Senate Fiscal Agency

AUGUST
2014
BALLOT PROPOSAL 14-1

An Overview

Prepared by
Suzanne Lowe,
Associate Director,
David Zin,
Chief Economist,
and
Elizabeth Pratt,
Fiscal Analyst

Ellen Jeffries, Director

Phone (517) 373-2768

http://www.senate.michigan.gov/sfa

On August 5, 2014, Michigan voters will decide whether to approve Public Act 80 of 2014, an amendment to the Use Tax Act that allocates a portion of the use tax revenue to local units of government. If approved, Public Act 80 also will trigger a series of other statutory amendments that allow property tax exemptions for industrial and commercial personal property and create mechanisms to replace the lost revenue.

Public Act 80 requires the following language to 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 [ ]

If a majority of the electors vote "yes" on Proposal 14-1, Public Act 80 of 2014 will take effect on January 1, 2015. If the ballot proposal is not approved, Public Act 80 will not take effect and the related legislation will be repealed.

Background

Proposal 14-1 is the product of legislative measures that originally were enacted in 2012 and then amended or replaced in 2014. The key provisions create exemptions for commercial and industrial personal property from the tax that is levied on personal property, and establish ways to replace the revenue lost from the exemptions. In general, personal property includes property that is not part of a structure, such as machinery, equipment, and furniture, but a wide variety of personal property is exempt from taxation. For example, the tax does not apply to personal property that is owned and used by a householder, such as furniture, clothing, and jewelry, or to property used in agricultural operations. The personal property tax, therefore, is paid by manufacturers and other businesses.

For purposes of assessment, taxable personal property is classified as industrial, commercial, or utility. The amount of the tax is based on the taxable value of the property (usually the purchase price less depreciation).

The personal property tax is collected by cities, townships, and villages, based on local millage rates (subject to statewide constitutional and statutory limits). The revenue is allocated to local school districts, intermediate school districts, community colleges, counties, cities, villages, townships, and authorities such as library authorities, transit authorities, and police and fire authorities, as well as entities such as downtown development authorities. The State also receives personal property tax revenue through the State Education Tax and other State-levied property taxes.

Over time, the personal property tax has come to be widely viewed as a tax on businesses' investment in machinery and equipment, which is usually considered essential to increasing productivity and promoting economic growth. In addition, the other states in the Great Lakes area, as well as several major manufacturing states in the mid-Atlantic region, either have eliminated their personal property tax or impose the tax at a rate lower than the rate levied in Michigan. Since today's industries are relatively mobile, and states often compete for business activity through exemptions and abatements, many believe that Michigan's personal property tax harms this State's ability to attract and retain businesses.

In addition, as part of the 2007 enactment of the Michigan Business Tax (MBT) Act, industrial personal property was exempted from the State Education Tax and nearly all local school district operating tax; commercial personal property was exempted from the first 12 school operating mills. The MBT Act also included a refundable credit for 35% of industrial personal property tax paid. Although the personal property school tax exemptions remain in place, the Act, including the 35% refundable credit, was repealed for most businesses beginning in 2012.

Combined, these factors led to calls for personal property tax relief, which resulted in the legislation enacted in 2012 and 2014. In addition to creating tax exemptions under the General Property Tax Act, the legislation amends the Use Tax Act to replace the property tax revenue that local units of government will lose. The amendments, enacted by Public Act 80 of 2014, divide the use tax into a local share and a State share. Because the State Constitution requires voter approval of a new local tax, Public Act 80 will not take effect unless it is approved by the voters. Proposal 14-1, therefore, presents the question to the voters. If the ballot proposal is not approved, the legislation either will be discontinued (in the case of changes that already have gone into effect) or will not take effect. An overview of the enacted legislation follows.[1]

Personal Property Tax Exemptions

Amendments to the General Property Tax Act establish several new exemptions for industrial and commercial personal property that meets various criteria. Other amendments continue existing exemptions until the property becomes exempt under the new provisions.

