



House
Legislative
Analysis
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SBT DEDUCTION/PROPERTY TAX RELIEF

House Bill 5537 (Substitute H-2)
Sponsor: Rep. Sharon Gire

House Bill 5538 (as introduced)
Sponsor: Rep. Ken DeBeaussiaert
Committee: Taxation

Senate Bill 598 (Substitute H-2)
Sponsor: Sen. John J.H. Schwarz
Senate Committee: Finance
House Committee: Taxation

First Analysis (2-28-90)

THE APPARENT PROBLEM:

In both his State of the State Message and budget message, Governor Blanchard proposed reducing the burden of local school property taxes on homeowners by limiting future assessment increases to the rate of inflation. The reasoning behind this proposal is that assessment increases are the primary reason why property tax rates have increased so dramatically over the past two decades and that steady assessment increases would work to eliminate the benefits of other kinds of tax reductions. The governor's proposal has been incorporated into a larger package of tax relief proposed by the Democratic Caucus in the House of Representatives. That proposal has as its stated aim the reduction of taxes for homeowners, small businesses, and retirees paid for by the elimination of the capital acquisition deduction under the Single Business Tax Act. That deduction has been ruled by a Michigan Court of Claims judge to be unconstitutional and has been severed from the rest of the act, which remains in effect. The elimination of that major deduction produces a windfall to the state of approximately \$400 million per year, and it has been proposed that the revenue be used to provide relief from high property taxes and from other taxes that burden Michigan residents.

THE CONTENT OF THE BILL:

House Bill 5537 would amend the Income Tax Act (MCL 206.30 et al.) to provide a new property tax credit based on the amount by which the assessment of a primary residence exceeds the rate of inflation; to expand the existing homestead property tax credit (or circuit breaker) in several ways; to increase the private pension exemption; and to increase the additional exemption provided to senior citizens and selected other taxpayers. House Bill 5538 would amend the General Property Tax Act (MCL 211.24c et al.) to specify the procedure by which a taxpayer could obtain the new assessment limitation credit. Senate Bill 598 would amend the Single Business Tax Act (MCL 208.23 et al.) to eliminate as of October 1, 1988, the capital acquisition deduction; to reduce the alternative tax rate for small businesses from four percent of adjusted business income to two percent of income; and to allow businesses to use adjusted business income from any of five previous years when determining if they qualify for the small business credit allowed under the SBT.

The following is a brief outline of the main provisions of the package of bills.

Assessment Limitation Credit

Assessment increases on residential and agricultural property would be limited to the rate of inflation for school operating taxes by extending to the taxpayer a credit based on the difference between the state equalized valuation of the property (50 percent of market value) and the limited state equalized valuation. In the first year, the limited SEV would be the 1990 assessment adjusted for inflation. In subsequent years, the limited SEV would be the previous year's limited SEV adjusted for inflation. However, if a homestead was sold in the preceding tax year, the limited SEV would be the previous year's regular assessment adjusted for inflation. (This means that when a property was sold, the inflation reduction calculations would begin anew.) As with the existing homestead property tax credit, taxpayers with incomes up to \$73,650 are eligible for the full credit, which is phased out gradually for incomes between that figure and \$82,650. Further, homesteads up to a market value of \$150,000 (an SEV of \$75,000) are eligible for the full credit, which is reduced for homesteads valued between that figure and \$195,000 (an SEV of \$97,500). The property must be the primary homestead of a Michigan resident.

An alternative credit would be available for homesteads whose assessments do not increase by more than the rate of inflation. These taxpayers would receive a credit equal to the difference between the percentage increase in average statewide residential SEV and the rate of inflation, multiplied by the school operating tax rate.

The assessment credit would be assigned by the taxpayer to the state for use in reimbursing the local school district and the amount of the credit would be deducted from the local tax bill. A taxpayer would have to file an affidavit with the treasury department to get the credit. The affidavit would be supplied along with a revised assessment notice by the local assessor. The treasury department would compute the credit for the taxpayer and notify the local treasurer, the taxpayer, and any designated agent (such as a bank or savings-and-loan) of the amount of the credit. The department would also be required to reimburse local school districts for the local tax revenue lost due to the credits.

Homestead Property Tax Credit Expansion

Currently, a taxpayer can claim a credit against the income tax equal to 60 percent of the amount by which his or her property taxes, or 17 percent of rent, exceed 3.5 percent

H.B. 5537 (2-28-90)

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of household income, with a limit of \$1,200 per credit. House Bill 5537 would base the credit on 75 percent of the amount by which taxes, or 20 percent of rent, exceed 3.5 percent of income, and raise the credit limit to \$2,600.

