House
Legislative
Analysis
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SCHOOL FUNDING/PROPERTY TAXES: HJR "I"

House Joint Resolution I (Substitute H-9)
Sponsor: Rep. Wilfred Webb

House Bill 4139 (Substitute H-1)
Sponsor: Rep. H. Lynn Jondahl

Committee: Taxation
First Analysis (5-18-89)

THE APPARENT PROBLEM:

Over more than two decades, Michigan's system of financing elementary and secondary schools has periodically been criticized for its overreliance on the local property tax, its wide disparities in spending between school districts, and its inability to produce enough revenue to provide a decent education in the lowest spending districts. Additionally, the state's public schools, like those elsewhere in the country, have come under fire for their alleged inadequate performance and for the disappointing, some say declining, levels of achievement of their students. Over the past several years, numerous plans aimed at reforming how public schools are financed have been launched with great expectations only to founder and sink when they failed to gain enough support. The issues involved are multidimensional and complicated, and a consensus is difficult to achieve even on which are the most compelling needs: property tax relief, more money for schools, equal per pupil spending, improved student performance, etc. A new school finance/property tax relief is currently before the legislature, this one supported by a broad coalition of leaders from business, labor, agriculture, education, and government, including the governor's office.

THE CONTENT OF THE BILL:

House Joint Resolution I proposes an amendment to Articles IV and IX of the state constitution "to provide for property tax reform and increased school funding." The proposal would be submitted to the voters at a special election on September 12, 1989. Following is a brief outline of the proposal and accompanying legislation, House Bill 4139.

- The sales tax and use tax would each be increased by one cent (from four cents to five cents per dollar) beginning January 1, 1990. The new revenue would be dedicated to the State School Aid Fund, with, generally speaking, one-half to be spent on schools and one-half to reimburse local school districts for property tax cuts.
- The first $5,000 of state equalized valuation (SEV) of a homestead (or $10,000 of market value) would be exempt from property taxes for local school district operating purposes, with the amount of the exemption indexed to growth in the School Aid Fund. House Bill 4139, moreover, would increase the existing homestead property tax credit (circuit breaker) for senior citizens and renters.
- Sixteen percent of the taxes levied on business personal property for local school operating purposes would be exempt, and that figure would be indexed to growth in the School Aid Fund and changes in the state equalized valuation of business personal property. "Business personal property" would mean personal property, as defined by law, classified as industrial, commercial, or utility, but not including buildings on leased land.
- Up to one-half of the revenue from the increase in sales and use taxes (as well as 15 percent of the existing 4 cents of use tax) could be used to reimburse local school districts for amounts lost due to property tax reductions. These revenues would be excluded from the revenue limit, state spending limit, and payments to local unit calculations under sections 26, 28, and 30, respectively, of the constitution, and a reimbursement to a local district would not be considered a transfer of responsibility for funding a program for purposes of section 26. In the 1990 fiscal year, local districts would be reimbursed for 100 percent of lost revenue. In subsequent years, that amount could be adjusted based on changes in a district's SEV or changes in school aid fund revenues, whichever were less. (However, for a district with an SEV per pupil at or above the 91st percentile, the reimbursement could be reduced by an amount not to exceed 10 percent of the amount paid by the state for the district's social security or retirement benefit obligations, minus any denial, withholding, or recapture of those payments, for each percent by which the district's SEV per pupil exceeded the 90th percentile.)
- The following revenues would be dedicated in the constitution to the School Aid Fund: the one cent increase in sales and use taxes; all net revenue and interest earned from lottery operations; 60 percent of the first four cents of the sales tax and, beginning, October 1, 1989, 85 percent of the first four cents of sales tax; the first four cents of the excise tax on spirits; the first mill of the excise tax on cigarettes (two cents per pack); beginning December 1, 1989, 20 percent of the first four cents of the use tax; and proceeds due the state from the industrial facilities tax, commercial facilities tax, and technology park facilities tax.
- Up to five percent of the proceeds of the first four cents of the use tax could be used for programs administered by the Department of Education for the benefit of local school districts.
- The state would be authorized to borrow an amount up to 25 percent of the previous year's School Aid Fund revenues to be repaid by the end of the same fiscal year out of dedicated school aid revenues.
- The legislature would have to provide by law that tax increment financing obligations entered into by certain dates not be impaired. The resolution refers to a financing obligation entered into or incurred before May 1, 1989; any obligation issued after May 1, 1989, in anticipation of those revenues if an agreement had been entered into before April 1, 1989, by a local unit providing for interim financing to be refunded; or any obligation incurred by or on behalf a local unit before July 1, 1989, if a plan had been adopted in anticipation of those revenues before May 1, 1989.

