MTA

MICHIGAN TOWNSHIPS ASSOCIATION

Testimony to the
Senate Finance Committee

Senate Bills 1065-1072
Repeal of Industrial Personal Property Taxes and Local Government Revenue Losses

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Thank you for the opportunity to provide the perspectives of the Michigan Townships Association (MTA), representing 1,240 local units of government that govern over 96% of Michigan's land area, provide essential services to over 51% of Michigan's citizens, and in which over 58% of Michigan's property values are located.

We respectfully provide our thoughts and concerns relative to Senate Bills 1065-1072, which propose to repeal industrial personal property taxes and provide a mechanism to reimburse local governments and other entities that rely to varying degrees on the revenues derived from this source to fund their programs and services.

The potential abolishment of industrial personal property taxation has been, for the past year or so, the number one concern of local governments, including the townships that rely on these revenues. Until the introduction of Senate Bills 1065-1072, MTA has avoided taking any public positions relative to conditions or processes to implement such a change. In particular, we have not called for a constitutional amendment to guarantee replacement funding—not because we would be opposed to a constitutional guarantee, but because we have tried to put ourselves in your position. MTA acknowledges the arguments made by the business community that the personal property tax is unduly onerous on economic growth. We respect the public policy objectives sought by Gov. Snyder and legislative leaders through abolishing the tax, and we understand the reluctance of the Legislature to cement into the constitution a revenue stream to local governments that has no such guarantee today.

But, our member townships, as is the case with other units of local government, have experienced 10 years of the Legislature shifting monies traditionally earmarked for local governments to finance other state budget spending. No one understands this more than township governments, which, unlike other governmental entities, have been essentially eliminated from statutory revenue sharing eligibility with no indication that this eligibility will ever be restored. Regrettably and understandably, these experiences have eroded local government officials' level of trust toward state policy decisions and their impact on local communities.

MTA has not advocated for a constitutional amendment guaranteeing replacement revenues, even though that approach would be appealing to townships. We have asked townships to not expect full reimbursement funding, but instead to wait and see if the legislation adequately addresses the financial

position in which local governments find themselves. We have asked our members to reserve judgment until we can discern if the reimbursement process and amounts reflect a respect for the value and importance of local government programs and services relative to the state budget. And finally, we have suggested to township officials that they defer judgment until the Legislature indicates the degree to which it is willing to demonstrate its good-faith intent to provide a reliable revenue stream to replace the lost industrial personal property tax revenues.

Unfortunately, the package of bills we discuss today fall far short of the level of confidence we have expressed to our members—that the Legislature will adopt an appropriate approach that is fair to local government. We come before the committee today with the objective to propose good-faith alternative approaches that will accomplish the overall goal to phase out industrial personal property taxes, yet prevent further chaos to local government programs and services.

We propose two major changes: First, we propose a funding mechanism that, while less secure to local governments than would result from reimbursement being cemented into the constitution, would be more stable than reimbursements being subject to the whims of the state's annual budget appropriations process. Second, we propose a more equitable distribution of the revenue shortfalls resulting from the industrial personal property tax repeal between the state budget and local government budgets.

We will conclude with offering a number of technical changes to the package of bills. These changes are intended to be helpful to both businesses and local governments, and to avoid adverse unintended consequences that will occur if the bills were to be adopted as introduced.

The Reimbursement Mechanism

Instead of either a constitutional amendment or the annual appropriations process, MTA proposes an admittedly "outside the box" approach, which is, for lack of a better term, a tax expenditure to local governments.

Instead of appropriating reimbursements from the general fund, which will perpetually put local governments into competition with the rest of the state budget, we propose that local governments receive a credit against the Corporate Income Tax (CIT). This approach is far simpler than the extraordinarily complicated process of documentation and calculations proposed in SB 1072. The amount that the local government is due would be submitted by the local government on a form, and the amount due to the local government would simply be subtracted from CIT collections. This is the same funding source offered in the governor's plan.

We concede that the term "tax expenditure" is unfortunate, as this approach has fallen in disfavor among some state leaders as a mechanism of public policy. However, this approach still exists in state public policy, such as the reenactment of the film credit program. The alternative, however, goes far in satisfying concerns of both state policy leaders and of local governments. First, to address the concerns of state leadership, the Legislature could still modify or repeal the reimbursement. Reimbursement is not guaranteed. The law could still be changed to alter the amount of reimbursements, the distribution of reimbursements, or even to eliminate the reimbursements altogether—which reflects the state of current law relative to personal property tax.

For local governments, a "tax expenditure" approach means that a legislative change would require an open debate, similar to the one we are having today. The Legislature would have to declare a change in priority and intent relative to its obligation to reimburse local governments and be accountable for that

action. This approach avoids local governments being annually pitted against other state budget spending concerns.

The Level of Local Government Reimbursement

The funding formula provided in SB 1072 was a major surprise and disappointment to MTA, as it deviates from what we understood to be the approach that the legislation would take and is far more draconian than what we anticipated. If adopted, very few local governments will ever see much, if any, of their lost industrial personal property tax revenues.

We strongly object to the threshold reimbursement being a percentage of a unit of government's total governmental funds. Governmental funds are defined by the Government Finance Officers Association to apply to all funds except for profit and loss funds (e.g., enterprise fund, internal service fund, and trust and agency fund). Examples of government funds are the general fund, special assessment funds, special revenue funds, and capital project funds.

