Citizens Research Council of Michigan

August 2014 Statewide Ballot Proposal

Proposal 1:
Conversion of State Use Tax to New Local Tax for Local Government PPT Reimbursement

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www.crcmich.org

Summary of Proposal 1

- Proposal 1 is a referendum vote on Public Act 80 of 2014
- Public Act 80 is a key component of recently enacted legislation bringing personal property tax (PPT) relief to Michigan businesses
  - Converts a portion of existing state use tax to a new local tax
  - Revenue from new local tax goes to a special authority to reimburse local governments for lost PPT revenues
- Why are we voting? New local tax requires voter approval under Headlee provisions of Michigan Constitution

Summary of Proposal 1

- Public Act 80 was "tie-barred" to other legislation implementing the PPT reforms; so if Public Act 80 is not approved by voters, the rest of the legislation is repealed as well
  - If Proposal 1 is approved: use tax conversion goes into effect; eligible businesses get PPT relief; local governments receive reimbursement for most losses
  - If Proposal 1 is defeated: PPT legislation is repealed; no business tax relief; no need for local reimbursement; existing state use tax remains in its current form

Outline of Webinar

- Background on PPT: arguments for repeal and its significance as a local revenue source

- PPT Relief: Overview of 2012 legislation that implements PPT reductions for eligible businesses

- Local reimbursement: Overview of 2014 compromise legislation that reimburses local governments for PPT losses

- Key considerations: What does it all mean?

Background: Personal Property Taxes and Local Government Revenues

Property Taxes in Michigan

- Local governments are heavily dependent on property tax revenues to finance local government services
- Tax year 2012: $10.9 billion in local revenue generated from general property taxes
- Property taxes are levied on:
    - Real property – land, buildings
    - Personal property – movable items such as furniture and equipment
- Property is also classified in accordance with its use: residential, agricultural, commercial, industrial, utility; use of property affects its tax treatment

Personal Property Taxes

- Personal property is included in the tax base for businesses (commercial, industrial, utility); exempted from the tax base for residential and agricultural properties
- Personal Property is property not affixed to land; this includes everything from machinery and equipment to tools, computers, and furniture
- Senate Fiscal Agency memo in 2011 estimated annual PPT burden on commercial and industrial personal property to be $844 million
  - $787 million to counties, municipalities, school districts, and community colleges
  - $57 million to state through State Education Tax

Arguments for PPT Relief

- Business community has long argued the PPT is particularly onerous as it taxes productive assets like equipment and machinery

- Some argue that the tax creates a disincentive to invest as the tax adds to the cost of capital equipment; this stifles business expansion and related job creation

- PPT also represents a form of double taxation: businesses pay state sales tax on property at time of purchase, then property taxes are levied on personal property on an annual basis after the purchase

PPT and Local Government Revenues

- Past efforts to implement PPT reforms have stalled over a key question: How can PPT relief be achieved so as to not cripple local finances?

- Statewide, the taxable value commercial and industrial (C&I) personal property accounts for about 7 percent of the total property tax base for all property

- Reliance on C&I personal property varies dramatically by local unit of government
  - Two-thirds of local units: C&I personal property accounts for 1 percent or less of property tax base
  - 30 cities and townships: C&I personal property accounts for more than 30 percent of the base

Examples of C&I-Dependent Units

Local Unit Name	County	2013 Taxable Value *Commercial & Industrial Personal Property*	*All Property*	*% of All Property*
City of Carson City	Montcalm	55,494,863	78,192,460	70.97
Riverton Township	Mason	88,859,100	128,774,319	69.00
Gilford Township	Tuscola	91,721,350	139,286,782	65.85
North Star Township	Gratiot	60,679,800	97,955,446	61.95
Minden Township	Sanilac	43,933,100	71,330,288	61.59
City of Midland	Midland	733,148,700	2,321,355,878	31.58
Covert Township	Van Buren	349,263,800	697,368,243	50.08
City of Holland	Allegan	184,200,600	446,484,508	41.26
City of River Rouge	Wayne	123,838,847	326,175,641	37.97
City of Ecorse	Wayne	93,502,600	223,835,405	41.77

Common thread: High manufacturing and industrial base within local economy (e.g., large local manufacturer, energy-producing facilities)

