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



**No. 1003** **MARCH 1992**

# SCHOOL DISTRICT TAX BASE SHARING IN MICHIGAN

## THE ISSUE IN BRIEF

Public Act 108 of 1991 established a system of tax base sharing to assist in equalizing the operating revenues of local school districts. Tax base sharing is a system whereby high property valuation units of government share revenue from their property tax base with low valuation units. Applying tax base sharing to financing the operations of school districts involves out-of-formula school districts sharing a portion of their growth in commercial and industrial property tax returns with in-formula districts. An out-of-formula district is one with a relatively high state equalized value per pupil that raises more revenue per pupil through the local property tax at a given tax rate than is guaranteed through the state aid membership formula.

The disparities in tax base combined with the differences in the number of operating mills levied have produced significant inequities in the amount of per pupil tax revenue available. Although school membership aid has attempted to reduce the disparities resulting from property tax resulting from property tax wealth, total revenues vary wildly among districts. This occurs even though in-formula districts usually levy a higher property tax millage for operations. In 1991-92, combined per pupil revenue from local property taxes and state membership aid varies from $2,600 to $9,000 among the 530 K-12 districts.

The new tax base sharing system requires an out-of-formula district to share with in-formula districts the proceeds from 50 percent of its growth in business and commercial state equalized valuation (SEV) multiplied by the district's operating millage. The growth each year is over the base year of 1990-91, and the property tax revenue shared would be cumulative over time. A number of compromises made during legislative deliberations will have the effect of minimizing the intended impact tax base sharing will have on reducing the per pupil revenue inequities among school districts.

In the short term, tax base sharing will not have much impact on reducing revenue disparities among school districts. Because of the cumulative effect of sharing a portion of the revenue growth of out-of-formula districts, there will be some salutary effect over time. However, there will not be an absolute reduction in per pupil revenue inequities, because half of the growth in business taxes will not be shared nor will any of the growth in the residential and agricultural classes. Other variables, such as the rate of growth in SEV, the membership in districts, and the number of operating mills levied by individual districts, also impact per pupil revenue disparities. As of this writing, the tax base sharing system has not become operational because of legal challenges in three counties.

## Tax Base Sharing Concept

The existing disparity in SEV per pupil results from the uneven distribution of property values among school districts in the state. Three specific elements contribute to per pupil revenue disparities.

1. The operating millage rate of school districts.
2. The total amount of and growth in industrial and commercial SEV in out-of-formula districts.
3. The total amount of and growth in residential and agricultural SEV in out-of-formula districts.

The 1991-92 state aid membership formula guarantees $94.38 per pupil for each mill levied in combined state aid and local property tax revenue. Thus, the higher the operating millage rate the greater per pupil revenue received by a district. A low operating millage levy can be a significant contributing factor to the disparity problem. In 1991-92, the Onaway Area Community School District levied 24.6 mills for operations and had per pupil revenue of $2,632. If the district had levied ten additional mills, which would have brought the district to approximately the state average operating levy, the district would have had operating revenues of $3,576 per pupil, or an increase of almost 36 percent. In this situation, the per pupil disparity between Onaway and the Bloomfield Hills School District, the highest per pupil revenue district, would have been $5,400 rather than $6,400. Thus, approximately $1,000 of the per pupil disparity was attributable to the lower than average property tax effort on the part of the Onaway district. Any effort to reduce per pupil disparity attributable to differences in rate requires an affirmative vote for an operating millage increase in the affected district.

A number of out-of-formula school districts derive their property wealth from agricultural and residential property. These districts essentially are not affected by tax base sharing, and will not have a role in reducing per pupil disparities. For example, the Bloomfield Hills and Grosse Pointe school districts in the first year will share about one-quarter of one percent of their total property tax revenues under the existing tax base sharing system.

In 1991-92, Bloomfield Hills and Grosse Pointe had minimal growth in the business classes, $8 million for the former and $10 million for the latter. The tax proceeds from 50 percent of the growth must be shared. Both districts had substantial growth in the residential and agricultural classes, $146 million in Bloomfield Hills and $145 million in Grosse Pointe. Ann Arbor and Southfield are out-of-formula districts with significant growth in the business classes. In the case of Ann Arbor, the growth was $82 million, and the growth in Southfield was $45 million. Ann Arbor and Southfield would share significantly more revenue than either Bloomfield Hills or Grosse Pointe. However, Bloomfield Hills and Grosse Pointe would continue to be subject to categorical recapture that will be phased out for Ann Arbor and Southfield. It also is worth noting that Ann Arbor had growth of $173 million in the agricultural and residential classes.

