Legislative Analysis

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EXCLUDE UNCAPPED VALUE FROM HEADLEE ROLLBACK

House Bill 4442 with House floor amendments
Sponsor: Rep. Paul Condino
Committee: Tax Policy

Complete to 3-16-07

A SUMMARY OF HOUSE BILL 4442 AS AMENDED ON THE HOUSE FLOOR 3-14-07

Under House Bill 4442, the increase in the total taxable value or real property in a local unit of government that results from the re-assessment (known as the "pop-up") that occurs when property is sold or transferred would be treated the way that taxable value increases from "additions" (such as new construction) are treated when calculating millage rollbacks required by the State Constitution. This would have the effect of allowing a local unit's millage rate to remain higher than it otherwise would under the current millage reduction calculation.[1]

The bill further provides that beginning with taxes levied in 2007, the additional revenue generated by using the new calculation would have to be used for "public safety" purposes; that is, for police officers, firefighters and other first responders, school safety officers and school resource officers, and also court and jail operations. The additional revenue resulting from the new calculation could not be used to supplant existing funding for the public safety purposes. The bill is an amendment to the General Property Tax Act (MCL 211.34d).

Under the provisions of the Headlee Amendment to the State Constitution (Article 9, Section 31), a local unit must rollback its millage rate when the increase in the assessed valuation as finally equalized (i.e., taxable value) of existing property increases faster than the rate of inflation; the millage rollback occurs so as to yield the same amount of revenue on that existing property, adjusted for inflation. The millage reduction fraction (MRF), as found in the General Property Tax Act is:

$$\frac{\text{Previous Year Total Taxable Value} - \text{Losses}}{\text{Current Year Total Taxable Value} - \text{Additions}} \times \text{Inflation Rate Multiplier}$$

For the purposes of calculating the MRF, the term "additions" in the formula does not include the increase in taxable value following a transfer of ownership (i.e. the uncapping of the taxable value to the level of state equalized value, or "pop-up"). House Bill 4442 would amend the formula to treat the uncapped value as an addition.

[1] The MRF is rounded to the nearest 1/10,000th (four decimal places) and is capped at 1.0000. For 2007, the inflation rate multiplier is 1.037 (a 3.7% change in the consumer price index). Since 1995, the MRF has served to permanently reduce the maximum number of mills a local unit may levy. Prior to that, local units could "roll up" their millage rates to the amount authorized by charter, statute, or voter approval when the growth on existing property was less than inflation.

Generally speaking, the increase in the assessment of a parcel of real property cannot increase from one year to the next by more than the rate of inflation or five percent, whichever is less. However, when property is sold or transferred, its valuation returns (or "pops up") to the state equalized value (SEV)—50 percent of market value. At that point, the assessment cap once again begins to apply, this time to the readjusted assessment.

FISCAL IMPACT:

The bill would increase revenue to local units of government by an indeterminate amount.

FLOOR AMENDMENTS:

The House Committee on Tax Policy reported the bill as introduced. The House adopted three amendments (two of which were identical): Rep. Horn's and Rep. Ebli's amendments would prohibit the additional revenue received as a result of the bill from being used to supplant existing funding. Rep. Condino's amendment would allow additional revenue to also be used for courts, jail operations, and administration.

BACKGROUND INFORMATION:

Headlee Rollback

The millage rollback provision of the Headlee Amendment is included in Article 9, Section 31 of the State Constitution, and states: *If the assessed valuation of property as finally equalized, excluding the value of new construction and improvements, increases by a larger percentage than the increase in the General Price Level from the previous year, the maximum authorized rate applied thereto in each unit of Local Government shall be reduced to yield the same gross revenue from existing property, adjusted for changes in the General Price Level, as could have been collected at the existing authorized rate on the prior assessed value.*

Following ratification of the Headlee Amendment in 1978, the legislature and governor enacted 1978 PA 532 (SB 519). Among other changes, P.A. 532 added a section to the General Property Tax Act (MCL 211.34d) to establish a statutory framework for implementing the Headlee rollback provisions. The act added a definition for "new construction and improvements" (a phrase not defined in the Headlee amendment), defining it to mean the difference between (1) all increases in value caused by new construction, improvements caused by new construction or a physical addition of equipment or furnishings, and the value of property which was exempt from taxes or not included on the assessment unit's previous year's assessment roll ("additions"); and (2) a decrease in value caused by the removal or destruction or real or personal property, and the value of property taxed in the prior year which has been exempted or removed from the assessment unit's assessment roll ("losses").

Prior to Public Act 415 of 1994—the act that amended the General Property Tax Act to implement changes made by Proposal A of 1994—"assessed value as finally equalized" for the purposes of the Headlee rollback meant the state equalized value, which, at the time, was the value on which property taxes were based. However, following Proposal A's cap on assessments and its calculation of "taxable value" as the basis for property taxes, P.A. 415 amended the General Property Tax Act to redefine "assessed value as finally equalized" (as used in the constitution's Headlee rollback provisions) to mean the property's taxable value. (For further information on this change, see the Citizen's Research Council January 1996 memorandum issue paper available through the CRC's website at http://www.crcmich.org/PUBLICAT/1990s/1996/cc1039.pdf.)

