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No. 1024 **FEBRUARY 1994**

STATEWIDE BALLOT PROPOSAL A: ELEMENTARY-SECONDARY SCHOOL FINANCE

On December 24, 1993 the Legislature adopted a complex plan to restructure the funding of elementary-secondary education. The plan consists of a ballot proposal to amend the state Constitution and implementing legislation and an alternative statutory plan which would take effect if the ballot proposal is rejected. The ballot proposal will be submitted to voters at a special election on March 15, 1994, and would amend several state constitutional provisions to:

– Permit school operating taxes to be imposed on a nonuniform basis.

– Limit the growth in assessments on individual parcels of property to the lesser of five percent or inflation beginning in 1995. Property would be reassessed at 50 percent of true cash value upon transfer in ownership.

– Increase the sales tax rate from 4 to 6 percent, beginning May 1, 1994, with the additional revenue dedicated to the state school aid fund.

– Require that the state guarantee each local school district in the 1995-96 state fiscal year and thereafter at least as much combined state and local operating revenue per pupil as in the 1994-95 fiscal year.

– Require a three-fourths vote of the Legislature to increase school operating taxes beyond those in effect on February 1, 1994.

The major difference between the two approaches is that the constitutional amendment and its implementing legislation rely primarily on a sales tax increase, while the statutory alternative plan relies primarily on increases in the income tax and the single business tax. The proposed sales tax increase requires voter approval of a constitutional amendment while income tax and single business tax increases can be enacted statutorily.

Proposal A is a proposed constitutional amendment and it must be distinguished from the various statutes adopted by the Legislature to implement it. It is the constitutional amendment (Proposal A), and not the implementing legislation, which voters will approve or reject on March 15, 1994. By contrast, the implementing legislation for the "ballot" plan as well as that for the "statutory" plan are subject to alteration at the discretion of the Legislature.

This Council Comment summarizes the issues addressed in Report No. 312 (26 pages) which is available on request.

Proposed Constitutional Amendment

Proposal A, if approved by voters, would make several significant changes in the local property tax and substantially increase the state sales tax rate.

The Local Property Tax

Section 3 of Article 9 of the Michigan Constitution imposes three requirements upon the Legislature regarding how property taxes must be assessed and levied: uniformity of taxation, uniformity of assessments, and equalization of assessments. Proposal A would alter each of these requirements, as summarized below.

Uniformity of Ad Valorem Taxation. Section 3 of Article 9 requires that the Legislature "shall provide for the uniform general ad valorem taxation of real and tangible personal property not exempt by law." The purpose of this uniformity requirement is to restrict, with respect to ad valorem taxes, the otherwise plenary authority of the state Legislature to classify property for ad valorem taxation purposes and then impose different levels of taxation on each classification.

Proposal A would amend Section 3 of Article 9 to permit the Legislature to authorize ad valorem taxes on a nonuniform basis for school operating purposes. Under Proposal A, the Legislature could authorize property taxes for school operating purposes upon one class of property at one rate and upon other classes of property at different rates. Given the fact that the uniformity requirement has been part of the fundamental law of Michigan since 1900, amending the state Constitution to permit the Legislature to impose ad valorem taxes on a nonuniform basis would represent a significant departure in public policy.

Uniformity of Assessments. Section 3 of Article 9 requires that real and tangible personal property not exempt by law be uniformly assessed at no more than 50 percent of its true cash value; in effect, a market-value based system of assessing property. The Legislature has provided by law that property must be assessed annually at 50 percent of true cash value (usual selling price).

Proposal A would superimpose upon the present system a modified acquisition value system of assessing property. Beginning with taxes levied in 1995, assessment increases on individual parcels of existing property would be limited to the lesser of five percent or inflation. A parcel of property would be reassessed "at the applicable proportion of current true cash value," only upon transfer.

The annual assessment cap and the reassessment-when-sold provision of Proposal A would create significant disparities in assessments among parcels. Because of the assessment cap, houses with a greater appreciation in price would have relatively lower assessments in relation to current market value. 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. These differences in assessments 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 receive the same benefits from local government services.

Equalization of Assessments. Section 3 of Article 9 of the state Constitution 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 of the 83 counties in the state and to ensure uniformity in assessment among the counties.

