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STATEWIDE BALLOT PROPOSAL PROPOSAL A: LOCAL PROPERTY AND SCHOOL FINANCE REFORM

The Legislature, with support of the Governor, has placed a proposed constitutional amendment on the statewide ballot, to be voted on at a special election on June 2, 1993. Proposal A would make a number of changes in local property taxation and in school finance; both of these subjects have been the source of major public policy controversy for the past 20 years.

THE ISSUE IN BRIEF

Proposal A was placed on the ballot by joint resolution of the Legislature and if approved by voters would substantively amend the following Sections of the state Constitution:

- Section 3 of Article 9, to limit the annual growth in assessments on individual parcels of property to the lesser of five percent of inflation, beginning in 1993. Property would be re-assessed at 50 percent of its true cash value upon transfer of ownership.
- Section 6 of Article 9, to limit local school operating millage to a maximum of 27 mills. A local school district could levy up to 18 mills without voter approval, plus up to an additional nine mills with voter approval. During the current school year, the statewide average school operating millage rate is 34.6 mills. The present 50 mill limitation would be reduced to 40 mills.
- Section 8 of Article 9, to increase the sales tax rate from 4 percent to 6 percent, beginning July 17, 1993. The additional revenue would be deposited in the school aid fund. A two percentage point increase in the sales (and use) tax rates would generate approximately \$1.7 billion in 1994.
- Section 11 of Article 9, to establish a school aid per pupil foundation of \$4,800 based on the first 18 mills levied for school operating purposes. The state would also guarantee a per pupil yield of \$100 for each of the nine additional mills that could be levied with voter approval. Statewide average operating revenue per pupil during the current school year is \$4,679, including categoricals.
- Section 41 of Article 4, to require that net state lottery revenue be deposited in the school aid fund. State law already contains such a requirement, but Proposal A would place that requirement in the state Constitution.

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I. Proposed Taxation Changes

Proposal A would make several significant changes in the general property tax, as well as substantially increase the rate of the general sales and use taxes. During the past 21 years in Michigan, there have been 12 statewide ballot proposals which attempted to reduce reliance upon the local property tax, including three proposals which would have increased the rate of the sales tax. The voters defeated all but one of these proposals, the 1978 tax limitation amendment (Headlee).

A. The Local Property Tax

The Present Assessment System

Section 3 of Article 9 of the state Constitution requires that real and tangible personal property not exempt by law be uniformly assessed at not more than 50 percent of true cash value -- its usual selling price. The Legislature has provided by law that all property is to be assessed annually at 50 percent of its usual selling price; in effect, a market-value based system of assessing property. Section 3 also requires that the Legislature provide for a system of equalization of assessments. Because Michigan has about 1500 local assessing jurisdictions -- cities and townships -- equalization of assessments is necessary to equitably distribute the tax burden among the assessing jurisdictions within each county and to ensure uniformity in assessments among the 83 counties in the state.

The Proposed Assessment System

Assessment Cap. Proposal A would superimpose upon the present system, a modified acquisition-value system of assessing property. Beginning with December 31, 1992 assessments, instead of annual assessments of property at 50 percent of current market value, annual assessment increases on individual parcels of existing property would be limited to the lesser of five percent or the rate of inflation. Inflation exceeded five percent during six of the past 15 years, thus the five percent cap would have applied. In the other nine years, the inflation rate ranged from 1.9 percent to 4.8 percent with a median increase of 3.7 percent. A parcel of property would be reassessed "at the applicable proportion of current true cash value," only when transferred as defined by law.

The Senate Fiscal Agency estimates that the value of existing property in 1993 increased an average of 7.3 percent over 1992 state equalized values which had been frozen at 1991 values. If Proposal A is adopted, the 3 percent assessment cap will result in a net reduction of \$220 million in 1993 property taxes and will have a cumulative effect over time. By 1996, official estimates indicate that the assessment caps will reduce property taxes by \$637 million a year as compared to current law.

Effects on Assessments. Both the annual assessment cap and reassessment-when sold provisions of Proposal A would create significant disparities in assessments among parcels. Because of the assessment cap, houses that have greater appreciation in price would have relatively lower assessments in relation to current market value. For example, assuming a five percent inflation rate, a house that increased in market value at five percent annually would continue to be

assessed at 50 percent of its market value, while one that increased by seven percent annually would be assessed at only 41 percent of its actual market value after ten years.

