

Ballot Proposal 1 of 2014



REFERENDUM ON PUBLIC ACT 80 OF 2014: PERSONAL PROPERTY TAX PHASE-OUT

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Ballot Proposal 14-1
August 2014 Primary Election
Placed on the ballot by the Legislature

Complete to 7-14-14

BRIEF SUMMARY OF THE BALLOT PROPOSAL:

The ballot proposal is a referendum on Public Act 80 of 2014 (created by passage of Senate Bill 822). A "YES" vote is a vote in favor of allowing that act to take effect. A "NO" vote is a vote against the act's taking effect.

When the Legislature enacted Public Act 80 of 2014 (Senate Bill 822), it stipulated that the act would only take effect if approved by voters. So essentially, the Legislature is asking for a referendum on its own legislation. All or part of nine other acts are tied to Public Act 80; they will not take effect unless Public Act 80 is approved by the voters.

Generally speaking, passage of the ballot proposal would mean:

- There would be a tax reduction for business through the phase-out of the tax on personal property such as machinery, equipment, furniture, tools, and computers; this benefits manufacturers and associated commercial enterprises, as well as all businesses that have relatively small amounts of personal property.
- Local units would be reimbursed for lost personal property taxes by dedicating a portion of state Use Tax revenues for that purpose, and school funding would be protected.
- The proportion of Use Tax revenues directed to the state's General Fund would be reduced and would no longer be available for other purposes in the state budget. Essentially, the proposals redirects to local units of government Use Tax revenue currently dedicated to the state budget. (However, the legislation anticipates General Fund losses would be offset partially by a new smaller state assessment on exempt personal property, based on acquisition cost. It also expresses the intent that revenue from expiring state tax credits also be used to offset GF losses, although that revenue would be available whether or not the personal property tax phase-out occurred.)

These features are described in more detail later in this analysis.

The **Personal Property Tax** is typically described as a tax on property not affixed to land, such as machinery, equipment, furniture, tools, and computers. It does not apply to inventory (which is not taxed). It is a tax that only businesses pay. The tax is paid primarily to local units of government, although the state receives personal property tax

revenue from the 6-mill State Education Tax, which benefits the State School Aid Fund. Local units vary greatly in the amount of personal property within their borders and, as a result, in how much they rely on personal property tax revenue. Many communities have negligible amounts of commercial and industrial personal property, while for others personal property constitutes one-third, one-half, or even more of the local tax base.

The **Use Tax** is, generally speaking, a companion to the Sales Tax. It is levied at 6% on the privilege of using, storing, and consuming certain tangible personal property. It applies to remote sales, such as catalogue and Internet purchases. It is also levied on telephone services, used auto sales between individuals, and the use of hotel rooms. The tax is levied on the purchase price of tangible personal property or service. The revenue currently is divided one-third to schools and two-thirds to the state General Fund.

The following is the official language as it will appear on the ballot.

APPROVAL OR DISAPPROVAL OF AMENDATORY ACT TO REDUCE STATE USE TAX AND REPLACE WITH A LOCAL COMMUNITY STABILIZATION SHARE TO MODERNIZE THE TAX SYSTEM TO HELP SMALL BUSINESSES GROW AND CREATE JOBS

The amendatory act adopted by the Legislature would:

1. Reduce the state use tax and replace with a local community stabilization share of the tax for the purpose of modernizing the tax system to help small businesses grow and create jobs in Michigan.
2. Require Local Community Stabilization Authority to provide revenue to local governments dedicated for local purposes, including police safety, fire protection, and ambulance emergency services.
3. Increase portion of state use tax dedicated for aid to local school districts.
4. Prohibit Authority from increasing taxes.
5. Prohibit total use tax rate from exceeding existing constitutional 6% limitation.

Should this law be approved?

YES

NO

THE CONTENT OF THE LEGISLATION:

Public Act 80 of 2014 and associated legislation would:

- o Phase out the personal property tax (PPT) levied on certain personal property owned by business enterprises. Specifically, the phase-out would apply to (1) personal property predominantly used in industrial processing or direct integrated support (property referred to as "eligible manufacturing property"), and to (2) the personal property of any business when the combined true cash value of its

personal property in a particular local tax collecting unit in the immediately preceding year is less than \$80,000. This second exemption is called the "small taxpayer exemption" and businesses must file an affidavit annually in the local unit where the property is located to claim the exemption.