Constitutional Considerations

Many stakeholders have expressed concern that the bill, by altering the calculation of the millage reduction fraction so as to subtract out a property's uncapped value resulting from a transfer of ownership, is constitutionally suspect, particularly following the Michigan Supreme Court's 2002 decision in *WPW Acquisition v. City of Troy* (466 Mich 117) and the State Court of Appeals' October 2006 decision in *Toll Northville, LTD and Biltmore Wineman, LLC v. Northville Township* (Docket No. 259021).

Critics contend that a property's uncapped value cannot be excluded from the calculation of the Headlee rollback because the constitution only excludes "new construction and improvements" and that the uncapped value is not new construction or an improvement. Altering the calculation, then, amends the constitution by statute.[2]

The issue of the legislature's ability to affect constitutional provisions through statutory change has become a major issue since the *WPW* decision. At issue in *WPW* was the meaning of terms "additions" and "losses" at the time Proposal A was ratified by the voters.[3] In the General Property Tax Act, as amended by P.A. 415 of 1994 following ratification, the term "losses" includes, among other things, an adjustment in value because of a decrease in a property's occupancy rate. Similarly, the act provided that the term "additions" included an increase in value attributable to an increase in a property's occupancy rate if either a loss because of a decrease in occupancy rate ("occupancy loss") was previously allowed or if the value of new construction had been reduced because of a below market occupancy rate.

In *WPW*, the Supreme Court held that the additional value attributable to an increase in occupancy rate was not consistent with Proposal A and, therefore, unconstitutional. At the time Proposal A was approved by the voters, the terms "additions" and "losses" as

[2] To complicate things, however, the Headlee Amendment did not define what constituted "new construction and improvements." That definition was set in statute following ratification, with the enactment of 1978 PA 532, and not only include newly constructed property, but also changes in value attributable to property that is destroyed, property that was previously exemption but now taxable, and property that was previously taxable and now exempt.

[3] The general rule in constitutional construction is to look to the common understanding of the plain meaning of the language as understood by the ratifiers (the people) at the time of ratification. However, state courts have recently held where technical, legal terms are employed the meaning ascribed to those terms is that of those sophisticated in the law at the time of ratification.

defined in the General Property Tax Act and amended most recently by 1993 PA 145, the two terms did not encompass any increase or decrease in value because of a change in a property's occupancy rate. The court noted that if the legislature were free to classify increased in value as "additions," it could undermine one of the intended purposes of Proposal A—to limit property taxes. The court stated,

If what the amendment [Proposal A] *had done was empower the Legislature, at its will, to define an increase in the value of property (such as an increase due to increased occupancy) to be classified as an "addition," then the property tax limiting thrust of §3 would be, or could soon be if the Legislature desired it, thwarted. To adopt Troy's position regarding legislative power to amend the meaning of terms understood at the time of ratification, would be to assume the drafters and ratifiers of this amendment desired to place a convenient sabotaging clause within this tax limitation amendment that could be triggered whenever the Legislature chose. Such a skewed view of the intent, to say nothing of the capabilities, of the drafters and ratifiers, should be rejected. Moreover, to adopt such a mode of interpretation would, when applied in the future to other constitutional language, hollow out the people's ability to place limits on legislative power. In short, to recognize such an expansive legislative power to redefine constitutional terms is inconsistent with the constitution's supremacy over statutes…Against this background, we see no principled way to determine the meaning of "additions" as used in §3 except by considering it as a term of art that must be construed in conformity with the meaning of "additions" as used in the General Property Tax Act at the time that Proposal A was adopted*[4]

In *Toll Northville, LTD* the Court of Appeals adopted the Supreme Court's *WPW* rationale in striking down a provision in the General Property Tax Act, MCL 211.34d(1)(b)(viii), that provided that the term "additions" also included the value of "public services"—i.e. water, sewer, primary access road, natural gas service, electrical service, telephone service, sidewalks, and street lighting. (That decision in on appeal to the Michigan Supreme Court.)

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■ This analysis was prepared by nonpartisan House staff for use by House members in their deliberations, and does not constitute an official statement of legislative intent.

[4] The City of Troy argued that the constitution did not specifically define "additions" and "losses" and, therefore, left it to the legislature to define these terms in statute. This reading, the court stated, runs counter to the principle that construing the meaning of constitutional language is a basic judicial function. The legislature may define terms, permitted in the constitution, as in the instance of defining what constitutes a transfer of ownership. See Article 9, Section 3 – "When ownership of the parcel of property is transferred *as defined by law*…"