SENATE FISCAL AGENCY
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MICHIGAN SCHOOL FINANCE REFORM

**ANALYSIS OF THE ENACTED
SCHOOL FINANCE/
EDUCATION REFORM PACKAGE**

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A Series of Papers Examining Critical Issues Facing the Michigan Legislature

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TABLE OF CONTENTS

INTRODUCTION

For many years prior to 1994 the property tax burden in Michigan, compared with the average property tax burden in the United States, had been among the highest in the nation. Of the annual property tax levy, approximately 67% had been used by schools for school operations. The heavy reliance on local property taxes to fund K-12 education, coupled with inequities in levels of per-pupil funding among school districts, resulted in numerous unsuccessful attempts to reform the system. In August 1993 the Legislature and the Governor took decisive action by enacting Public Act 145, which eliminated local property taxes as a source of K-12 and intermediate school district (ISD) school operating funding beginning in the 1994-95 school fiscal year. Because this action eliminated approximately 64% of the $10.2 billion total funding for schools statewide, it became necessary for the State to adopt a new system to fund the schools. In the following months the Legislature debated several proposals to restructure K-12 finances, resulting in the December 24th passage of a comprehensive package.

In effect, the school finance reform package offered Michigan's voters a selection between two tax reform/funding reform plans as contained in a ballot proposal and a statutory proposal. While the ballot proposal and the statutory proposal had some similarities, they took quite different approaches to the funding of K-12 schools. The proposals each used a mixture of State and local taxes to fund the K-12 educational system, and they would have funded the system at similar levels and distributed funds to school districts through the same foundation allowance mechanism; however, the mix of taxes to reach those levels was different. While there were several differences in the application of various taxes, the general question that faced the voters was the choice between: 1) a two-cent increase in the sales and use taxes plus a six-mill levy on homestead property plus a reduction in the income tax from 4.6% to 4.4% (ballot proposal); and 2) a 1.4% increase in the State income tax rate plus a 12-mill levy on homestead property (statutory plan). Both plans would have levied a 24-mill tax on nonhomestead property. The actual impact on individual taxpayers under either plan depended on a combination of income levels, purchasing decisions, property values, and other factors. On March 15, 1994, the voters approved the ballot proposal, thus preventing the statutory proposal from taking effect. The proposal passed 1,684,541 (yes) to 750,952 (no) (69% to 31%).

The enacted K-12 school finance reform package includes three major components. The first is a K-12 school funding reform portion. Included in this portion of the package are some tax reform items that do not have a direct impact on the funding of K-12 schools. The second part of the package involves the reform of how State and local K-12 education funds are distributed to the State's K-12 school districts. The final piece is a K-12 education reform component that does not deal directly with K-12 finances.

This Senate Fiscal Agency (SFA) analysis of the enacted school finance/education reform package presents a comprehensive review of the issues affected by the reform. The first section reviews the overall financial components of the package including: tax reform issues, K-12 revenue, and the impact on the State budget. The second section specifically addresses funding reform issues. The third section of the analysis deals with K-12 spending, and the fourth section with education reform issues.

This analysis includes legislation that was adopted subsequently to the passage of the reform package, but prior to October 1, 1994, to implement or revise the provisions of the package.

I. SCHOOL FINANCE OVERVIEW

The school finance reform package contains a series of complex changes in laws that will have an impact on the State and local tax structure, State expenditure policy for K-12 school districts, and the level of resources available for expenditure in the State budget for all other programs. This section of the analysis attempts to clarify the overall financial impact of the school finance reform package. Included are a brief discussion of Michigan's tax structure regarding property, sales, and income taxes; the changes brought on by the reform package; and a description of State and local tax burdens regarding school funding.

Table 1 provides a summary of the major revenue components of the reform package. The reform package uses a mixture of State and local taxes to fund the K-12 education system.

Table 1

TAX REFORM COMPONENTS OF SCHOOL FINANCE REFORM

Tax	Rate or Base Change
Sales Tax Rate	Increase from 4.0% to 6.0%
Use Tax Rate	Increase from 4.0% to 6.0%
Sales & Use Tax Base Adjustments	Exempt residential utilities from 2-cent increase Tax interstate phone calls (exclude 800 service)
Income Tax Rate	Decrease from 4.6% to 4.4%
Income Tax Credit Adjustments	Increase renter's credit
Assessment Cap	Limit annual assessment increases to lesser of 5% or rate of inflation, until property is transferred
Real Estate Transfer Tax	Impose at 0.75% on all property
State Education Property Tax	Levy 6 mills statewide
Local Homestead Property Tax	None*
Local Nonhomestead Property Tax	Levy 18 mills Exempt qualified agricultural property
Cigarette Tax Rate Increase	Increase from 25 cents to 75 cents per pack
Tax on Other Tobacco Products	Tax at 16.0% of wholesale price

* Supplemental or "hold harmless" millages may be levied locally on homestead property, and in some cases, nonhomestead property, by a limited number of high revenue school districts. With voter approval, districts may levy three "enhancement" mills on all property.