("Direct integrated support" means research and development, testing and quality control, engineering, and warehouse facilities that directly support industrial processing and store tangible personal property, as well as sorting and distribution centers that optimize transportation and use just-in-time inventory management and material handling for inputs to industrial processing.)

- Reimburse local units of government and the School Aid Fund for the lost revenue. The reimbursement would come from Use Tax revenues. The amount of reimbursement from the Use Tax for local units is specified in Public Act 80 and would increase from \$96.1 million in FY 2015-16 to \$572.6 million in FY 2027-28, with the amounts thereafter adjusted by a personal property growth factor calculated in the bill at 1%. (For more detail, see *Fiscal Impact* below.)
- Split the Use Tax into two parts: (1) a state Use Tax component, levied by the state; and (2) a local Use Tax component levied and distributed by a newly created Local Community Stabilization Authority, or LCSA. The local component is referred to as the local community stabilization share tax. The rate of the two use taxes combined would be 6%, the same rate as the current Use Tax. The state-local split would depend on the amount needed to be raised by the LCSA Use Tax component. Basically, the LCSA Use Tax would be at the rate necessary to generate an amount specified in statute, with the state rate being 6% minus that calculated LCSA rate. (This is explained in more detail later in the analysis.)
- Hold the State School Aid Fund harmless from the loss of State Education Tax revenue and the 18-mills (generally) levied for school operating purposes resulting from the PPT exemptions. The proposal stipulates that the state share of the Use Tax would include the additional 2% rate added when voters approved Proposal A in 1994, which is dedicated to the School Aid Fund. Additionally, revenue from the state share would be deposited into the School Aid Fund to hold the SAF harmless from the loss of State Education Tax revenue and the 18-mills (generally) levied for school operating purposes that results from the PPT exemptions. Thus, the School Aid Fund would receive the 2% provided via Proposal A, plus a "hold harmless" amount.
- Establish a State Essential Services Assessment to be levied against exempt personal property beginning in 2016, with the revenue going to the state's General Fund. The rate of the special assessment would depend on the length of time the taxpayer has owned the eligible personal property. Personal property would be assessed based on its acquisition cost and taxed at a rate of 2.4 mills in the first five years after it is acquired, 1.25 mills for the next five years, and 0.9 mills thereafter.

- Impose an alternate assessment on eligible personal property that is specifically exempted from the State Essential Services Assessment by the Michigan Strategic Fund Board. The alternative assessment would be equal to 50% of the state special assessment, and revenue would also be credited to the General Fund. This is only available to businesses that enter a written agreement with the MSF and demonstrate that a minimum of \$25 million will be invested in additional eligible personal property in this state during the duration of the written agreement.
- Express the intent of the legislature to offset the negative fiscal impact on the state General Fund from the reduction of the state use tax with new revenue generated by the Essential Services Assessment "and with new revenue resulting from the expiration of . . . refundable tax credits that were awarded to individual businesses under tax laws enacted by past legislatures."

Phase Out of Personal Property Tax

In December 2012, the legislature and the governor enacted a package of bills that aimed to phase out the personal property tax for (1) personal property predominantly used in industrial processing or direct integrated support, and (2) the personal property of any business when the combined true cash value of its personal property in a particular local tax collecting unit is less than \$80,000; and to provide reimbursement (through the Use Tax) of the revenue that would be lost to local units of government.

The 2012 plan was to be put before the voters in August 2014; however, the original proposal has since been replaced by new legislation with the same aim but with a different, and more generous, approach to providing reimbursement to local units. That 2014 legislation is now what is before voters in this ballot proposal. Under the current proposed legislation, the phasing out of property taxes occurs as follows.