It is clear that for tax base sharing purposes, not all out-of-formula school districts are impacted equally. An out-of-formula district with a concentration of ‘Industrial and commercial property will share more revenue than an out-of-formula district that derives most of its revenue from the districts residential and agricultural base.

The success of tax base sharing will depend on the growth in commercial and industrial property in out-of-formula school districts. Over the last decade (1982-1991), industrial and commercial property have constituted about 33 percent of the total property base (see **Table 1).** It is estimated that approximately 56 percent of commercial and industrial property is located in out-of-formula school districts. The SEV of business property grew 64 percent or $20.8 billion during the ten year period.

**Table 1**

**State Equalized Values**
**(in millions of dollars)**

| | 1 | 2 | 3 | 4 | 5 |
|---|---|---|---|---|---|
| **Year** | **Residential and Agricultural** | **Percent of Total** | **Business** | **Percent of Total** | **Total*** |
| 1982 | $64,869 | 66.1% | $32,627 | 33.2% | $98,210 |
| 1983 | 64,407 | 65.5 | 33,221 | 33.8 | 98,344 |
| 1984 | 65,462 | 65.4 | 34,004 | 34.0 | 100,171 |
| 1985 | 66,474 | 64.7 | 35,653 | 34.7 | 102,795 |
| 1986 | 67,637 | 63.7 | 37,962 | 35.7 | 106,243 |
| 1987 | 69,870 | 62.8 | 40,769 | 36.6 | 111,257 |
| 1988 | 74,780 | 62.8 | 43,717 | 36.7 | 119,089 |
| 1989 | 81,372 | 63.2 | 46,838 | 36.4 | 128,813 |
| 1990 | 88,985 | 63.5 | 50,558 | 36.1 | 140,171 |
| 1991 | 96,813 | 64.2 | 53,406 | 35.4 | 150,861 |

Source: State Tax Commission.

* Includes timber cutover and developmental classes not included in columns 1 and 3.

Assuming that the 56 percent share of commercial and industrial property held for the past ten years and that the tax base sharing system had been in effect for the ten years, the amount available for distribution to in-formula districts in 1991-92 would be an estimated $197 million or $170 per in-formula pupil. The total operating levy is estimated to be $5.1 billion; thus an estimated 3.8 percent of the total operating levy of school districts would be shared.

As **Table 1** indicates, residential and agricultural property increased $32 billion or 49 percent during the ten year period 1982 to 1991. The 1991 residential and agricultural classes are in excess of 64 percent of the state's total SEV. Clearly, these two classes contribute significantly to the disparity problem. Using 1986 data, 38 percent of residential and agricultural property is estimated to be located in out-of-formula districts; the 1982-1991 SEV growth in out-of-formula districts for these two classes is estimated to be $12 billion.

The out-of-formula school districts' share of business property growth is estimated to be $12 billion between 1982 and 1991, of which 50 percent, or $6 billion, would have been shared. Total SEV grew an estimated $24 billion in out-of-formula districts. Thus, out-of-formula districts would have shared 25 percent, or $6 billion, of their total growth with in-formula districts, but would have retained the other $18 billion of their total growth.

## Current Tax Base Sharing System

As finally enacted, there are a number of provisions that have the effect of reducing the impact tax base sharing will have on the per pupil revenue disparity issue. Following is a summary of the major provisions of the statute:

- Districts will share property tax revenue derived from their commercial and industrial property base using a sliding scale based on adjusted gross income per pupil (AGIPP). Districts with AGIPP of less than 76 percent of the state average AGIPP share none of the growth in their tax base. For each percentage point above 75 percent up to 125 percent, a district will share one percent of its revenue growth (maximum amount shared is 50 percent).

- Two provisions deal with out-of-formula districts that levy more than 40 mills for operations. Districts meeting the criteria established in either of these provisions are required to share one-half of the amount calculated in the above formula up to a maximum of 25 percent of their revenue growth.