Overview of PPT Reform Legislation: New Exemptions

Key Features of PPT Reforms

- PPT exemptions: Exemptions cover all industrial personal property and a portion of commercial personal property
  - Small personal property holders: those with property valued at $80,000 or less within a local tax collecting unit can apply for exemption starting in tax year 2014
  - Other businesses: PPT assessed on industrial personal property and eligible commercial property is phased out beginning in tax year 2016; full phase-out is achieved in tax year 2023
- Local revenue reimbursement: Portion of existing state use tax is converted to a new local use tax to be collected by a new special statewide authority; revenues from local tax are dedicated to local reimbursement for PPT losses

Personal Property Tax Reforms

Small Personal Property Holder Exemption

- Businesses with commercial and industrial personal property valued at $80,000 or less within a specific tax collecting unit are now eligible for PPT exemption (started in tax year 2014)
- Business taxpayer must file an annual affidavit with local assessor to claim the exemption
- "Cliff effect": $80,000 threshold represents an all-or-nothing limit for businesses
  - $79,999 in C&I personal property: full exemption
  - $80,001 in C&I personal property: no exemption

Personal Property Tax Reforms

Businesses Not Eligible for Small Property Holder Exemption

- Beginning in tax year 2016, PPT liability for industrial personal property and certain eligible commercial personal property is phased out; full exemption of all eligible property is reached in tax year 2023

- Eligible commercial personal property includes property used predominantly in industrial processing or "direct integrated support" functions such as:
  - research and development
  - engineering
  - testing
  - storage

Personal Property Tax Reforms

Phase-out for Larger Personal Property Holders

- Tax year 2016 exemptions for eligible personal property:
  - New property purchased and placed in service during 2013 or after
  - Older, existing property placed in service in 2005 or earlier
- Tax year 2017 exemptions add eligible property placed in service in 2006, with similar annual phase-in continuing through 2023

Exemptions for Existing Eligible Personal Property

Year placed in service	Tax year 2016	2017	2018	2019	2020	2021	2022	2023
2005 and before	☒	☒	☒	☒	☒	☒	☒	☒
2006		☒	☒	☒	☒	☒	☒	☒
2007			☒	☒	☒	☒	☒	☒
2008				☒	☒	☒	☒	☒
2009					☒	☒	☒	☒
2010						☒	☒	☒
2011							☒	☒
2012								☒
2013 and after	☒	☒	☒	☒	☒	☒	☒	☒

☒ = exempt from personal property tax

State Essential Services Assessment

- Larger personal property holders will be subject to this new statewide tax levied against the acquisition cost of exempted personal property; does not apply to small personal property holders

- Assessment is a state tax with revenue deposited to the state's General Fund; revenue estimated at $20 million in FY2016, $73 million in FY2017, and eventually $117 million in FY2028

- Millage rate is 2.4 mills for property acquired from 1 to 5 years prior to the assessment year; 1.25 mills for property acquired in the prior 6 to 10 years; and 0.9 mills for property acquired more than 10 years earlier

- Michigan Strategic Fund has authority to waive one-half or all of the tax for claimants that demonstrate a plan to invest at least $25 million in new personal property in Michigan

Overview of PPT Reform Legislation: Local Reimbursement

Local Community Stabilization Share Tax

- Existing 6 percent state use tax would be split into two distinct taxes:
  - Local Community Stabilization Share Tax: levied by new Local Community Stabilization Authority with proceeds used to reimburse local governments of PPT revenue losses
  - State Share Tax: levied by the state with revenues used for state purposes
- Local share tax is a local tax; Michigan Department of Treasury will calculate the tax rate annually to equal the rate necessary to achieve revenue targets set in the legislation; the targets reflect estimated local reimbursement needs
- Revenues: tax would raise $96.1 million in FY2016, $380.6 million in FY2017, and continue increase to $572.6 million in FY2028; 1 percent annual adjustment thereafter

Local Community Stabilization Share Tax

- State share tax rate then simply equals the current 6 percent use tax rate minus the computed local share rate
- <u>NO CHANGE</u> in overall tax burden to citizens; state share tax rate and new local tax rate would equal current 6 percent use tax rate
- 2 percent of the state's current use tax is currently dedicated to the state's School Aid Fund; new local tax does not affect this allocation
- New local tax comes out of the 4 percent use tax base that is deposited in the state's General Fund

