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THE CITY INCOME TAX

The development of the municipal income tax is, for the most part, a post-World War II phenomenon. Philadelphia imposed the first local income tax immediately prior to the war and this set the pattern which other cities later followed. Toledo enacted a local income tax in 1946. During the late 1940's the use of the income tax spread in Ohio and in Pennsylvania, and several cities in Kentucky and St. Louis, Missouri, imposed the tax. In the mid-50's Gadsen, Alabama imposed the tax. In 1962 the city income tax was first used in Michigan and, as of January 1, 1968, a total of nine Michigan cities were imposing the tax. In 1966 New York City and Baltimore began imposing the tax. Today, income taxes are levied by over 2,000 local units of government in eight states--Alabama, Kentucky, Maryland, Michigan, Missouri, New York, Ohio and Pennsylvania.

As used in these states, the tax assumes a variety of forms and many variations of legal and popular names are used to describe it; for example, earnings tax, payroll tax, wage tax, earned income tax, wage and income tax, occupational license tax, gross license tax, income and net profits tax, and just plain income tax. Taxation experts generally agree, however, that its general characteristics as used in most localities would be best described were it titled a "gross earnings and net profits" tax.

The tax is most commonly a low flat rate tax on the earned income of individuals and the net profits of businesses and professions. An employer withholding system is almost always used as a collection device. Inter-jurisdictional tax crediting or reciprocity arrangements have been developed and are commonly used to cope with potential problems of double taxation.

In six of the eight states, including Michigan, the net profits of corporations are subject to the tax. In these various units the tax ranges from one-quarter of one percent to five and a half percent under the new New York City tax. Most local income taxes are imposed at a flat rate--New York City is the only city using graduated rates. A total of $472 million was collected from such taxes nationally in 1966. Since 1966 major cities such as New York, Cleveland and Baltimore have imposed the tax and for fiscal 1968 local income tax collections will pass the one billion dollar mark. In many of the cities that use it, the income tax has become the most important source of revenue, outstripping the property tax.

There are several major differences between the, local income tax levied in Michigan and those levied by cities in other states. Unlike the federal income tax and state income taxes, local income taxes generally do not allow personal exemptions or non-business deductions. Warren, Ohio, New York City and Baltimore are the only cities outside Michigan that allow personal exemptions. In Michigan, the local income taxes permit a personal exemption of $600 per taxpayer and dependent. A second major difference between the municipal income tax used in Michigan and that used in other states is in the treatment of unearned income. In most other states the tax is on earned income only, such as salaries and wages, and unearned income such as dividends, interest, capital gains, etc., are not subject to tax. In Michigan and in New York City and Baltimore, however, the tax is imposed on the unearned income of resident individuals, unincorporated businesses and corporations as well as on their earned income.

These two differences, allowing personal exemptions and taxing dividend and interest income, make the local income tax in Michigan a much more sophisticated tax than that found in most other cities. The Michigan municipal income tax is more similar in character to state income taxes than it is to the "payroll"- type income tax found in most cities.

Development of the Income Tax in Michigan

In 1951, the voters of Saginaw approved a charter amendment for a one percent tax on individual and corporate income. A suit was brought to enjoin the city from levying the tax and the circuit court granted an injunction. When the issue reached the Supreme Court it ruled that the charter amendment proposing the income tax was improper in form. Thus, the early attempt by Saginaw to impose a city income tax was knocked down by a procedural technicality.

The next effort in Michigan to enact a city income tax came in Detroit. In an attempt to solve the city of Detroit's financial problems, the Detroit city council in 1960 adopted a city income tax ordinance, which was vetoed by the mayor. Following a change in city administration Detroit enacted a city income tax in the spring of 1962. This tax was enacted pursuant to provisions of the home rule act and city charter authorizing the city to levy and collect rents, tolls and excises.

The Detroit tax became effective July 1, 1962, and Hamtramck followed suit, adopting an identical ordinance effective October 1. The Detroit and Hamtramck ordinances taxed corporations and both resident and nonresident individuals at one percent and solved the problem of double taxation by providing that the city of employment had priority in taxation. This served both to discourage the spread of the tax to the suburbs and to stimulate opposition on the part of many suburban officials to the tax.

In 1962, the legislature adopted the income of non-residents, which Detroit and Hamtramck were able to residents and non-residents at the bill prohibiting cities from taxing was vetoed by Governor Swainson, and continue to levy the tax on both one percent rate.