- An exemption is already in place for 2014 and beyond for commercial and industrial personal property when the combined true cash value of all such property owned by the taxpayer in a particular local tax collecting unit is less than \$80,000 in the immediately preceding tax year. (While this is in effect already, it would no longer apply if the ballot proposal fails.)
- An exemption begins in 2016 for eligible manufacturing property that is new personal property. "New personal property" means property initially placed in service in this state or outside of this state after December 31, 2012.
- An exemption begins in 2016 for eligible manufacturing property that, generally speaking, has been subject to or exempt from the collection of taxes for the immediately preceding 10 years, or would have been subject to taxes or exempt if located in the state for that period.

This means that in the first year of the exemption—2016—the exemption would apply only to eligible personal property subject to taxation before 2006. In the next year, the exemption would apply, by going back 10 years, to personal property subject to taxation before 2007 (and thus adding property first taxable or exempt in 2006). In the next year, personal property subject to tax before 2008 would qualify, and so on, until by 2023 all such property would become exempt.

Division of the Use Tax

As noted earlier, the current Use Tax would be divided under this legislation into two components: the *state share* and the *local community stabilization share*.

The rate of local community stabilization share tax is the rate calculated by the Department of Treasury annually as needed to raise the amount established in statute for the local community stabilization share. The rate of the state share is 6% minus the local share rate. The total of the two shares cannot exceed 6% (the current Use Tax rate).

Revenue from the local share would not be credited to the state treasury, but instead be transmitted to the Local Community Stabilization Authority (LCSA) for disbursement only as authorized under the Local Community Stabilization Authority Act. Public Act 80 of 2014 specifies that the local community stabilization share is *a local tax*, not a state tax, and that money received and collected for the local community stabilization share is money of the authority and not money of the state.

The state share would be collected and distributed in the same manner as the current Use Tax. The LCSA would have the exclusive power to levy the local community stabilization share under the Use Tax Act; however, the Department of Treasury would administer the collection of the local share tax as an agent of the authority. The authority would distribute the local share tax according to criteria and formulas in the legislation.

The local community stabilization authority would be created by a new act (PA 86 of 2014, Senate Bill 821) and established as "a metropolitan government for the metropolitan areas of this state" under Section 27 of Article VII of the State Constitution of 1963. The agency would not be an agency or instrumentality of state government. The authority would be governed by a five-member council, consisting of state residents appointed by the governor, with at least three members from separate metropolitan areas within the state. An officer or employee of the state could not serve as a member of the council. The council would be subject to the Open Meetings Act and the Freedom of Information Act.

[Section 27 of Article VII of the State Constitution of 1963 says, "The legislature may establish in metropolitan areas additional forms of government or authorities with powers, duties and jurisdictions as the legislature shall provide. Wherever possible, such additional forms of government or authorities shall be designed to perform multipurpose functions rather than a single function." The LCSA, in addition to the distribution of Use Tax revenues, would also exercise responsibilities under the Metropolitan Extension Telecommunications Rights-of-Way Oversight Act. That act was designed to encourage competition among providers of telecommunication services and to streamline the process for authorizing providers' access to and use of local public rights-of way, among other things.]

Reimbursement to Local Units

The revenue from the local community stabilization share tax is, as mentioned earlier, to be used to reimburse local units of government for revenue lost from the personal property tax phase-out. Public Act 80 (Senate Bill 822) requires the following distributions of revenue (and in the following orders of priority).

** Beginning in Fiscal Year 2015-16, the local community stabilization authority would distribute revenue from the local share of the use tax to provide the following reimbursement:

- 100% of the debt loss experienced by school districts and intermediate school districts (ISDs), and 100% of the loss for school district sinking fund and recreation millages.
- 100% of the loss for ISD taxes (e.g., special education and vocational education).
- 100% of the school operating loss not reimbursed by the School Aid Fund.
- 100% of the amount of the revenue loss related to the cost of providing "essential services." The term "essential services" means ambulance services, fire services, police services, jail operations, and the funding of pensions for personnel providing such services.
- 100% of personal property tax-related losses experienced by tax increment finance authorities (or TIFAs).
- 100% of the amount for lost revenue from the small taxpayer exemption.