OVER

- House Bill 4139, as referred to above, would amend the Income Tax Act (MCL 206.520, 522) to increase the homestead property tax credit for renters and senior citizens. Taxpayers can claim a credit against the income tax equal to 60 percent of the amount by which their property taxes, or 17 percent of rent, exceed 3.5 percent of household income. The bill would increase the percentage allowed for renters from 17 percent to 20 percent. Currently, a senior citizen or handicapper with an income below $3,000 can claim a refund equal to 100 percent of property taxes paid. A person with a higher income can claim a smaller refund, depending upon the income level. The following tables show the current and proposed percentages of household income that cannot be refunded.

Current		Proposed	
Income	Pct.	Income	Pct.
0-3,000	0	0-6,000	0
3,001-4,000	1	6,001-8,000	1
4,001-5,000	2	8,001-10,000	2
5,001-6,000	3	10,001-15,000	2.5
Over 6,000	3.5	15,001-20,000	3.0
		20,001-30,000	3.25
		Over 30,000	3.5

FISCAL IMPLICATIONS:

According the staff of the House Taxation Committee, the resolution would produce $400 million annually in new revenue for education. Of that, $265 million would be put into a revised school aid formula and $135 million would be distributed through categorical aid for "educational quality" programs. (In the 1989-90 fiscal year, the new revenue would be $300 million, because the proposal would be in effect for three-quarters of the year.) Material from the group that produced the proposal (the "Harden Group") suggests that new revenue would equal $486 million by 1993-94, assuming five percent annual growth in the one-half cent sales tax monies.

The House Taxation staff says that residential property tax relief under the proposal would amount to $380 million (a 14 percent reduction in school operating taxes) and business tax relief would equal $88 million (a 5.6 percent reduction). The difference reflects the fact that individuals pay a larger share of the sales tax versus business than of the property tax. The additional homestead property tax credit (circuit breaker) for renters would cost $15 million and for seniors $40 million.

ARGUMENTS:

For:

House Joint Resolution I is supported by a wide range of powerful interests willing to finance a vigorous campaign for its adoption by the voters. The coalition supporting the proposal describes it as a major step forward toward improving the quality of Michigan's public schools and in reducing the property tax burden on the state's residential property owners and businesses. HJR I raises the sales and use taxes one cent, with half going for education and half for property tax relief. It provides $400 million in new money for schools, with the understanding that key quality improvement programs will be adopted that will set measurable performance standards for schools, encourage community involvement in school improvement efforts, encourage higher academic performance levels for students, give parents more choice about which school their children will attend, expand pre-school opportunities for "at-risk" children, promote and improve the teaching of math, science, and technology, and encourage the restructuring of schools to give more decision-making power to teachers and principals. Furthermore, the proposal takes the significant step of locking in — constitutionally dedicating — revenue for elementary and secondary schools to add greater stability and predictability to school district planning and to guarantee that the new money raised by the sales tax increase would not replace existing dollars. Many Michigan school districts are in serious financial distress and have been forced to eliminate basic services, and many others face yearly uncertainty as to the amount of money available to them. The proposal significantly reduces that uncertainty and ties school funding to the anticipated growth in the sales tax. Over time, this will produce substantial new revenue for education.