The Uniform City Income Tax Ordinance

With the adoption of the new constitution in 1963, all cities and villages were authorized to levy non-property taxes subject to limitations and prohibitions provided by the constitution and laws. The 1964 session of the legislature was faced with continuing demands from suburban groups to prohibit the taxation of non-residents. Also, the legislature was faced with the possibility of cities and villages using their new constitutional non-property taxing power to impose a wide variety of local taxes. Detroit and Hamtramck were Imposing identical taxes, using the same rules and even using the same forms. This made it relatively easy for an individual or business operating in both communities to comply with the tax. However, there was concern that if other cities in the metropolitan area imposed the tax they might use a different definition of income, allow different exemptions, and set up different rules, which would make employer withholding and taxpayer compliance a hopelessly complicated task.

Faced with these twin problems of meeting suburban objections to the tax and the possibility of a multitude of conflicting local taxes, the legislature in its 1964 session enacted a law which provided that no city or village could impose a non-property tax unless specifically authorized by law to do so. The legislature also enacted another bill, a uniform city income tax, which authorized cities to adopt a uniform ordinance. The act contained a "grandfather" clause for Detroit, Hamtramck and Flint, which were already levying an income tax. The tax was to be administered by the local unit adopting it, but provision was made for appeal to the commissioner of the state department of revenue in order to maintain uniformity in the application of the tax. The uniform city income tax act contained two major compromises with the opponents of city income taxes:

> First, it cut the rate of tax on non-residents from one percent to one-half of one percent; and,
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> Second, it provided that while the governing body of the city could adopt the ordinance, it would be subject to voter referendum upon petition of not less than ten percent nor more than 20 percent of the electors voting in the last city election. The state law contained a grandfather clause for those cities which had a tax in effect on January 1, 1964, exempting them from the referendum provision of the act. Detroit, Hamtramck and Flint came under this grandfather clause.

Referenda in the City Income Tax

The referendum provision in the uniform ordinance was to prove an item of major significance. Shortly following the adoption of the uniform city income tax act by the legislature, the city councils in six additional cities adopted the uniform city income tax--Muskegon, Muskegon Heights, Saginaw, Grand Rapids, Jackson and Pontiac. Detroit, Hamtramck and Flint which had previously imposed local taxes also adopted the uniform ordinance. In all six of the new cities the necessary petitions were filed calling for a referendum. In addition, Flint held an advisory referendum.

Of the nine cities enacting the uniform city income tax ordinance in 1964 all but two, Detroit and Hamtramck, held local referenda on the question of levying the tax. In the seven cities holding referenda the tax was approved by the voters in only two--Flint and Saginaw, while it was defeated in the five other cities. In Flint, the advisory referendum was approved by a two-to-one vote. In Saginaw the tax was approved by 56 percent of those voting on the question.

In the five cities where the tax was defeated the margins tended to be quite decisive--as much as four-to-one.

To obtain some insights into the results of these local referenda on the income tax, the Research Council sent questionnaires to each of the seven cities.

In summing up the results of the referenda in these seven cities, several factors stood out:

- In none of the cities did the political party organizations publicly support nor oppose the tax.

  In the two cities where voters approved the tax (Flint and Saginaw) it had the support of both the AFL-CIO and business groups.

- In four of the cities in which the tax was defeated the AFL-CIO actively opposed the tax (all but Pontiac).

- In the five cities where the tax was defeated, the business groups took no public position on the question.

- In all seven cities, the city commission promised property tax relief--generally about three mills.

- The possibility of a state income tax seemed to loom large in a number of cities as a reason for defeat of the measure.

Thus, in the initial round of enactments of the uniform city income tax, two cities (Detroit and Hamtramck) continued their taxes without referenda; in two cities (Flint and Saginaw) voters approved the tax; and, in five cities (Muskegon, Muskegon Heights, Grand Rapids, Jackson and Pontiac) the tax was defeated decisively by the voters.

Subsequently, a number of other cities adopted the uniform ordinance --Highland Park, Lapeer, Battle Creek, Royal Oak, Bay City, Cadillac, Ferndale, East Jordan, Warren and Swartz Creek--and two cities (Grand Rapids and Pontiac) re-enacted the ordinance following its initial defeat by the voters. The tax was approved by the voters in Highland Park, Lapeer, Battle Creek and Grand Rapids and took effect in Pontiac without a referendum (petitions were filed, but contested--the case is now in court).