- Any school district with SEV per pupil that is 2.5 times or more of the state average SEV per pupil will share 50 percent of the increase in its commercial and industrial revenue regardless of its AGIPP.

- Out-of-formula districts with fewer than 500 pupils are excluded from tax base sharing.

- Subject to not receiving any categorical state-,-aid, a district may opt not to participate in tax base sharing.

- Two regions are created and revenues are collected by region from out-of-formula districts and distributed on a per pupil basis to in-formula districts within each region. The Oakland Intermediate School District will collect and distribute revenue to the 50 counties in region 1 and the Wayne County Regional Educational Service Area will collect and distribute revenue for the 33 counties in region 2.

- If the variance between the two regions in per pupil revenue shared exceeds ten percent, tax base sharing in the next year shall be on a statewide basis, unless the Legislature adjusts the regions to meet the ten percent standard.

- Captured value in tax increment finance authorities is excluded from the definition of SEV for tax sharing purposes, and a procedure is established to account for abated property.

- In 1991-92, categorical recapture would be reduced by $1.00 for every $2.00 shared. In recognition of the 1992-93 property assessment freeze, recapture would be reduced by $2.00 for every $1.00 shared, but for that year only. In subsequent years, recapture would be reduced $1.00 for every $1.00 shared. Categorical recapture for any out-of-formula district cannot exceed the amount recaptured in 1990-91 as reduced by an amount equal to the tax base revenue shared.

- Because of the one year assessment freeze, the amount shared by each district in 1992-93 is capped at the 1991-92 level.

As the above summary demonstrates, what was supposed to have been an uncomplicated system for revenue sharing has become a system with numerous exceptions that adversely affect the reduction in the per pupil revenue disparity among school districts. Although the estimated 45 in-formula and out-of-formula K-12 districts in 1991-92 with a membership of less than 500 pupils constitute a small portion of the total K-12 system, there is no apparent public policy purpose to exclude these out-of-formula districts from sharing property tax revenues. There also does not appear to be any rational reason for creating two regions for purposes of allocating tax base sharing revenues, except to avoid having these funds distributed from the state level.

## Use of Adjusted Gross Income Per Pupil

There are two issues relating to adjusting tax base sharing for out-of-formula districts based on the personal income of district residents. One issue concerns the appropriateness of using personal income data when allocating property tax revenue as part of a school finance tax base sharing system. The other matter relates to the quality of the income tax data reported for each school district on state income tax returns. Following is a summary of problems associated with these two issues:

### Appropriateness of Using Personal Income Data

- Not all property taxes in a district are paid by residents of that district from personal income. For example, the 1991 SEV is $150.9 billion, of which $53.4 billion is industrial, commercial and personal property. Property taxes paid on these property classes are not direct payments from personal income.

- The property taxes on residential resort property often are paid by non-residents of the school district.

- Existing Department of Treasury data does not support the contention that low income out-of-formula districts are not able to afford high school operating property tax rates. Using 199091 data, the 20 school districts with the highest school operating rates are spread randomly among the 573 K-12 and primary districts ranked on adjusted gross income.

- The state already administers a comprehensive property tax credit system to reduce the property tax burden of low income residents. Based on Department of Treasury data, the 1989 general property tax levy for all purposes was $6.8 billion,. and the state rebated $764.8 million through the state income tax system to offset this property tax liability of homeowners and renters.

**Reliability of Data Used to Determine Average Adjusted Gross Income Per Pupil**

- The data base is derived from annual state individual income tax returns processed by the Department of Treasury. Based on 1989 income tax returns, 13.6 percent of income tax returns and 10.3 percent of property tax credit claims listed no school district code or a non-existent code.

- There is reason to believe a number of state residents, especially those without children, may not know the legal name of the school district in which they reside. For example, residents of the City of Warren live in one of six school districts within the city. Others may be confused because of the similarity of school district names. For example, there is a Huron School District and a Huron Valley School District in the state.

- The income data base for any individual school district is not complete, because significant amounts of income are not included in state adjusted gross income and thus not reported. Examples include pension income, social security income, and armed forces compensation, which are included in household income for property tax relief purposes, but not included in adjusted gross income for state income tax purposes.