Under what is sometimes called the small business exemption, a person who owns, leases, or uses industrial and commercial personal property that has a combined true cash value of less than $80,000 in a local tax collecting unit may claim an exemption for that property. This exemption took effect for 2014 property taxes.

Other new exemptions apply to industrial and commercial personal property that meets a definition of "eligible manufacturing personal property". These exemptions will take effect for 2016 property taxes. One of the exemptions is for "qualified new personal property", which refers to property purchased after 2012. The other applies to "qualified previously existing personal property", which refers to property that is at least 10 years old. This means that property purchased before 2006 will be exempt beginning in 2016. In each subsequent year, the 2006 threshold will advance by one year such that, for taxes levied in 2022, property purchased in 2011 will be exempt. By 2023, therefore, all eligible manufacturing personal property will be exempt, if Proposal 2014-1 is approved.

---

[1]For additional information about the legislation enacted in 2012, please see the Senate Fiscal Agency's summary of Senate Bills 1065-1071 and House Bills 6022-6026 dated 2-19-13, and the accompanying State Notes article, "Personal Property Tax Reform Legislation", winter 2013: http://www.senate.michigan.gov/sfa/Publications/Notes/2013Notes/NotesWin13dz.pdf For additional information about the legislation enacted in 2014, please see the Senate Fiscal Agency's summary of Senate Bills 821-830 dated 3-26-14: http://www.legislature.mi.gov/documents/2013-2014/billanalysis/Senate/pdf/2013-SFA-0821-U.pdf

Revenue Replacement Legislation

The enacted legislation includes several measures to replace the revenue that will be lost due to the new tax exemptions for industrial and commercial personal property, subject to voter approval of Proposal 14-1. These include 1) Public Act 80 of 2014, which amends the Use Tax Act to shift a portion of use tax revenue to local units of government; and 2) legislation that levies a new State tax called the "essential services assessment" on the exempt eligible manufacturing personal property. The legislation enacted in 2014 expresses a legislative intent that the State essential services assessment, and revenue from expiring refundable business tax credits, offset the impact on the State's General Fund from the reduction of State use tax revenue.

Local Use Tax Share

The Use Tax Act imposes a tax on a person purchasing or using personal property or selected services on which sales tax has not been paid. A number of exemptions apply to specific types of property or transactions. The rate of the use tax is 6% of the purchase price. At present, the State levies the entire use tax and the State's General Fund receives two-thirds of the use tax revenue (the tax imposed at a 4% rate) and the School Aid Fund receives the balance (the tax imposed at a 2% rate).

Public Act 80 divides the use tax into a "local community stabilization share tax" and a "state share tax", subject to the 6% limit. The Act establishes a maximum dollar amount that the local share may generate annually, which determines the rate of the local share; the rate of the State share then is determined by subtracting the local rate from 6%. The amount that the local share may generate ranges from $96.1 million in fiscal year (FY) 2015-16 to $572.6 million in FY 2027-28. In each of the following years, the amount is to be adjusted by an "industrial and commercial personal property growth factor", as calculated by the Michigan Department of Treasury.

All of the funds attributable to the local share are to come out of revenue generated from the use tax imposed at a 4% rate. The State then is to receive the remaining revenue from the tax imposed at that rate. From the money collected for the State share, the School Aid Fund is to receive an amount equal to revenue lost from basic school operating mills as a result of the new property tax exemptions for commercial and industrial personal property, as well as revenue lost under the State Education Tax Act (which levies a tax on property that is not exempt under the General Property Tax Act, except industrial personal property). In addition, the allocation to the School Aid Fund from the use tax imposed at a 2% rate will not be affected.

Additional legislation creates a Local Community Stabilization Authority to levy the local share of the use tax and distribute that revenue to municipalities (counties, cities, villages, townships, authorities, local school districts, intermediate school districts, community college districts, libraries, and other local or intergovernmental taxing units). The distributions are based on a number of factors, including the type of municipality, whether it provides essential services (ambulance, fire, and police services, jail operations, and the funding of pensions for personnel who provide those services), and the amount of revenue lost due to the property tax exemptions for industrial and commercial personal property.

