a manner that is inconsistent with the constitutional provision in question. *Richardson* v *Secretary of State*, (381 Mich 304; 1968). Furthermore, courts long have held that the meaning of a constitutional provision is to be found not in the intent of its drafters, but in the common understanding of the voters who ratified it. *People* v *Dean*, (14 Mich 406; 1866); *Kuhn* v *Department of Treasury*, (384 Mich 378; 1971). In *People* v *Dean*, the Michigan Supreme Court noted that

> [t]he cardinal rule of construction, concerning language is to apply to it that meaning which it would naturally convey to the popular mind, in all cases where the propriety of such construction is not negatived by some settled rule of law. *In all instruments which are submitted for confirmation to the people themselves, and which derive all their validity from a popular vote, such a construction is peculiarly necessary; for otherwise they would be defrauded of the right to frame their own government according to their own will.* (14 Mich at 417-418; emphasis supplied.)

[2] Of course, it is doubtful that the Legislature could have proposed amending Section 31 without arousing the suspicions of voters, which in turn might have jeopardized passage of Proposal A. Ironically, one such suspicion might have been that the Legislature was attempting to substitute the taxable value limitation for Headlee rollbacks.

to continue to be calculated upon assessed value. Indeed, if Headlee rollbacks were permitted in combination with the taxable value limitation, units of local government would experience millage rate reductions due to growth in valuations upon which they could not levy taxes in the first instance.

The foregoing argument has much merit, given the fact that the purpose of Headlee rollbacks was to limit the annual rate of growth in local property tax revenues to the rate of inflation, absent voter approval of a higher rate. In most cases it would appear that the spirit of Headlee rollbacks is satisfied by application of the taxable value limitation.

However, the rejoinder simply is that, whatever the efficacy of the taxable value limitation, voters may not have intended to substitute it for Headlee rollbacks. Nor was there anything in the text of Proposal A to suggest that the taxable value limitation and Headlee rollbacks were to be mutually exclusive.

The fact that the state Constitution already limited growth of the property tax levy by restricting the rate of the tax did not preclude voters from concluding that the Legislature was proposing that the base of the tax also be restricted. It was well within the authority of the Legislature to propose an amendment to the state Constitution that would have provided property tax relief which supplemented existing constitutional arrangements.

Conclusion

Proposal A amended the state Constitution to require, among other things, that annual increases in the taxable value of parcels of existing property be limited to the lesser of five percent or inflation, but did not define what was meant by taxable value. Subsequently, the Legislature defined "taxable value" as being synonymous with a different constitutional term, "assessed value of property as finally equalized."

The taxable value limitation hardly was the result of sedate legislative reflection; it was added to Proposal A just prior to its passage by the Legislature during the wee hours of Christmas Eve 1993. Thus, actual legislative intent never may be known. In the final analysis, however, the dispositive consideration is not what the Legislature may have intended to propose, but what the voters understood they were being asked to ratify. Courts long have held that the meaning of a constitutional provision is to be found not in the intent of its drafters, but in the common understanding of the voters who ratified it.

Voters reasonably could have presumed that Proposal A meant what it said, particularly since the Legislature could have resolved any conflicts with other constitutional provisions before placing Proposal A on the ballot. Because Proposal A did not amend Section 31 of Article 9 of the state Constitution, Headlee rollbacks should continue to be required whenever the "assessed value of property as finally equalized" in a unit of local government increases by more than the rate of inflation.

A Tale of Three Approaches

Had the Legislature implemented the taxable value limitation as it was ratified by voters, property taxpayers would receive a greater reduction in local property taxes than otherwise will occur under Public Act 415. To illustrate this, consider the following three examples, each of which depicts a home with a $100,000 state-equalized valuation (SEV) in a unit of local government with an aggregate SEV of $100 million. In all three examples, the initial millage rate is 40 mills, yielding a 1990 tax bill of $4,000.