Local Community Stabilization Authority

- Created in the PPT legislation to collect and distribute revenues from the new local share tax; also will take on responsibilities of Metropolitan Extension Telecommunications Right-of-Way Authority

- Established under authority granted in the Local Government article (Article VII, Section 27) of the Michigan Constitution which allows for creation of "additional forms of government" in metropolitan areas

- LCSA would be a unique statewide local unit of government governed by a 5-member council appointed by the Governor

PPT Exemptions: Local Revenue Impact

- Legislative analyses suggest that PPT revenue collections will decline by $127 million in FY2016 – the first year an exemption is available for larger property holders
- Losses are expected to climb to $414 million in FY2017 and eventually to $577 million in FY2023 and $603 million in FY2028
- Revenue losses can be grouped into two categories:
  - Losses from State Education Tax and local 18-mill school operating levies: revenue from the state use tax will be deposited into the School Aid Fund to offset these losses
  - All other PPT-related losses: revenue from the local share tax administered by the LCSA will be used to offset some portion of these losses

Local Reimbursement Process

- PPT legislation prioritizes local reimbursement administered through the new LCSA
- First priority for local share tax revenue: 100% reimbursement of revenue losses attributable to:
  - School operating, debt, and sinking fund/recreation millages
  - Intermediate school district debt and operating millages
  - Tax increment financing authorities
  - The small personal property holder exemption
  - Revenue used to finance "essential services" – defined as police, fire, ambulance, and jail services
- Any remaining local share tax revenue would be distributed by formula to cover remaining local losses (e.g. revenues for non-essential services, community college millages)

Key Considerations

Why Are We Voting?

- State legislature added a requirement to Public Act 80 requiring a statewide vote regarding the conversion of a portion the state's use tax to the new local share tax
- WHY?
  - Article IX, Section 31 of the State Constitution (part of 1978 "Headlee Amendment"): local governments are prohibited "from levying any tax not authorized by law or charter when this section is ratified… without the approval of a majority of the qualified electors of that unit of Local Government voting thereon."
  - Local share tax is taken from existing state use tax, but it is still a <u>new local tax</u>
  - LCSA is a statewide entity, but is a <u>local government</u>
- Section 31 requires voter approval of the new local tax, and since the local government here comprises the entire state, a statewide vote is needed

The LCSA and the Local Share Tax

- The LCSA is a statewide entity administering a statewide tax; yet it is designated a local government and the statewide tax is designated as local revenue
- Simpler solution: Have a component unit of state government collect a state tax for distribution to local governments
- WHY THIS ARRANGEMENT?
  - Local governments want assurances that promised reimbursement will be realized
  - Local tax collected by local metropolitan authority means revenues do not flow through the state treasury and are not subject to annual appropriations by the state legislature

Will Locals Receive Full Reimbursement?

- The reimbursement provisions in the PPT legislation are designed to hold local governments harmless from revenue losses from the PPT exemptions; however, there is no guarantee of full revenue replacement

- Risk factors for local governments
  - Some municipalities (e.g., counties, townships, villages) will incur losses during 2014 and 2015
  - Small personal property holder exemption based on a one-time calculation of change in taxable value of C&I personal property
  - Revenue for reimbursement is based on <u>estimated</u> losses

Implications for the State Budget

- State general fund/general purpose (GF/GP) revenues will be reduced as a result of two elements of the reimbursement plan:
  - The new local share tax will take away state use tax revenues that would otherwise go the General Fund
  - The legislation requires state share tax revenues to be deposited in the School Aid Fund to offset State Education Tax and local 18-mill school operating losses

- New state essential services assessment helps to mitigate some of the GF/GP revenue loss

- Net impact: State GF/GP revenue $107 million lower in FY2016; $350 million lower in FY2017; $500 million lower in FY2023

Implications of the Vote

If voters **approve** Proposal 1:

- Enacted PPT exemptions go forward
- Portion of use tax is converted to new local share tax, but no overall change for individuals
- Local governments reimbursed from local share tax revenue

If voters **reject** Proposal 1:

- PPT exemptions are repealed in tax year 2015; businesses pay the local PPT again; no state essential services assessment
- State use tax remains at 6 percent; no local tax and no new authority
- Local reimbursement not needed

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