A. TOTAL K-12 SCHOOL FUNDING

State and local school funding for K-12 education will total an estimated $10.0 billion in fiscal year (FY) 1994-95. This represents an increase of about 4.0% from the FY 1993-94 funding level (excluding transitional payments) of $9.7 billion. The $10.0 billion funding level for FY 1994-95 (which excludes Federal funds distributed through the School Aid Act and the Department of Education budget) will be financed by a combination of State revenues, which are distributed by the FY 1994-95 School Aid Act (Public Act 336 of 1993 and Public Act 283 of 1994, a school aid supplemental bill), and property taxes levied and collected by local school districts. The total State and local revenue that will finance K-12 school funding in FY 1994-95 is summarized in Table 2.

The FY 1993-94 funding level, which was originally set at $9.7 billion, was subsequently increased by about $1.0 billion, bringing the total funding level to $10.7 billion. This one-time increase in funding was largely due to supplemental appropriations that were enacted to provide transitional funding to schools as they switched to the new funding system.

Table 2

TOTAL STATE AND LOCAL REVENUE TO BE USED TO FUND K-12 EDUCATION IN FY 1994-95 (millions)

	FY 1994-95 Estimate
SCHOOL AID FUND:	
Existing Earmarked Revenue:	
Sales Tax	$ 1,956
Lottery	457
Liquor Excise Tax	23
Cigarette Tax	18
Industrial & Commercial Facilities Tax	44
Commercial Forest Tax	1
Subtotal Existing SAF Revenue	$ 2,499
New SAF Revenue:	
Sales Tax Increase	$ 1,630
Use Tax Increase	300
Sales Tax Residential Utility Exemption	(70)
Cigarette Tax in Sales Tax Base	13
Interstate Phone Use Tax	18
Income Tax Earmarking	864
Real Estate Transfer Tax	109
State Education Property Tax	1,075
Tax Increment Financing Capture	(14)
Tobacco Tax	349
Commercial & Industrial Facilities Tax	81
Subtotal New SAF Revenue	$ 4,356
Subtotal School Aid Fund	$ 6,855
OTHER STATE FUNDS:	
General Fund/General Purpose Grant	$ 668
School Aid Fund Surplus Drawdown	293
PSERS Health Reserve	140
Interest Earnings Adjustment	2
Subtotal Other State Funds	$ 1,102
LOCAL PROPERTY TAXES:	
Non-Homestead Property Tax	$ 1,312
Hold-Harmless Property Tax	231
Intermediate School District Property Tax	503
PA 198 Industrial Facilities Tax	7
Subtotal Local Property Taxes	$ 2,053
K - 12 SCHOOL REVENUES	$10,012

Source: SFA and Consensus Revenue Estimates.

B. STATE SCHOOL AID FUND

The State School Aid Fund (SAF) will provide most of the funding for K-12 education under the school finance reform package. In FY 1994-95, the SAF will provide about $8.0 billion for K-12 education. The SAF will receive revenue from a variety of sources including numerous dedicated taxes, Federal aid, interest earnings, a grant from the State's General Fund/General Purpose (GF/GP) budget, and a $352 million balance carried over from FY 1993-94. In addition, funds from the Public School Employees Retirement System's (PSERS) prefunded health reserve will finance a portion of the expenditures from the School Aid Act. The SAF revenue estimates and enacted expenditure level for FY 1994-95 are summarized in Table 3.

Table 3

FY 1994-95 SCHOOL AID FUND REVENUES AND EXPENDITURES (millions)

	FY 1994-95 Estimate
REVENUES:	
Beginning Balance	$ 352
School Aid Fund Revenues:	
Existing Tax Revenue:	
Sales Tax	$1,956
Cigarette Tax - Existing	18
Liquor Excise Tax	23
Lottery	457
Industrial & Commercial Facilities Tax	44
Commercial Forest Tax	1
Subtotal Existing Taxes	$2,499
New Tax Revenue:	
Sales Tax Increase	$1,630
Use Tax Increase	300
Sales Tax Residential Utilities Exemption	(70)
Cigarette Tax on Sales Tax Base	13
Interstate Phone Use Tax	18
Income Tax Earmarking	864
Real Estate Transfer Tax	109
State Property Tax	1,075
Tax Increment Finance Capture	(14)
Tobacco Tax - Increase	349
P.A. 198 Industrial Facilities Tax	81
Subtotal New SAF Tax Revenue:	$ 4,356
Subtotal School Aid Fund Tax Revenue	$6,855
Other SAF Revenue:	
Federal Aid	$ 92
Interest Earnings Adjustment (PA 123 of 1994)	2
PSERS Health Reserve	140
General Fund/General Purpose Grant	668
Subtotal Other SAF Revenue	$ 901
TOTAL REVENUES	$8,108
TOTAL EXPENDITURES	$8,051
BALANCE	**$ 57**

Source: SFA estimates and Consensus Revenue Estimates.