As of January 1, 1968, the following nine cities are imposing the city come tax:

Table 1

Effective Dates of City Income Taxes

City	Effective Date of Tax
Detroit	July 1, 1962
Hamtramck	October 1, 1962
Flint	January 1, 1965
Saginaw	July 1, 1965
Highland Park	July 1, 1966
Lapeer	January 1, 1967
Grand Rapids	July 1, 1967
Battle Creek	July 1, 1967
Pontiac	January 1, 1968

In addition to the nine cities now imposing the tax, ten other cities enacted the ordinance, but it was rejected by the voters (Royal Oak, Jackson, Cadillac, Ferndale, Bay City, East Jordan, Muskegon, Muskegon eights, Warren and Swartz Creek).

Provisions of the Uniform City Income Tax

The uniform city income tax, Act 294 of 1964 as amended, provides that the uniform city income tax ordinance can be adopted or rescinded by the governing body of the city at any time. The ordinance can take effect on either January 1 or July 1 as provided in the ordinance, but it cannot become effective earlier than 45 days after adoption or until approved by the electors if a referendum petition is filed. Petitions or a referendum may be filed not later than the sixth Monday following the adoption of the ordinance. The petitions must be signed by not less than 10 percent nor more than 20 percent of the registered electors of the city voting at the last general municipal election. If proper petitions are filed, the ordinance shall be submitted to the electors.

The major features of the uniform city income tax ordinance are as follows:

Resident Individuals are taxed at one percent (1%) on all income (salaries, wages, net profits from unincorporated businesses, dividends, interest, capital gains, net rentals, income from estates and trusts, etc.).

Non-Resident Individuals are taxed at one-half of one percent (1/2 of 1%) on income earned in the city from salaries, wages, and other compensation, the distributive share of the net profits of unincorporated businesses, and on capital gains from sales of, and net profits from, rentals of real and tangible personal property located in the city.

Reciprocity is provided if both the city of residence and the city of employment impose the tax. A taxpayer can take a tax credit against his liability in his city of residence for taxes paid in his city of employment.

Exemptions are the same as for the federal income tax--$600 for each taxpayer and dependent with additional exemptions for persons blind or over 65 years of age.

Deductions are allowed only for business expenses. Non-business deductions are not allowed.

Corporations are taxed at one percent on net profits earned in the city. Net profits are defined as federal taxable income.

Allocation of Business Income is on separate accounting or on a three-factor formula (property, sales and payroll).

Withholding by employers maintaining an establishment or doing business in the city is required.

Administration--each city imposing the tax is responsible for its administration. An appeals procedure to the Commissioner of the State Department of Revenue is provided in order to maintain uniformity in application of the ordinance.

Public Act 268 of 1967, which was adopted as part of the 1967 tax package, provides that beginning on January 1, 1970, any city imposing the city income tax may enter into an agreement with the state revenue department to administer the tax on behalf of the city. A two percent collection fee is provided.

Experience of Michigan Cities with the Income Tax

The revenues of Michigan cities from the city income tax in 1966-67 are as follows:

Table 2

Yield of City Income Taxes

City	1966-67 Yield	Yield Per Capita
Detroit	$46.6 million	$28.41
Hamtramck	1,234,665	38.95
Saginaw	3,150,000	31.50
Flint	8,126,000	39.64
Highland Park*	1,174,000	32.25

* Not a full-year collection

The four other cities imposing the tax (Lapeer, Grand Rapids, Battle Greek and Pontiac) have not yet had a full-year's collection experience. Grand Rapids estimates that on a full year basis the tax will yield $4.5 million or about $22 per capita and the city of Lapeer estimates a yield of about $135,000 or $20 per capita. Thus, depending on such characteristics of the city as average income, number of non-resident workers and amount of corporate profits, the yield of the income tax in cities now levying the tax ranges from about $20 to $40 per capita.

Impact on Property Tax Rates. The table below shows the city property tax rates in cities with the income tax. For 1967, for the year prior to adoption of the income tax, and the increase or decrease in city property tax rates between the two years. The figures shown include the rates for both operating and debt service. It should be noted that the increase or decrease in property tax rates may be attributable to factors other than the imposition of the income tax. For example, a city may have decreased its property tax rate immediately following adoption of the income tax but subsequently raised it. Or, a city may have been reassessed, or its state equalized value changed significantly since enactment of the income tax and this could change its property tax rate. Detroit, for example, was completely reassessed in 1967 and while the rate per $1,000 of state equalized value has increased by $1.68, the "spread" rate on local assessed value has decreased from $25.73 in 1961 to $24.00 in 1967, a $1.73 decrease.