The modified acquisition-value system of Proposal A would be superimposed upon the existing system of equalization of assessments. Since assessments within a given assessing jurisdiction no longer would be at 50 percent of market value, assessments among assessing jurisdictions would also vary from this 50 percent standard, depending on their relative rates of increase in property values and relative rates of turnover from property sales. Legislation implementing Proposal A would be needed to address this impact upon the system of equalization of assessments.

The State Sales Tax

The state Constitution limits the rate of the sales tax to 4 percent and requires that 60 percent of sales tax revenue be deposited in the state school aid fund, that another 15 percent be allocated to townships, cities, and villages on a population basis, and the remaining 25 percent be deposited in the state general fund. Proposal A would increase the sales tax and use tax rates to 6 percent beginning May 1, 1994, and dedicate all of the revenues generated from the 2 percentage point increase to the state school aid fund.

Statutory Changes in Taxes

If Proposal A is approved by voters on March 15, 1994, numerous statutory changes in taxes would subsequently take effect. In the event Proposal A is rejected, alternative statutory changes would take effect. Both are summarized below, with the ballot plan implementing legislation changes stated first and *the alternative statutory plan in italics*.

Sales and Use Tax. While the constitutional amendment increases the sales and use tax rates from 4 to 6 percent, by statute the 2 percent increase would not apply to residential consumption of electricity, natural gas or home heating fuels. *Under the statutory plan the sales and use tax rates remain at 4 percent.* Both plans extend the use tax to interstate telephone service -- percent under the ballot plan and 4 percent under the statutory plan.

Personal Income Tax. Beginning May 1, 1994 the Income tax rate would decrease from 4.6 to 4.4 percent under the ballot plan. *Under the statutory plan the rate would increase from 4.6 to 6.0 percent and the personal exemption would increase from $2,100 to $3,000.* Both plans would increase the homestead property tax credit for renters.

Single Business Tax. The single business tax rate would be maintained at 2.35 percent. *Under the* statutory plan, *the rate would increase to 2.75 percent* beginning *May 1, 1994.*

Property Taxes. Homestead property would be taxed at a different rate than non-homestead property. Under the ballot plan both homestead and non-homestead property would pay a 6 mill statewide levy and non-homestead property would pay an additional 18 mills in local school district taxes, for a total of 24 mills on non-homestead property. *Under the statutory alternative, both homestead and non-homestead property would be taxed at 12 mills locally and non-*

homestead property would pay another 12 mills statewide, a total of 24 mills on non-homestead property. The current statewide average property tax rate for K-12 school operating purposes is 34 mills.

Both plans would authorize additional local millage for "enhancement" and to "hold harmless" those districts now spending over $6,500 per pupil. Also, intermediate school districts could continue to levy millage for special education, vocational education and operating purposes.

State Real Estate Transfer. A new state real estate transfer tax would be imposed. Beginning January 1, 1995 transfers of interest in real property would be taxed at the rate of $10 per $500 (two percent) of the value of the property transferred. *Under the statutory plan, the tax would be imposed, beginning May 1, 1994 at a rate of $5 per $500 (one percent).*

Tobacco Taxes. The cigarette tax would increase from 25 cents to 75 cents per pack. *Under the statutory plan, the tax would increase to 40 cents per pack.*

School Funding -- The Allocation Formula

As contrasted with the dual tax plans, the school funding allocation system would be essentially the same under both plans. This funding system provides $10.5 billion for elementary and secondary education during 1994-95, compared to an estimated $10.1 billion in the current year.

Both plans replace the current power-equalizing formula with the same foundation grant program. In the foundation grant program the state would make up the difference between the foundation grant per pupil and the per pupil property tax revenue raised locally under the two plans. For 1994-95, the foundation grant is set at $5,000 per pupil, but is to be adjusted to accommodate the per pupil revenue disparities that currently exist in the state. Districts with 1993-94 per pupil revenue below 4,200 will be raised to that level, or will receive a $250 per pupil increase, whichever is greater. Districts with 1993-94 revenue per pupil of $4,200 to $6,500 will continue to receive their 1993-94 revenue per pupil, plus increases along a sliding scale which will range from $250 at $4,200 per pupil to $160 per pupil at $6,500. Districts above $6,500 per pupil that wish to continue their current level of spending would be authorized to levy local millage needed to provide a $160 per pupil increase in 1994-95. It is estimated that 35 districts would be able to levy additional millage in order to be held harmless. Existing voter approved millage could be used or new millage approved by the voters.