Basing the reimbursement as a percentage of total government fund revenues means that local governments would be penalized in the amount of reimbursement due to having diverse funding sources. They would be penalized for receiving state transportation funds, statutory and constitutional revenue sharing, state funding of local courts, for state and federal grants, and for all other special revenues including dedicated millages. Every dollar received by a local government, other than fees and charges related to enterprise funds, will diminish the amount of state reimbursement for lost industrial personal property taxes. **Many local governments that will lose 8 to 10% of their property tax revenues would not be eligible for any reimbursement using this 2% of government funds formula.**

Based on U.S. Census Bureau data, we estimate that 2% of the total of governmental funds for all Michigan local governments, excluding educational entities, is approximately $500 million. If the proposed distribution formula is adopted, local governments would have a maximum exposure for **unreimbursed** property tax losses of $500 million per year. Previous informal presentations on this package indicated that local government revenue losses would total just 20% of that figure. By using governmental funds in the calculation, we believe that local governments will be required to absorb the vast majority of the revenue loss, when earlier discussions had the state shouldering the lion's share of that responsibility.

If this legislation returns to the direction that had earlier been represented to our Association and, we hope, is still intended, we still question the relative sharing of the resulting financial burden between the state and local governments. It is our understanding that the state's resources will be provided by shifting current tax credits into what is essentially an alternative economic development plan. No additional state resources will be provided to reimburse local governments, yet impacted local governments are expected to absorb significant revenue reductions. This loss of revenue will be offset by reduced assessing and tax collection costs in only a very few local governments, mainly smaller entities with minimal personal property tax revenues.

The state has "no skin in the game." Only existing tax credit money will be directed to the local governments, but local governments are expected to incur revenue losses—in some cases in the millions of dollars for individual entities. The state loses nothing, but will hopefully see the benefits of increased income tax and corporate income tax revenues if the repeal results in new economic activity. To be blunt, the intent of the bills appears to include shielding the state budgets from any adverse impact and placing the entire burden of the resulting revenue shortfalls on local governments.

To be clear, MTA would prefer full reimbursement of all revenues lost through the repeal of the industrial personal property tax. We could, however, concede local governments taking modest, phased-in revenue losses, particularly if proportionate to their reduction in costs related to administration of the personal property tax.

We propose that instead of basing the amount of reimbursement on a percentage of total government fund revenues, the same percentage proposed in SB 1072, or less, should be applied to a unit of government's total property tax revenues. This approach will still require local governments to assume some loss, but losses would be proportionate to the degree to which the programs funded by the personal property tax are impacted, instead of to the entire local government budget, including functions unrelated to the personal property tax revenues.

We respectfully draw attention to a recent EPIC/MRA poll, which revealed that 78% of Michigan voters oppose eliminating or significantly cutting the personal property tax if cuts to local services (police, fire, schools, parks, libraries, and more) would likely result. While the total financial impact is not part of this discussion, efforts by the state to come up with additional funding approaching full reimbursement, which might be by some calculations to be $70-$100 million, would put the Legislature's priorities more in line not only with that of local government officials, but with Michigan's voters as well.

Recommended Technical Amendments

The procedures established in this package of bills for administering the exemption of personal property are in certain ways incompatible with current assessing procedures. However, simple modifications cannot only correct these issues, but also further reduce administrative issues for both business owners and local government.

For many years, MTA has supported the concept of exempting smaller parcels of personal property from taxation. This position was supported by our general membership at our annual meeting. We agree that the reduction in administrative costs compared to revenue make this topic worthy of consideration.

The proposed legislation requires business owners to affirm on an annual basis that they own less than $40,000 in taxable value in commercial and industrial personal property. The legislation should be changed to reflect that the exemption applies to businesses owning less than $80,000 of equipment in *market value*. Business owners cannot be held responsible for determining taxable value, which is an involved assessing calculation, as they would be providing market value. The law further specifies that this affidavit be filed by May 1. However, if information is not received by March 1, the assessor is already creating an estimated assessment that will be mailed to the business owner a few days later.

The procedure MTA suggests is that we not create a second form. A check box could be added to the top of the personal property statement that every business receives. If a business has less than $80,000 in equipment, it checks the box indicating compliance and signs the form; if not, it fills out the rest of the form. The form must be returned by the current deadline in order to prepare assessment statements that are mailed in early March. One form, one new line.

We also note that the legislation contains no specific penalty for claiming an exemption that is not allowed. There needs to be a punitive penalty for abusing the system.

The bills that exempt manufacturing equipment are written from the perspective that all determinations for when equipment becomes exempt will be made in early 2016. This legislation provides three years to administratively prepare for this conversion but pushes all of the decisions to the last few months.

MTA believes that the legislation should be rewritten so that assessors and businesses can use the next few years to agree on proper classifications and timelines for when each piece of property is to be removed from the rolls. Appeals of those decisions should be made and decided before January 1, 2016. This will ensure a smoother transition.

The legislation, as proposed, requires business owners to file affidavits with both the assessing unit as well as the state. MTA sees no need to have any form filed with anyone other than the local assessor.

MTA fully believes that this legislation will spawn many appeals regarding classification, especially related to the new manufacturing subcategory. The handling of the 10,000 appeals from the last change in tax rates for industrial and commercial personal property was a disaster. Assessors were told not to change classifications, while property owners were told they had no right to appeal decisions coming out of the State Tax Commission until the courts interceded. MTA believes that legislation should move these appeals to the Michigan Tax Tribunal, which is better structured to handle this high volume of appeals. Saying that, we also believe that the MTT staffing needs to be increased to deal with the backlog of appeals as well as this new potential for appeal.

Finally, for some reason, the definition of eligible manufacturing personal property has been placed in the local government reimbursement legislation. That definition belongs in the General Property Tax Act.