Table 3

Property Tax Rates in Cities Imposing The Income Tax (Tax Rate Per $1,000 State Equalized Value)

City	In 1967	In Year Preceding Enactment of Income Tax	Increase (+) or Decrease (-)
Detroit[a]	$24.00	$22.32 (1961)	+ $1.68
Hamtramck	20.71	22.42 (1961)	- 1.71
Flint	7.79	10.06 (1963)	- 2.27
Saginaw	8.72	12.73 (1964)	- 4.01
Highland Park	20.16	20.23 (1965)	- .07
Lapeer	12.40	19.44 (1966)	- 7.04
Battle Creek	10.73	12.77 (1966)	- 2.04
Grand Rapids[b]	12.79	12.78 (1966)	+ .01
Pontiac[c]	14.30	14.30 (1967)	--

[a] Rate per $1,000 local assessed value has decreased by $1.73.

[b] City officials report that the Grand Rapids rate will be decreased by $2.00 in 1968.

[c] City officials report that the Pontiac rate will be decreased by $3.00 in 1968.

As can be seen from the above table, in most of the cities imposing the city income tax the property tax rate has decreased or a decrease is planned. The average (median) change in property tax rates in the nine cities will be slightly over $2.00 per $1,000 state equalized value.

Administrative Costs. Comprehensive data are not available on costs incurred by cities for administering the city income tax. Available data indicate, however, that the cost in large cities amounts to about three percent of yield while in small cities administrative costs can approximate seven percent of yield. The city of Lapeer, which is the smallest city imposing the tax, indicates that its first year administrative costs will approximate $10,000 or slightly over seven percent of the estimated $135,000 yield. Lapeer reports that costs after the first year might be somewhat less because of the initial costs involved in printing, developing lists, etc.

Public Act 268 of 1967 authorizes a city to enter into an agreement with the state department of revenue to administer the city income tax beginning January 1, 1970. The law provides for a two percent collection fee to be retained by the state to help cover its costs. This provision could permit a local unit to impose the tax and to contract with the state for collection of the tax on behalf of the city. It appears from available evidence that the two percent collection fee charged by the state would be significantly less than the costs of local administration, particularly in smaller cities.

The City Income Tax - Pro and Con

Here have been a number of arguments pro and con on the use of the local income tax by Michigan cities. These arguments may be summarized as follows:

Arguments in Favor

1. It produces additional revenues for cities hard pressed for tax revenues to support needed services. The $20-$40 per capita yield of an income tax makes it a major source of revenue.

2. An income tax can provide relief from the property tax, which is the only source of tax revenue of cities, school districts and counties. The yield of the income taxes in Detroit, Hamtramck, Flint and Saginaw is the equivalent of a property tax of from $6 to $10 per $1,000 state equalized value. Most cities imposing the income tax have been able to reduce property taxes, even during a period when costs are rising.

3. The income tax is more equitable than the property tax--a low income family would pay less income tax in proportion to its income than would a high income family. The $600 per dependent exemption together with the tax on interest and dividend income makes the city income tax slightly progressive. The property tax is generally regressive--that is, a low income family tends to pay a larger portion of its income in property taxes than does the higher income family. Since pensions and annuities are exempt from the tax, the tax is not burdensome to retired persons with limited incomes.

4. The income tax can exact some payment from non-residents of the city who contribute to city costs, but pay nothing in city taxes.

5. The income tax tends to produce increased revenues as the population and economy expand. In three years the yield of the Detroit tax increased by $10 million or about 30 percent, while during the same period the property tax base of the city decreased slightly. This growth factor can help cities keep pace with rising costs.

Arguments Against

1. The city income tax is simply another way of increasing taxes and does not provide substantial property tax relief. While the yield of the income tax would permit significant reductions in property tax rates, the actual cut in property taxes has been relatively small. Further, despite city income taxes, the total property tax bill keeps increasing.

2. The taxation of the income of non-residents constitutes "taxation without representation". In view of the need for cooperative action between the central city and suburbs, the taxation of non-residents causes more ill will than it is worth in terms of revenue received.

3. People already pay a federal income tax and a state income tax. A city income tax is a third tax on the same income and requires the filling out of another set of forms. Cities share in the yield of the new state income tax on individuals--the return to cities is equivalent to almost a quarter of one percent (0.22%) income tax and counties receive a like amount.

4. While the yield of the income tax will expand more rapidly than the yield of the property tax in good times, it will fall more rapidly in poor times when cities need money the most.

5. As compared to the property tax, the income tax tends to shift the tax burden from business and industry to wage earners.

These are some of the major arguments pro and con on the income tax. The weight of these arguments and a variety of local factors will determine whether a city income tax is appropriate in any given community. Under Michigan's home rule doctrine, each community can decide for itself whether it wishes to impose the city income tax.