Essential Services Assessment

If the voters approve Proposal 14-1, the State Essential Services Assessment Act will levy a specific tax on eligible personal property (property that is exempt from taxation under the eligible manufacturing personal property exemptions and existing exemptions that are extended under the legislation). The amount of the assessment will be calculated by multiplying the property's acquisition cost (as defined in the Act) by a rate that is based on how long the taxpayer has owned the property: 2.4 mills during the first five years of ownership; 1.25 mills for the next five years; and 0.9 mill in later years.

This legislation also allows the board of the Michigan Strategic Fund to exempt property from the assessment, if an eligible claimant has a plan to invest at least $25.0 million in additional eligible personal property in the State and meets other criteria. Property exempt from the assessment may be subject to an alternative essential services assessment, which will be 50% of the standard assessment, or the property may be exempted from both assessments.

All revenue from the essential services assessment and the alternative assessment is dedicated to the State's General Fund.

If the voters approve Proposal 14-1, the assessments will begin to be levied on January 1, 2016.

Fiscal Impact

If Proposal 14-1 is approved, the estimated net loss to the State General Fund is $39.2 million in fiscal year 2014-15, $126.3 million in FY 2015-16, and $349.5 million in FY 2016-17, after which the revenue losses will increase more slowly, reaching $502.2 million in FY 2027-28. Based on current estimates, local unit revenue in aggregate will be unaffected, although specific local units will realize increased or decreased revenue relative to what they would receive if the proposal were not adopted. The Senate Fiscal Agency's analysis of Public Acts 80, 81, and 86-93 of 2014 contains tables summarizing the revenue impact of the exemptions and reimbursement provisions and the timing of reimbursements.[2]

State and local property tax reductions associated with the exemption provisions actually began with tax year 2014; if approved, the proposal will continue those exemptions, and add additional exemptions. Initially, exemptions apply only to "small parcels" of commercial and industrial personal property (those with a combined true cash value in a local unit of less than $80,000). Beginning January 1, 2016, exemptions will be extended to eligible manufacturing personal property acquired after 2012, as well as such property acquired before 2006. In later years, the exemptions will expand to cover property acquired between 2006 and 2012. As a result, projected revenue losses from the exemptions increase from $39.2 million in FY 2014-15 to $127.1 million in FY 2015-16 and $414.3 million in FY 2016-17, eventually reaching $603.3 million in FY 2027-28.

A portion of the State use tax will be converted into a local tax levy of the Local Community Stabilization Authority. A fixed amount of use tax revenue each year will be levied by the authority for reimbursements to eligible local units. State use tax revenue is estimated at about $1.5 billion in FY 2015-16. The amount of use tax to be levied by the authority will start at $96.1 million in FY 2015-16, increase to $380.6 million in FY 2016-17, and $410.5 million in FY 2017-18, increasing annually to $572.6 million in FY 2027-28, and indexed each subsequent year. The shift of a significant portion of the use tax from a State tax to a local tax will reduce revenue to the State General Fund, reducing funds available for the State budget. In addition, the State will be required to use General Fund/General Purpose (GF/GP) revenue to reimburse revenue losses to the School Aid Fund from reduced collections of the State Education Tax and additional State costs of the foundation allowance payments to school districts due to reduced local operating revenue.

If the voters approve Proposal 14-1, revenue from the new State essential services assessment and alternative assessment will offset a portion of the loss to the State General Fund. Under certain conditions, however, a business's property may be exempted from the assessment or both of the assessments by a resolution adopted by the Michigan Strategic

---

[2] See Note 1.

Fund board, if the business will be investing at least $25.0 million in eligible manufacturing personal property during the term of its written agreement with the Strategic Fund. While an exemption agreement may require repayment if its terms are not met, the law imposes few conditions upon an agreement, and it does not limit the number of years an agreement may cover or the types of investments that must be undertaken, and there is no limit on the number of agreements and exemptions that may be approved. As a result, the estimates for revenue under the essential services assessment, and under the alternative assessment for exempt property, are subject to a high degree of uncertainty. At this time, it is not known whether the revenue collected from the assessments will be sufficient to offset the State's General Fund revenue loss, if the ballot proposal is approved. Also, at this time, the availability of expiring business tax credits as a source of revenue to offset the State's losses cannot be predicted with certainty.

