



**House
Legislative
Analysis
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REVENUE SHARING: SPECIAL ASSESSMENTS

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Senate Bill 40 (Substitute H-1)
First Analysis (3-17-87) Floor Copy

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Sponsor: Sen. Harry Gast
Senate Committee: Finance
House Committee: Appropriations

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THE APPARENT PROBLEM:

Under the State Revenue Sharing Act, the state shares revenues from state personal income and single business taxes with cities, villages, townships, and counties based on a formula which measures a local unit's "tax effort" (calculated by dividing the local unit's property, local income, and excise taxes by its state equalized valuation) and compares that to the statewide average. The higher a unit's local tax effort is, the more it will receive from the state in shared revenue payments.

Although the 1971 state revenue sharing law does not permit the inclusion of special assessments in the revenue sharing formula, until 1984 some local units of government had been improperly including certain special assessments (primarily those for police and fire protection) in their reports of local tax rates to the Treasury Department. In October, 1983, a study by a citizen's group noted this fact, and the following year the Treasury Department revised its reporting forms to require local units of government to identify clearly each tax or assessment they levied.

Since the total amount of revenue sharing money remains fixed, the change in reporting requirements meant that a shift in revenue sharing payments occurred, with payments to some local units — mainly large cities — increasing while payments to other units — mainly townships — decreased. Since, in addition, revenue shared with the state represents anywhere from 15 percent (for some cities) to 40 percent (for small townships) of the operating funds of local governments, this shift in revenue sharing posed potentially serious financial problems for those townships and smaller cities whose payments would be significantly reduced if special assessments were no longer included in the calculation of their local tax effort. In 1985, the legislature voted to appropriate money from the state general fund to make up the losses suffered by townships and smaller cities due to the new reporting requirements. However, no such supplemental payment was voted for subsequent fiscal years, and those units experiencing reduced revenue sharing payments are faced with a total potential loss of nearly \$2.5 million.

Some people feel that this change has placed an unfair burden on some townships and smaller cities, and have requested legislation that includes certain special assessments in the determination of a local unit's tax effort, thereby restoring lost revenue sharing money to these local governments. In order, however, to avoid penalizing large cities, which would lose revenue under such legislation, some people have also requested that the state make up for any potential losses in revenue to larger cities should special assessments be included in the revenue sharing formula.

THE CONTENT OF THE BILL:

The bill would amend the State Revenue Sharing Act of 1971 in two ways: It would (a) change the existing distribution formula allocating the existing pool of state shared revenue but (b) in a way that would require the state to calculate payments based on the old distribution formula and then "make whole" those local units of government (basically certain townships and smaller cities) that otherwise would lose revenue under the old formula.

More specifically, the bill would change the definition of "local taxes" (upon which the revenue sharing formula is based) by including in the definition (after June 30, 1987) those special assessments levied on an *ad valorem* basis against all real property in an entire city, village, or township.

The bill also would require the state to use the original formula (the one that does not include any special assessments in the definition of "local taxes") for the distribution of revenue sharing payments beginning in June, 1988, and would then require the Department of Management and Budget to make supplemental payments to local units of government who otherwise would receive reduced revenue sharing payments under the old formula. The state legislature would have to appropriate money from the general fund for these supplemental payments, but could not appropriate more than \$2.5 million for this purpose in any one fiscal year (MCL 141.904).

FISCAL IMPLICATIONS:

The bill would require the legislature to appropriate \$2.5 million annually from the general fund, beginning in fiscal year 1987-88, to make supplemental payments to local units of government whose revenue sharing payments would be reduced under the bill.