Currently, a senior citizen (or a person who is a paraplegic or quadriplegic) with an income below \$3,000 can claim a refund equal to 100 percent of property taxes paid. A person with an income of \$3,000 and over can claim a smaller refund, depending upon the income level. The following tables show the current percentage limits and proposed percentages of household income that could not be refunded. Further, a person who is totally and permanently disabled or hemiplegic would be added to the list of those eligible for this expanded credit.

<u>Current</u>		<u>Proposed</u>	
<u>Income</u>	<u>Pct.</u>	<u>Income</u>	<u>Pct.</u>
0-3,000	0	0-4,000	0
3,001-4,000	1	4,001-5,000	1
4,001-5,000	2	5,001-6,000	2
5,001-6,000	3	6,001-20,000	3
Over 6,000	3.5	Over 20,000	3.5

ARGUMENTS:

For:

The proposal provides substantial, meaningful tax relief for homeowners, senior citizens, and small businesses. It would provide \$344 million in tax relief in the first year through expansions of property tax credits, limits on property assessments, and reductions in small business taxes, among other measures. Further, it deals effectively with a major problem: the dramatic increases in property assessments, which in some areas are said to be two or three times the rate of inflation annually. The proposal would, essentially, limit the increase in assessments for school tax purposes (about 60 percent of the total property tax bill) to the rate of inflation. The state would make up to the schools any lost local revenue. (Taxpayers in areas of slower growth would also get relief based on the statewide average increase in residential property assessments.) The tax reductions, moreover, are paid for with real dollars, which makes this a responsible proposal and not a "cut taxes now, find the money later" proposal. Revenue to the state from the recent ruling judging a major deduction in the Single Business Tax Act unconstitutional would be used to fund the tax reduction package.

Income Tax Changes

The additional personal exemption that is granted to senior citizens and handicapped persons under the Income Tax Act would be increased from \$900 to \$1,500 for tax years beginning after 1989. (Further, those eligible for the additional exemption could in the 1990 tax year claim an extra \$100 if they had been eligible in 1987; an extra \$300 for 1988 eligibility; and an extra \$300 for eligibility in 1989.) The exemption for private retirement or pension benefits would be increased from \$7,500 to \$12,500 for a single return and from \$10,000 to \$25,000 for a joint return.

FISCAL IMPLICATIONS:

According to by the staff of the House Taxation Committee, the tax changes carry the following costs:

	<u>Million</u>
Assessment limitation credits	\$30
Increased maximum homestead credit	\$105
Basing homestead credit on 75 percent of taxes over 3.5 percent of income	\$100
Allowing 100 percent reimbursement for disabled and hemiplegics	\$5
Increased renter and low-income senior relief	\$42
Increased private pension exemption \$20 million	\$12
Increased additional exemption for seniors and handicappers	
Reduction in small business tax rate	\$30
Total	\$344

The elimination of the capital acquisition deduction in the Single Business Tax (which a court has ruled unconstitutional) would generate about \$400 million in revenue, \$344 million of which would cover the costs of the tax relief in this package, with the remainder going to local revenue sharing. (2-27-90)

Against:

Several objections and concerns have been raised, including the following.

- A representative of the state's manufacturing interests has termed this a destructive proposal that is anti-business and anti-jobs. It would raise taxes on job providers by over \$400 million annually, which would hurt the state's business climate. It would be better for the health of the state's businesses to adopt a revenue neutral plan for dealing with the loss of the capital acquisition deduction, one that keeps the issue within the Single Business Tax Act rather than penalizing manufacturers, financial institutions, and other businesses in order to provide property and income tax relief. It also would be preferable to allow the court decision on the deduction to be appealed rather than preemptorily eliminating the deduction.
- Some people are concerned that some elements of this proposal will only make matters worse. For example, giving a tax break to high-growth areas might only serve to make it more likely people will leave older urban areas for areas of new development. There is also concern that measures of this kind will only make the disparities between "have" and "have-not" school districts greater. Expanding the homestead property tax credit might make it easier for local units to increase tax rates, which puts those who are not eligible for tax credits at an extra disadvantage. Local officials are concerned about the increased administrative burden they will face with the new assessment limitation credit system. Some people are concerned that there are not sufficient guarantees that out-of-formula school districts will receive in future years their full reimbursement under the assessment limitation plan.
- POSITIONS:
- The state treasurer testified in support of the proposal before the House Taxation Committee. (2-27-90)
The Michigan Manufacturers Association is opposed to the repeal of the capital acquisitions deduction. (2-27-90)
A representative of the National Federation of Independent Business testified in opposition to the proposal in its current form before the House Taxation Committee (although viewing it "positively as a first step"). (2-27-90)