Similarly, the Proposal A assessment cap and reassessment-upon-sale provisions would also result in significantly different assessments on given parcels of the same market value, depending upon when they were sold. For example, with a seven percent annual increase in market value, a house sold after ten years would be assessed at 21 percent more than a comparable house that had not been sold. This difference in assessment would result in differences in the amount of taxes paid. In short, a modified acquisition-value assessment system would create significant disparities in the taxes paid on houses of the same market value which received the same benefits from local government services. On the other hand, a modified acquisition-value system does provide an element of certainty because property owners would know the maximum amount by which their assessments could increase annually and purchasers would know that property would be reassessed upon sale.

Effects on Equalization. The modified acquisition-value system of Proposal A would be superimposed upon existing constitutional provisions, previously described, that require the Legislature to provide for a system of equalization of assessments. Since assessments within a given assessing jurisdiction would be no longer at 50 percent of market value, assessments among assessing jurisdictions would also vary from the 50 percent standard, depending on their relative rates of increase in property values and relative rates of turnover from property sales. Implementing legislation for Proposal A would have to address this impact upon the system of equalization of assessments.

Present Tax Rate Limitations

Section 6 of Article 9 of the state Constitution provides limitations upon the rate of ad valorem local property taxation of 15, 18, and 50 mills. Millage from within the 15 and alternate 18 mill limitations is allocated in each county among school districts, unchartered counties and townships. Voters may increase either the 15 or 18 mill limitations to a maximum of 50 mills, for up to 20 years at any one time. Such millage is generally referred to as “extra-voted” millage because it is in addition to that allocated from within the 15 or 18 mill limitations.

Proposed Rate Limitations

Allocated Millage. Proposal A would remove school districts from the 15 or 18 mill limitations and decrease those limitations in each county by the number of mills allocated for local school district operating purposes in 1992. The amount of allocated millage reduction would range from 5.45 mills in Keweenaw County to 11.30 mills in Midland County; the median is 8.2 mills.

Beginning in 1993, in place of allocated millage, local school districts would be authorized to levy up to 18 mills for operating purposes without voter approval and up to an additional nine mills with voter approval. The constitutional allocation of this new 18 mills to school districts, when added to the current allocation for unchartered counties and townships, would significantly increase the total number of mills that can be levied without voter approval.

Extra-Voted Millage. Proposal A would reduce the overall 50 mill limitation to a 40 mill limitation. As at present, the maximum extra-voted millage would be the difference between the

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overall limitation and allocated millage. Allocated millage would consist of those mills currently allocated to unchartered counties and townships, about seven mills on average, plus the 18 mills that could be levied without voter approval for school operating purposes. Thus, there would be on average up to 15 extra-voted mills remaining to be levied by unchartered counties and townships, and school districts. School districts could not levy more than nine of those extra-voted mills. Proposal A does not specify whether a county or township could seek voter authorization to levy all or a portion of the nine mills if a school district had not been authorized by voters to levy them. Implementing legislation for Proposal A would have to address this issue. Proposal A would reduce total local school operating property taxes by \$2 billion in 1993.

B. Sales Taxation

The Present System

Section 8 of Article 9 of the state Constitution limits the rate of the general sales tax to 4 percent. The rate of the state use tax, which complements the sales tax, is also set at 4 percent, but by statute. The state Constitution requires that 60 percent of sales tax collections be deposited in the school aid fund, that another 15 percent be allocated to townships, cities, and villages on a population basis, and that the remaining 25 percent be deposited in the state general fund.

The Proposed System

Proposal A would increase the sales and use tax rates from 4 percent to 6 percent beginning July 17, 1993, and would require that all of the revenue generated from the 2 percentage point increase be deposited in the state school aid fund. The allocation of revenue from the existing 4 percent rate would not be affected. It is estimated that a 2 percentage point increase in the sales and use tax rates would generate \$1.7 billion during the state's 1993-94 fiscal year.

The 4 percent general sales tax rate in Michigan is relatively low compared to other states. The median rate in the 45 states imposing sales taxes is 5 percent and 16 of those states impose state-level rates of 6 percent or higher. In addition, 31 states have local general sales taxes which are not authorized in Michigan. Michigan sales taxes were \$341 per capita in 1991, 31.3 percent below the U.S. average of combined state and local sales taxes. An increase in the Michigan sales tax rate to 6 percent would make Michigan sales tax collections per capita slightly higher (2.9%) than the U.S. average of state and local general sales taxes.