Any remaining funds would be allocated proportionally to municipalities that have a "qualified loss" (i.e., for millages that are not for debt, schools, essential services, etc.).

** Beginning in FY 2019-20 the authority would distribute 5% of the remaining balance to each municipality other than school districts, ISDs, or TIFAs based on the "acquisition cost" of all eligible personal property and applicable millage rates of each municipality (based on the lowest millage rate since 2012 for each millage).

Also, in FY 2014-15 and FY 2015-16, the legislature would appropriate to the authority an amount equal to all debt loss for municipalities (other than TIFAs), all school debt loss, and an amount equal to all tax increment small taxpayer loss for TIFAs.

Beginning in fiscal year 2015-2016, and each fiscal year thereafter, the Department of Treasury would be required determine the amount of the distributions and each municipality would have to submit to the department sufficient information for the department to make its calculations.

(Note: the calculation for reimbursing local units for the small taxpayer exemption loss is essentially the taxable value of all commercial and industrial personal property in 2013 minus the taxable value of all commercial and industrial personal property in 2014. This means the ongoing annual reimbursement for a local unit is based on a one-time calculation. If a local unit's 2014 taxable value exceeds its 2013 taxable value due to tax base growth—even with the loss of small taxpayer personal property taxable value—it appears as if there would be no reimbursement for that unit for small taxpayer exemption loss.)

BACKGROUND INFORMATION:

For additional discussion of the ballot proposal, see the analysis from the Citizens Research Council of Michigan issued in July 2014, at: <http://www.crcmich.org/>

Analyses from the House Fiscal Agency and Senate Fiscal Agency on the legislation that forms the basis for the ballot proposal are available (by searching for Senate Bill 821) at www.legislature.mi.gov

FISCAL IMPACT:

Public Act 86 of 2014 (Senate Bill 821), which is tied to Public Act 80 and only goes into effect if voters approve the ballot proposal, creates the Local Community Stabilization Authority (LCSA), and charges the Department of Treasury with additional responsibilities. Both of these changes will increase state administrative costs relative to current levels. For FY 2014-15 and FY 2015-16 the Authority will be charged with disbursing a \$19.3 million appropriation to local units, for the purposes of reimbursing debt loss incurred from the small taxpayer exemption, including school debt loss. This amounts to a loss to the state.

The disbursement of the portion of the Use Tax levied by the LCSA in FY 2015-16 and FY 2016-17 would be according to the actual losses to local units, based on their reporting of the taxable value of industrial and commercial personal property.

Public Act 80 will effectively transfer Use Tax revenue from the state to local units, resulting in a loss to the state General Fund. The amount of this transfer, referred to as the community stabilization share tax, is specified in the bill for FY 2015-16 through FY 2027-28. This levy is intended to replace 100% of local unit revenue loss from the exemption of qualified personal property. The statutory amounts are listed in the table below.

Use Tax Levied for Local Units under PA 80 (in millions)

2015-16	\$96.1	2022-23	\$548.0
2016-17	\$380.6	2023-24	\$561.7
2017-18	\$410.5	2024-25	\$569.8
2018-19	\$437.7	2025-26	\$571.4
2019-20	\$465.9	2026-27	\$572.2
2020-21	\$491.5	2027-28	\$572.6
2021-22	\$521.3		

After FY 2027-28 the dollar amount of use tax levied by the LCSA would increase 1% per year. While these annual use tax levies are intended to provide 100% reimbursement for local units, using statutory amounts may not achieve this aim in practice. The amounts are estimates; therefore, they could be too low or too high in any given year. (Since the Use Tax levy is specified in statute, a future legislature and governor could change these amounts.

The state's General Fund would also have to reimburse the state's School Aid Fund for its losses due both from loss of State Education Tax revenue and the 18-mills (generally) levied locally for school operating purposes resulting from the PPT exemptions. While other local school millage revenue losses would be reimbursed through the Local Community Stabilization Authority, the reduction in local 18-mill school operating revenue is, for the most part, automatically offset by increased state School Aid contributions through the foundation allowance formula in the School Aid budget at an

increased cost to the School Aid Fund. The net impact to the School Aid Fund is intended to be \$0. The cost to the state's General Fund for this reimbursement would phase-in initially and is estimated to be \$19.9 million in FY 2014-15, \$30.9 million in FY 2015-16, \$42.4 million in FY 2016-17, and then would grow more slowly reaching an estimated \$47.1 million by FY 2027-28.