Example One illustrates what would have happened prior to Proposal A, assuming that the SEV of the local unit increased at the same annual rate as SEV statewide, excluding additions and losses, and that the SEV of the home increased at the same rate as existing residential property as a class. The 1991 and 1992 SEV are the same because of a one-year statutory assessment freeze. In 1994, the tax would have been $4,645.

Example One

	Local Unit SEV	Home SEV	MRF[3]	CMRF[3]	Millage Rate	Tax
1990	$100,000,000	$100,000			40.0000	$4,000
1991	105,040,000	106,630	0.9923	--	39.6915	4,232
1992	105,040,000	106,630	1.0303	1.0000	40.0000	4,265
1993	112,361,288	117,293	0.9625	0.9625	38.5005	4,516
1994	115,013,014	120,648	1.0000	0.9625	38.5005	4,645

* * * * *

Example Two illustrates what would have happened under current law as implemented by Public Act 415. Both the SEV of the local unit and that of the home would have increased more slowly than in the first example because the taxable value limitation would have limited annual increases on each parcel in the local unit to the lesser of five percent, inflation, or the percentage increase in SEV from the prior year, assuming no transfer in ownership.

Because the SEV of the local unit would have been prevented from increasing faster than inflation, and because Act 415 defines taxable value and SEV synonymously, rollbacks would not have occurred. Thus, the millage rate would have remained the same. However, the tax bill would have been lower in each year than in the first example because the tax would have been calculated using taxable value rather than SEV. By 1994, the taxable value of the home ($110,105) would have been almost nine percent less than its SEV ($120,648) and the tax would have been $4,404**,** or $241 less than in the first example.

Example Two

	Local Unit Taxable Value	Home Taxable Value	MRF[3]	CMRF[3]	Millage Rate	Tax
1990	$100,000,000	$100,000			40.0000	$4,000
1991	104,230,000	104,230	--	--	40.0000	4,169
1992	104,230,000	104,230	--	--	40.0000	4,169
1993	107,315,208	107,315	--	--	40.0000	4,293
1994	109,847,847	110,105	--	--	40.0000	4,404

*** * * * ***

A Tale of Three Approaches (Continued)

Example Three essentially is a combination of the first two examples and illustrates what would occur if the taxable value limitation worked in conjunction with Headlee rollbacks. Increases in the SEV of the local unit in excess of inflation would trigger reductions in the milage rate. At the same time, the taxable value limitation would cause the taxable value of the home to increase more slowly than its SEV. The millage rate, as reduced by Headlee rollbacks, would be applied to the taxable value of the home, yielding a lower tax than would be the case under either of the other methods alone. In 1994, the tax would have been $4,239**,** or $406 less than in **Example One** and $165 less than in **Example Two**.

Example Three

	Local Unit SEV	Home Taxable Value	MRF[3]	CMRF[3]	Millage Rate	Tax
1990	$100,000,000	$100,000			40.0000	$4,000
1991	105,040,000	104,230	0.9923	--	39.6915	4,137
1992	105,040,000	104,230	1.0303	1.0000	40.0000	4,169
1993	112,361,288	107,315	0.9625	0.9625	38.5005	4,132
1994	115,013,014	110,105	1.0000	0.9625	38.5005	4,239

* * * * *

Source: Michigan Department of Treasury; CRC calculation. It is estimated that statewide (and residential) SEV, excluding additions and losses, increased as follows: 5.04 (6.63) percent in 1991; 0 (0) percent in 1992; 6.97 (10.00) percent in 1993; and 2.36 (2.86) percent in 1994. Inflation, as measured by the United States consumer price index, was 4.23 percent in 1991; 3.03 percent in 1992; 2.96 percent in 1993; and 2.60 in 1994.

[3] A rollback is required if the existing SEV of a local unit increases faster than inflation. When this occurs, a millage reduction fraction (MRF) is calculated and applied to the maximum authorized tax rate. Millage reduction fractions are cumulative, meaning that the millage reduction fraction for a given year is multiplied by the millage reduction fraction from the prior year to yield a compounded millage reduction fraction (CMRF).