In summary, there does not appear to be any good public purpose served by adjusting the commercial and industrial property tax revenue shared by out-of-formula school districts based on adjusted gross income. Parenthetically, if it makes any sense to reduce tax base sharing for low income out-of-formula districts, it would make more sense to adjust the distribution of the commercial and industrial property tax revenue to in-formula districts based on the personal income of the districts' residents.

## Financial Impact

At this time, there is an absence of firm factual data upon which to make financial estimates concerning the effect of tax base sharing. Based on legislative staff estimates, the 1991-92 estimate is that $27.2 million will be shared or $23 per in-formula pupil. Assuming 460,000 out-of-formula pupils in 1991-92, the sharing of $27.2 million on average will reduce the revenue of out-of-formula school districts by $59 per pupil ($27.2 million divided by 460,000 pupils).

Thus, the disparity gap on average will be reduced by $82 per pupil through a combination of increasing the revenue of in-formula districts and reducing the revenue of out-of-formula districts.*

Based on Senate Fiscal Agency estimates, in the tenth year, a total of $341 million would be shared. This translates to an increase of $290 per pupil for in-formula districts and a reduction of $741 per pupil in out-of-formula districts. The average per pupil disparity would have been reduced an estimated $1,031 from what it would have been otherwise.

Although out-of-formula districts are sharing one-half of the growth in revenue from business property, they retain the other half, $741 per pupil. Thus, in ten years, the revenue per pupil for in-formula districts would increase $290 from tax base sharing, while out-of-formula districts would increase $741 per pupil. Although business property revenues are only one element in the disparity issue, it is believed that per pupil disparity will continue to grow, but at a slower rate than it would otherwise.

If the commercial and industrial property tax revenue had been deposited in the school aid fund and then reallocated to in-formula districts through the membership formula, these revenues would have equalized local property tax effort. Under the existing statutory system, a district levying 25 mills for operations will receive the same amount per pupil from tax base sharing as a district levying 40 operating mills.

In order to make tax base sharing more palatable to out-of-formula districts, a tradeoff was included in the tax base sharing statute. The specific benefit to out-of-formula districts was the phasing out of the recapture provision in the state aid act that denied or reduced categorical state aid to such districts for specific programs such as special education, vocational education, and transportation.

The reduction in the categorical recapture provision of the state school aid act in the early years mitigates the impact of tax base sharing on out-of-formula districts. The 1990-91 recapture is $72.1 million. It is estimated that recapture in 1991-92 will drop to $60.2 million, a reduction of $11.9 million, because of the one dollar recapture reduction for each two dollars in tax sharing revenue. Since the recapture amount presumably has been added to the membership formula, the net gain to in-formula districts is $15.3 million ($27.2 million minus $11.9 million).

---

* This may be a tenuous estimate. As reported above, school districts may opt out of tax base sharing by forfeiting any state categorical aid the district is eligible to receive. The Midland Public Schools calculated the district's tax base sharing liability to be $5.6 million, and estimated the districts 1991-92 categorical aid to be $4 million. Clearly, the Midland district's interest is served by not participating in the tax base sharing program. In an effort to limit the loss of revenue distributed through the tax base sharing system, the state school aid act was amended by Public Act 200 of 1991 to allocate the categorical aid of out-of-formula districts not participating in the tax base sharing program to in-formula districts on the same basis tax base revenue is distributed. Based on the Midland situation, this would result in an estimated reduction of $1.6 million in tax base sharing revenue. Absent any further statutory change, the number of out-of-formula districts opting, out of tax base sharing is expected to increase in subsequent years.

**[8]**

As explained above, the 1992-93 adjustments for recapture and tax base sharing are reversed. Recapture will be reduced $2 for every $1 shared. This results in recapture dropping to an estimated $39.9 million or $32.2 million below the amount recaptured in 1990-91. Because tax base sharing in 1992-93 is limited to no more than the prior year level of $27.2 million, in-formula districts actually will experience a slight decrease in state aid of $5 million ($32.2 million minus $27.2 million) from the combined effect of recapture and tax base sharing. This trend will be reversed in 1993-94 and subsequent years when the tradeoff becomes a $1.00 reduction in recapture for each $1.00 in property tax revenue shared.