The proposal also contains meaningful, progressive property tax relief. It lowers taxes to homeowners through a homestead exemption, which means that each residential property owner will receive the same dollar amount of property tax reduction (which offsets the regressivity of the sales tax). The average reduction will be about $168. This is a fair and easy-to-understand method of tax reduction. Further, the proposal keeps the current taxpayer balance by giving business a smaller share in property tax relief, in recognition that individuals bear a greater burden than business under the sales tax. It also extends additional circuit breaker relief to renters and senior citizens, who otherwise would not benefit from the property tax cuts (because renters do not directly pay the tax and because many seniors would otherwise have the circuit breaker credits reduced dollar for dollar with reductions in property taxes). Business personal property taxes would be reduced by 16 percent. This tax has been described as "vexatious," and the business climate will be improved as a result of its reduction. Overall, there would be a $380 million reduction in property taxes for homeowners and an $88 million personal property tax reduction for business.

Supporters say that this is a significant and realistic proposal. Polls indicate that a larger sales tax increase, which some advocate, would meet with overwhelming opposition. This compromise proposal is one that a large group of interests will campaign for (including not only all the major education organizations but also manufacturers, retailers, labor, small business, and agriculture) and that the people will support, particularly since the sales tax increase will be linked to measurable improvement in the public schools and in increased educational opportunities for the state's schoolchildren.

Against:

Business groups opposing this plan, and others, complain that the property tax relief it offers is minuscule and unfairly distributed. The proposal simply does not address the problem of the high property tax burden on the state's businesses and homeowners. It amounts to a $400 million tax increase and gives more money to schools despite the fact that there appears to be little relationship between levels of spending and quality of schools. Further, it offers no guarantees that the sales tax base won't be expanded to cover services now exempt, which means the prospect of higher taxes looms in the future.

MORE

There is no tax relief in this proposal for many small businesses and service sector businesses. The choice of the personal property tax as the target for reduction benefits large manufacturers and retailers at the expense of many other businesses. What of those businesses that have little or no personal property tax liability yet pay large amounts of sales taxes? Complaints have come from the construction industry, bankers, realtors, and others about the lack of any serious tax relief for them compared with a handful of large companies. A fairer method of tax relief would be to reduce assessment ratios. Some people believe that sufficient additional revenue for the schools can be found elsewhere, in the reduction of other government budgets or in the projected surplus in the budget. At the very least, the plans to improve the performance of the state's public schools should be put in place before any financing proposal is contemplated.

Response: At least one small business group is supporting the proposal, and a representative of that group has said that some small companies have large personal property tax liabilities. Further, according to tax specialists, some small companies that lease their business premises pay mostly personal property taxes.

Against:

The homeowner property tax reduction is a flat amount, which works against those with the most expensive homes and highest property taxes. At the same time, the business personal property tax reduction is a percentage reduction. Why is this? Why not reduce residential taxes by a certain percentage, which many think would be fairer, or, alternatively, cut business taxes by a fixed amount?

Against:

The main elements of the school financing problem are the overreliance on the local property tax, the disparities in spending per pupil from school district to school district, and the inadequate levels of funding in the lowest spending districts. This proposal does not do enough about any of these elements. What is needed, some say, is a greater shift away from the property tax or at least a greater common sharing in commercial and industrial property taxes; and a more equitable financing formula or considerably more money in the current formula. Some people think that unless the state makes dramatic changes in its school finance system, the courts will eventually uphold challenges to that system as unconstitutionally discriminatory and force change to occur on their terms rather than the legislature's.

POSITIONS:

The following testified on behalf of the resolution before the House Taxation Committee at its meetings on 5-11-89 and 5-15-89:

The Michigan Manufacturers Association

The Michigan Retailers Association

The Michigan Farm Bureau

The Michigan Education Association

The Michigan Federation of Teachers

Michigan AFL-CIO

The Small Business Association of Michigan

The president of the State Board of Education and the superintendent of public instruction

The state treasurer on behalf of the administration of Governor Blanchard

The Michigan Association of School Boards supports the proposal. (5-17-89)

The following testified against the resolution: (5-11-89 and 5-15-89)

The Michigan State Chamber of Commerce

The Michigan Association of Realtors

The Michigan Bankers Association

The Associated Builders and Contractors Inc. of Michigan