Beginning in 1995-96, the $5,000 foundation grant will change based on an index determined by changes in school aid fund revenue and pupil membership. Assuming growth in school aid fund revenues, districts below the $5,000 foundation grant as adjusted will receive larger per pupil increases than those above the foundation level. Districts above the foundation grant level will all receive the same dollar amount of increase in the foundation grant from the state.

Per pupil revenue disparities will be reduced under the new funding allocation system. In 1993-94 per pupil revenues in K-12 districts ranged from $3,277 to $10,358, a ratio of 1:3.2. In 1994-95 the range would be $4,200 to $10,518, a ratio of 1:2.5. The average disparity would be reduced by about 10 percent in the first year. Disparities would continue to decrease in future years as the base foundation grant increases reflect growth in school aid fund revenues.

Education Quality

The Legislature has authorized creation of public school academies (charter schools). The 1994-95 formula provides public school academies, a foundation allowance of $5,500 per pupil, or an amount equal to the foundation allowance of the district in which the academy is located, whichever is less. Public school academies are an effort to modify the existing delivery system. The governing board of a local school districts, intermediate school district, community college, or state public university are authorized to issue a charter for an academy. Establishing academies is seen as an alternative to existing public school district educational programs, and as a means of improving the quality of such programs by introducing an element of choice and competition.

In addition to the authorization to establish public school academies, several other quality changes were enacted into law:

– The State Board of Education is to promulgate administrative rules establishing a core curriculum which would be effective, beginning with the 1997-98 school year.

– By 1997, local school boards seeking accreditation for its schools must establish performance standards consistent with the core curriculum.

– The minimum number of hours of student instruction required is increased from 900 hours in 1994-95 to 990 hours in 1995-96 and to 1,080 hours in 1999-2000.

– A comprehensive professional development system is established.

Conclusion

For many years, school finance reform had three major focuses: to reduce reliance on the local property tax as the principal revenue source to support elementary and secondary education; to shift more of the funding responsibility to the state level; and to reduce the per pupil financial resource disparities among school districts. More recently, school finance reform has expanded to include educational quality and accountability. These issues were the cornerstone of the debate which culminated in the current plan to restructure elementary and secondary education.

As described earlier, both of the tax plans provide significant reductions in property taxes and shift much of the funding responsibility to the state. The school funding allocation system is essentially the same under both plans and would significantly reduce over time the disparities in per pupil revenues among school districts. The total amount of funding for K-12 education is the same under both plans. Authorization for public school academies and several other quality changes were enacted into law. The primary difference between the two plans is the mix of taxes used to finance K-12 education.

REVENUE IMPACT OF PROPOSAL A & STATUTORY PLAN
(in millions)

STATE TAXES	Proposal A	Statutory Plan
Sales and Use Tax	$1,898	$9
Residential Utilities	(70)	--
Personal Income	(255)	1,782
Renter's Credit	(40)	(40)
Personal Exemption	--	(352)
Property Tax Credit	694	573
Single Business Tax	--	349
Statewide Property Tax	1,062	926
State Real Estate Transfer Tax	340	213
Tobacco Taxes	343	135
Telephone Use Tax	60	40
Utility Property Tax	76	76
Industrial & Commercial Abatement	165	132
Tax Increment Finance Capture	--	(27)
TOTAL STATE TAXES	**$4,273**	**$3,816**
LOCAL TAXES		
School District Property Tax	1,389	2,124
Local School District Hold Harmless	223	223
Intermediate School Districts	510	503
Assessment Lag Elimination	102	102
Restored Tax Increment Finance Revenue	--	101
Tax Increment Finance Capture	--	(27)
Restored Tax Abatement Revenue	15	--
Property Tax Collection Fee	14	11
TOTAL LOCAL TAXES	**$2,253**	**$3,037**
TOTAL STATE AND LOCAL TAXES	**$6,526**	**$6,853**

Source: Michigan Department of Treasury; CRC calculations