Public Act 92 of 2014 (Senate Bill 829) created the State Essential Services Assessment. This levy on exempt eligible manufacturing personal property would increase state General Fund revenues, relative to current law. Personal property will be assessed based on its acquisition cost, and taxed at a rate of 2.4 mills in the first five years after it is acquired, 1.25 mills for the next five years, and 0.9 mills thereafter. Public Act 93 (Senate Bill 830) allows for an adjustment to the state essential services assessment. A firm that has an approved plan to invest in \$25 million worth of new eligible personal property in the state (as stipulated in Section 9 of PA 92) would pay half the millage rate of the State Essential Services Assessment. Initial estimates suggest that the State Essential Services Assessment could generate \$20.0 million in FY 2015-16 and grow to an estimated \$117.5 million by FY 2027-28.

The overall loss from exempting eligible manufacturing personal property will be somewhat mitigated by an increase in General Fund revenue resulting from the expiration of existing certificated tax credits. However, because the revenue realized from expiring tax credits would have accrued to the General Fund anyway, identifying it as a funding source to offset the revenue loss from exempting EMPP means that it would no longer be available for any other General Fund purpose. Regardless, even with the additional General Fund revenue attributable to expiring certificated credits, the net impact of exempting EMPP could potentially reduce overall GF/GP revenue by \$75 million to \$125 million per year on an annual basis through FY 2024-25. As the 10-year phase-in of EMPP becomes complete, the annual revenue losses could drop to around \$50 million.

BRIEF DISCUSSION:

Briefly put, the supporters of the ballot proposal argue that it represents the long-sought solution to the problem of how to eliminate an onerous tax on business, and at the same time find a method of reimbursing local units of government for the lost revenue. The legislation in question would phase out over a number of years the personal property tax for manufacturers, small businesses, and many other commercial enterprises.

The personal property tax has been characterized by business interests as burdensome, both financially and administratively, and duplicative (because it taxes property on which sales tax has already been paid); it is portrayed as a tax that penalizes companies for their capital investment, and thus discourages growth. The 2014 legislation that is before the voters provides a significantly larger amount of reimbursement for local units than previous proposals to reduce or eliminate personal property taxes. This explains the widespread support for the proposal from local government organizations and advocates for human services and programs for low-income persons.

A group of business and local government organizations have created a coalition called *Michigan Citizens for Strong and Safe Communities* to advocate for the ballot proposal. Their website, containing arguments for the proposal, can be found at:
<http://strongandsafecommunities.com/>

The list of members of the coalition can be found at:
<http://strongandsafecommunities.com/wp-content/uploads/2014/04/MCSSC-Supporters-Updated-July-8.pdf>

The legislation itself contains a number of "findings" indicating that the stated aims of the proposal are to "modernize the tax system to help small businesses grow and create jobs," to "strengthen and revitalize the economy of this state," and to "dedicate revenue for local purposes, including, but not limited to, police safety, fire protection, and ambulance emergency services."

The bill that is subject to referendum, Senate Bill 822, passed the state House of Representatives 104-5, and passed the Senate 35-2.

It has been noted in discussions of the proposal, however, that the legislation would represent a major shift of current revenue from state budgets to local units of government in order to provide the reduction in personal property taxes for manufacturers, small business, and other commercial enterprises. In other words, the use of this money for local unit reimbursement means it is not available for other purposes. Other major uses of General Fund revenue currently include the state's Medicaid and other health care programs, Corrections spending, operational support for public universities and community colleges, human services programs, the Michigan State Police, and transportation spending. The discretionary portion of local revenue sharing is also tied to General Fund revenue.

Thus, as commentators have noted, the question for voters is whether in this case this is a wise "expenditure" of current state revenue.

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