II. Proposed School Finance Changes

Proposal A would also make several significant changes in school finance.*

The Present School Finance System

Section 2 of Article 8 of the state Constitution requires the Legislature “to maintain and support a system of free public elementary and secondary schools as defined by law.” Under current state law, school districts receive two basic types of state aid: unrestricted general membership aid and categorical aid. The amount of the former is determined through a school aid formula. The formula is designed so that a school district is guaranteed a specified amount of revenue per pupil for each mill levied. To the extent the property tax base of a school district is insufficient to generate this guaranteed amount, the difference is supplied by the state. Local school districts may utilize general membership aid for a variety of operating purposes, while categorical aid may be expended only for specific activities, such as special education or preschool.

The Proposed School Finance System

Foundation Funding. Proposal A would place in the state Constitution a per pupil guarantee of \$4,800 for any local school district that levied the first 18 mills of property taxes for operating purposes authorized by Proposal A during the 1994 state fiscal year. The guarantee would be indexed to the per pupil, percentage change in sales tax revenues and lottery proceeds dedicated to the school aid fund and to revenue from the first 18 mills of property taxes. The per pupil guarantee could either increase or decrease, as the dedicated revenues increased or decreased, because Proposal A ensures a per pupil guarantee of \$4,800 only for the 1993-94 state fiscal year and not for subsequent fiscal years. No school district receiving state aid to achieve the guarantee could increase total per-pupil revenue by more than ten percent in any given year.

Extra-Voted Millage. Proposal A would require the state to guarantee that the nine additional school operating mills that could be levied with voter approval would yield at least \$100 per pupil per mill. The \$100 per pupil per mill guarantee is not indexed and, therefore, the purchasing power of the guarantee would decrease in real terms over time due to inflation.

* Much of the discussion regarding Proposal A has confused what actually is in the proposal with matters that proponents may intend to address through legislation which would implement Proposal A. For example, while it has been stated by various parties that the \$4,800 per pupil guarantee is to replace all categorical aid except special education (and transportation) and preschool, Proposal A is entirely silent on the matter. The proposal is likewise silent with regard to the intended treatment of teacher retirement, social security, and adult education. Similarly, estimates of the magnitude of second year property tax reductions that would be realized under Proposal A have generally included \$234 million that would result from a proposed assessment freeze in 1994; however, the proposed assessment freeze is not contained in Proposal A but rather in pending legislation. With respect to these matters, voters will be required to evaluate Proposal A without the benefit of knowing how the Legislature subsequently may address them in implementing legislation.

Hold-Harmless Provision. Proposal A would guarantee that no local school district would suffer a loss in per pupil operating revenue during the 1994 state fiscal year caused by the reduction in school operating millage required under the proposal. Under Proposal A, a local school district which levied 27 mills for operating purposes during the state's 1994 fiscal year would be guaranteed per pupil revenues in an amount equal to that generated during the prior year, plus an inflationary increase of three percent.

State Lottery Proceeds

Section 41 of Article 4 of the state Constitution authorizes the Legislature to establish lotteries. Proposal A would amend Section 41 to require that net state lottery revenue be deposited in the state school aid fund. State law already imposes such a requirement, but Proposal A would place that requirement in the state Constitution. In recent years, lottery revenues have amounted to approximately \$460 million annually.

Net Balance in State-Local Taxation and School Finance

Total state and local taxes in Michigan in 1991 were \$2,106 per capita, about one percent above the U.S. average. By source of tax revenue, Michigan relied more heavily on property taxes (42 percent) than the U.S. average (32 percent) and less heavily on sales taxes (16 percent) than the U.S. average (24 percent). The shift in taxes from property to sales should Proposal A be adopted would bring the Michigan state and local tax system more into balance with other states in terms of reliance on various sources of tax revenues.

In Michigan, the state provides a relatively smaller share of the total revenues for funding elementary-secondary education than is the case in most other states. Michigan ranked 42nd among the 50 states in 1992 in terms of the estimated share of total school revenue paid by the state. This year, the state will provide an estimated 30 percent of school operating revenue. Under Proposal A, the state would increase to 62 percent and the local share would decrease to 38 percent.