ARGUMENTS:

For:

The proportion of revenue sharing payments that local governments receive from the state depends upon calculations involving a local unit's tax effort rate, that is, how much of a tax burden a local unit places on its taxpayers relative to other local units in the state. In the past some local governments have included certain special assessments for police and fire protection in figures reported to the treasury department for determining local tax effort rates. However, a recent change in treasury reporting requirements excluded any special assessments from consideration as part of a local unit's tax burden. This decision caused adjustments in calculations that resulted in those local units with relatively high taxes, mostly

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cities, gaining in revenue sharing payments, while those that made extensive use of special assessments, mostly townships, lost revenue. The bill would restore the revenue sharing levels of those who suddenly lost revenue, and would prevent further inconsistencies in the calculation of local tax efforts, by specifying that special assessments would be recognized as a local tax effort.

Against:

Special assessments are not subject to millage limitations or truth in taxation procedures, and in many instances can be levied without voter approval. In addition, special assessments can only be levied on real property and cannot be imposed on personal property. Because special assessments are different than all other taxes that local units impose upon their taxpayers, they should not be included as tax revenue in calculating local tax effort.

Response: As the Citizen's Research Council pointed out in its study of special assessments, the theory underlying special assessments is that the general revenue of a governmental unit — that is, taxes — should not be used to finance improvements that do not benefit the entire community. Instead, a charge ("special assessment") is imposed for the payment of the costs of public improvements that confer a corresponding and special benefit upon the property assessed. Prior to the 1950s, public improvements financed through special assessments consisted exclusively of capital asset construction and maintenance, such as streets and street lighting, sewers, drains, and sidewalks. However, in recent years, the definition of "special assessment" has been expanded to include police and fire protection, refuse collection, and other municipal services, and the local governments authorized to assess for these operating services have levied the assessments throughout the entire jurisdiction on the value of the property ("ad valorem"). Under this expanded definition, "special assessments" often wind up being virtually indistinguishable from general ad valorem property taxes. In those cases where there is no clear distinction between general taxes and special assessments — namely, when the special assessments are levied on an ad valorem basis over the entire community — it is only fair that these special assessments be included in the state's calculation of the local unit's tax effort. (Or, as proponents of this view sometimes say, if it looks like a duck and walks like a duck and quacks like a duck, then for all intents and purposes it ought to be treated like a duck.)

Reply: If special assessments are to be included in the revenue sharing formula, then these assessments ought truly to be indistinguishable from ad valorem property taxes. That is, these special assessments not only should be ad valorem and jurisdiction-wide, but they also should be approved by the voters for a specified number of years and mills. Otherwise, the bill winds up making a substantive change in the definition of tax effort instead of a minor change to correct a bureaucratic mistake, as its proponents contend.

For:

If certain special assessments are going to be included in the revenue sharing formula, then those units of government — mainly large cities — which have been correctly reporting their taxes to the state (and thereby, in effect, subsidizing those units who have been overreporting their tax rates) and which would suffer decreased shared revenue payments as a result of this change should not have to lose any of their existing payments. Since the cities in question are not responsible for the existing problem, and since the townships are not being asked to pay back their overpayments from past years, the least the legislature can do is to ensure that the cities would not have to pay for the mistakes of others. The provisions for

supplemental payments from state general funds would ensure that injustice will not prevail and that cities will continue to receive their fair share of state revenues.

Against:

The bill is internally inconsistent. The first set of amendments proposed by the bill changes the definition of "local taxes", and thereby the state revenue sharing formula. But the second amendment, regarding supplemental appropriations, basically directs the state to ignore the new formula resulting from the new definition. Since the bill cannot bind future legislatures to appropriate money, the problem which apparently inspired the original bill would remain an annual issue under the House substitute. What really is needed is a careful and well-thought-out consideration of how "tax effort" is to be viewed by the state for purposes of revenue sharing, not one which, in effect, rewards certain government officials for using a gimmick to obtain a larger share of the state's revenue sharing pie.

POSITIONS:

The Department of Treasury supports the bill (3-11-87).

The Michigan Municipal League supports the bill (3-11-87).

The Michigan Townships Association supported the original bill but has not taken a position on the House substitute (3-11-87).