

QUESTIONS AND ANSWERS RELATING TO THE EXEMPTION OF PROPERTY FROM SCHOOL OPERATING TAXES

THE ISSUE IN BRIEF

Public Act 145 of 1993 exempts all property from general ad valorem taxation for school operating purposes beginning December 31, 1993. It is estimated Act 145 will reduce property taxes by almost \$6.9 billion (a \$6 billion net reduction after accounting for reduced homestead property tax credits). The exemption of property from local property taxes for school operating purposes will require state policymakers to provide alternative sources of funding. While agreement has yet to emerge regarding how much of the \$6 billion should be replaced there is general agreement that a combination of state and local taxes will be necessary, given the magnitude of revenue involved. The state Constitution imposes various restrictions upon an otherwise plenary authority of the Legislature to tax, or to authorize units of local government to do so. This **Council Comments** examines these constitutional restrictions and the extent to which they limit the ability of state policymakers to replace this revenue.

When does Public Act 145 of 1993 take effect?

All real and tangible personal property will be exempt from millage levied for local and intermediate school operating purposes as of December 31, 1993. As a practical matter, local property taxes will be eliminated for school operating purposes beginning with summer 1994 taxes. The provisions of Act 145 which concern the holding of millage elections took effect on August 19, 1993.

Can Act 145 be subjected to referendum?

Yes. Voters, through the state Constitution, have reserved to themselves the power to approve or reject laws enacted by the Legislature, which is referred to as the referendum. Referendum may be invoked, as to any law not containing an appropriation or enacted to meet deficiencies in state funds, by collecting petition signatures equal in number to five percent of the total vote cast for governor at the last general election (approximately 128,000 signatures). The state Constitution requires that a referendum be invoked within 90 days of final adjournment of the legislative session at which a law is adopted. ("Legislative session" is understood to mean an annual, and not a biennial, session.) Since it is unlikely the present legislative session will adjourn sine die before the end of December 1993, petitions could be filed as late as the end of March 1994. According to the state Attorney General, a referendum is invoked upon filing petitions. If subjected to referendum, Act 145 would be suspended until the next general election (November 1994) at which time voters would decide whether to approve the law.

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With respect to alternative funding sources at the state level, how much revenue is collected from the major state taxes?

It is estimated that the major state taxes (personal income, single business, and sales and use taxes) will yield nearly \$11 billion during the state's current fiscal year, which will end September 30, 1994, as follows:

Table 1
Estimated Gross Collections From Major State Taxes, 1993-94
(In Millions)

Tax	Total	Current Rate	Yield Per Percentage Point
Income	\$5,428	4.6%	\$1,180
Single Business	1,894	2.35%	806
Sales and Use	3,532	4.0%	883
Total	\$10,854		

Source: Consensus estimates, executive and legislative branches.

What impact will the state revenue limit have upon the state's ability to provide replacement revenue?

The state Constitution restricts total state revenues as a percentage of state personal income. In essence, in no fiscal year may state revenue exceed 9.49 percent of personal income in the prior calendar year. Total state revenue is estimated to be currently \$3.9 billion below the limit. However, the \$6.9 billion property tax reduction will increase state revenues by approximately \$850 million, since the state will not have to remit that amount in homestead property tax credits, and will decrease available capacity within the revenue limit by an equal amount. Eliminating other tax credits which are based on actual tax liability would also decrease capacity within the revenue limit. Thus, absent a constitutional amendment, state replacement revenues will be limited to approximately \$3 billion, or only one-half of the net property tax reduction.

Would the constitutional limitations which apply to local property taxes apply to a statewide or regional general ad valorem property tax?