Beginning in FY 2015-16, the reimbursement provisions will distribute revenue from the local portion of the use tax to local units in a specified priority: 1) school debt loss, 2) losses to intermediate school districts, 3) school district losses not reimbursed by increased payments from the School Aid Fund, 4) losses associated with the provision of essential services, 5) losses to tax increment finance authorities (TIFAs), 6) losses associated with the exemption of small parcels, and 7) all other reimbursements which include levies not related to essential services, such as other municipal operating millages, community colleges and authorities. The first six categories of losses will be 100% reimbursed, while the last category will be subject to a two-stage formula that will distribute remaining local use tax revenue.

In aggregate, the revenue redistributed to local units of government is forecasted to be the same as the estimated losses local units are expected to experience. However, given the nature of the distribution formulas, many local units are likely to receive a reimbursement that differs from their actual loss. In some cases, individual local units might receive a reimbursement greater than the revenue lost as a result of the exemptions, while other local units may receive less. Losses reimbursed under the formulas generally will not provide 100% reimbursement to individual local units, particularly when the second stage of the formula is fully phased in. Generally, the deviations relate to issues associated with a shifting basis for computing reimbursements, potential revenue estimation errors, renaissance zone expirations, differences in the speed of communities' growth, and differences between current depreciation rates and the implied depreciation rates under the new legislation. In addition, the timing of reimbursement for certain losses will vary based on the type of local unit and the nature of the loss.

Additional reasons and detail regarding potential deviations from 100% reimbursement of losses to individual local units, as well as timing, are provided in the Senate Fiscal Agency's analysis of Public Acts 80, 81, and 86-93 of 2014.

If approved, the proposal also will increase property tax administration costs at the State and local levels due to the need to track exempt parcels, calculate and distribute reimbursements, and levy the essential services assessments. Public Act 196 of 2014, the School Aid budget for FY 2014-15, includes a General Fund increase of $19.9 million for increased State costs of the small parcel exemption that began in 2014. Public Act 252 of 2014, the omnibus State budget for FY 2014-15, appropriates $20.8 million and 9.0 full-time equated positions to the Department of Treasury for first-year reimbursement and implementation costs.

Summary of the Proposal

Proposal 14-1, if approved by the voters, will phase in a reduction in State and local property taxes levied on industrial and commercial personal property and provide a reimbursement mechanism for local government losses. It will shift a portion of the use tax from a State tax to a local tax levied by the Local Community Stabilization Authority, which will make the reimbursements according to statutory distribution formulas. Based on current estimates, total reimbursements are expected to cover total local unit revenue losses; however, an individual local unit of government may receive more or less than its actual revenue loss. State revenue will be used to reimburse the School Aid Fund for lost revenue. A portion of the State's reduced revenue and increased costs will be offset by revenue from the new State essential services assessment, which will be levied on some personal property otherwise exempt from taxation; however, the Michigan Strategic Fund board will have the authority to exempt a business from the State essential services assessment if the business plans to invest at least $25.0 million in eligible manufacturing personal property. Overall, the State General Fund revenue available for other portions of the State budget will be reduced by an estimated $39.2 million in FY 2014-15, $126.3 million in FY 2015-16, and $349.5 million in FY 2016-17, with the loss increasing annually to an estimated $502.2 million in FY 2027-28.

Collections from the State essential services assessment will offset the General Fund losses to an indeterminate extent. Also, as various business tax credits expire in the future, money in the General Fund will no longer be required to pay those credits, and a potentially significant amount of revenue will be available for other purposes. It is not possible to predict with certainty, however, when the business tax credits will expire or the extent to which the expiration of those credits will offset the cost to the State from the personal property tax credits.