Yes. The state Constitution imposes an aggregate limitation upon ad valorem taxation of 15 mills for operating purposes (or an alternative local option of 18 mills). With voter approval, these limitations may be increased to 50 mills for up to 20 years. Since these limitations apply to the "total" of ad valorem taxes, they would encompass a statewide ad valorem property tax as well. However, two exceptions should be noted. First, since the limitations only apply to general ad valorem taxes, conceivably the Legislature could levy a property tax upon some basis other than an ad valorem basis, and the limitations would not apply. The state Constitution specifically permits the Legislature to levy alternative taxes upon property "in lieu of general ad valorem taxation." (The revenue from such a tax, if imposed by the Legislature, would still be subject to the state revenue limit.) Second, since the 15, 18, and 50 mill limitations do not apply to operating millage imposed by charter units or authorities, the Legislature could create a

statewide authority or regional authorities to levy a property tax. Under such circumstances, the foregoing limitations would not apply, provided the tax rate was limited by general law. However, such a tax imposed by an authority created by the state would require voter approval.

Could the state Legislature avoid the requirement of voter approval for new or increased local taxes by creating a statewide or regional taxing authority?

No. While the state constitutional requirement for voter approval of new taxes (those not authorized by law or charter on December 23, 1978) applies only to units of local government and not to the state, the state constitutional definition of "local government" includes "any political subdivision of the state, including, but not restricted to, school districts, cities, villages, townships, charter townships, counties, charter counties, authorities created by the state, and authorities created by other units of local government." Thus, any new or increased taxes imposed by any units of local government, including any "authorities created by the state," would require voter approval.

With respect to alternative local funding sources, could the state Legislature authorize the imposition of a local income tax?

Yes. The Legislature authorized cities to impose an income tax in 1964 and 20 of the 273 cities in Michigan presently do so. The Legislature could authorize other local units to levy an income tax, but voter approval would be required in each local unit so authorized. The state Constitution prohibits units of local government from levying, without voter approval, taxes not authorized by law or charter before December 23, 1978. In addition, a local income tax would be subject to the state constitutional prohibition against a graduated income tax. (The Detroit School District is authorized to impose an income tax, without voter approval, unless it is authorized to levy at least 24.76 mills for operating purposes; the school district will continue to be precluded from imposing an income tax until the year 2002, because voters on September 14th reauthorized 32.25 extra-voted mills for the next eight years.)

Could the state Legislature increase the sales tax rate or authorize the imposition of a local sales tax?

No. The state Constitution limits the sales tax rate to four percent. As to a local sales tax, according to the state Attorney General, the Legislature cannot authorize imposition of such a tax without amending the state Constitution because the voters who adopted the state Constitution Intended to preempt the sales tax "as a state sales tax." While state Attorney General opinions are not binding upon the Legislature, any attempt to statutorily authorize a local sales tax would likely be challenged in court. Furthermore, the state Constitution requires that of all taxes levied upon retail sales, 15 percent be allocated to townships, cities, and villages and another 60 percent to the state school aid fund. Hence, even if the Legislature could statutorily authorize a local sales tax (the imposition of which would require voter approval in each unit of local government so authorized) 75 percent of the revenue generated by any unit of local government would be required to be allocated elsewhere.

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How much revenue has been made available for elementary-secondary education in Michigan for the current school year?

Approximately \$10 billion. During the 1993-94 school fiscal years which began on July 1, 1993, state and local revenues are estimated to be as follows:

Table 2
Revenues Available for School Operations, 1993-94
(In Millions)

Sources	Amount	Percentage of Total
Local Taxes	\$ 6,530	65.3
State Support*	<u>-3,474</u>	<u>34.7</u>
Total	\$10,004	100.0

Source: Consensus estimates executive and legislative branches; Enrolled House Bill 4836. *Excludes federal aid.

The components which comprise the property tax reduction are as follows:

Table 3
Property Tax Reduction by Category
(In Millions)

School districts:	
Local	-\$6,020
Intermediate	-510
Local governments assessment freeze)	-128
Tax abatements & tax increment financing	-180
Property tax administration fee	<u>-39</u>
Gross tax reduction	-\$6,877
Homestead tax credit	<u>+850</u>
Net tax reduction	-\$6,027

Source: Consensus Estimates, executive and legislative branches.