C. OTHER STATE REVENUE CHANGES

Most of the revenue from the various tax increases will automatically go into the School Aid Fund. Most of the tax changes had an effective date of May 1, 1994. As a result, the School Aid Fund will receive an estimated $1.4 billion in new revenue in FY 1993-94. (See Table 4 on the following page.) This revenue will be used to fund the transition payments to schools in the summer of 1994 and the other supplemental appropriations that total over $1 billion. As a result, the SAF is expected to have an ending balance of $352 million at the end of FY 1993-94. In FY 1994-95, the changes in these State taxes will be in effect for the entire fiscal year; the real estate transfer tax, however, goes into effect on January 1, 1995. As a result, these tax changes will generate an estimated $4.4 billion in new revenue to the SAF in FY 1994-95. The General Purpose portion of the GF/GP budget also will be affected by some of the school finance reform tax changes. (See Table 4 on the following page.) The reduction in the income tax rate from 4.6% to 4.4% will lower GF/GP revenue by an estimated $102 million in FY 1993-94 and $262 million in FY 1994-95. The other major changes in GF/GP revenue will occur only in FY 1994-95. The amount the State pays to homeowners in homestead property tax credits will be decreased by an estimated $747 million due to the overall reduction in school property taxes. (The homestead property tax credit allows taxpayers to claim a credit against income tax liability for an amount by which their property taxes exceed a percentage of their household income; in general, persons may claim a credit equal to 60% of the amount by which their property taxes exceed 3.5% of their household income.) These savings, however, will be more than offset by the earmarking of 14.4% of gross income tax collections to the SAF beginning in FY 1994-95. This will reduce GF/GP revenue by an estimated $864 million in FY 1994-95. In total, GF/GP revenue will be reduced by an estimated $131 million in FY 1993-94 and $438 million in FY 1994-95. In addition, changes in the tax on tobacco products will generate additional revenue for State health-related programs, totalling a net $6 million in FY 1993-94 and $27 million in FY 1994-95.

D. THE STATE/LOCAL FUNDING SPLIT

The reform package substantially changes the financing of K-12 education in Michigan, increasing the share of revenue raised by the State and decreasing the reliance on property taxes as a revenue source. Table 5 on the following page illustrates these changes. When the effect of the property tax credit is excluded, the share of education revenues raised by the State is estimated to rise from 37.1% in 1993-94 to 80.0% in 1994-95. Local property taxes for school operating purposes, which provided 62.9% of education revenues in 1993-94, will be reduced. In 1994-95, these local taxes are estimated to be only 20.0% of total revenues. When both State and local property taxes are considered, the share of expenditures supported by property taxes is estimated at 30.5% in 1994-95.

Table 4

ESTIMATES OF STATE REVENUE IMPACT FROM SCHOOL FINANCE REFORM (PROPOSAL A) (millions)	FY 1993-94	FY 1994-95
SCHOOL AID FUND REVENUE IMPACT:		
Sales Tax Increase	$ 647	$1,630
Use Tax Increase	120	300
Exempt Residential Utilities Sales Tax Increase	(23)	(70)
Income Tax Earmarking	---	864
Real Estate Transfer Tax	---	109
Tobacco Tax Increase	100	349
Cigarette Tax on Sales Tax Base	1	13
Interstate Phone Tax	8	18
State Education Property Tax - 6 Mills	490	1,075
State Education Tax Captured by Tax Increment Financing	(6)	(14)
PA 198 Reinstatement	53	113
PA 198 Tax Captured by Tax Increment Financing	(15)	(33)
Total New School Aid Fund Revenues	**$1,374**	**$4,355**
GENERAL FUND/GENERAL PURPOSE IMPACT:		
Income Tax Decrease	(102)	(262)
Circuit Breaker Savings	---	747
Increased Renter's Credit	---	(40)
Income Tax Earmarking to SAF	---	(864)
Utility Property Tax Shortfall	(24)	(24)
Sales Tax on Cigarette Tax	1	3
Cigarette Tax Loss	(20)	(33)
Interstate Phone Tax	15	36
Total GF/GP Revenues	**$ (131)**	**$ (438)**
HEALTH-RELATED REVENUE IMPACT:		
Health and Safety Fund	(4)	(7)
New Health Fund	10	33
Total Health-Related Revenue Impact	**$ 6**	**$ 26**
NET STATE REVENUE IMPACT	**$1,249**	**$3,943**

Source: SFA and Consensus Revenue Estimates.

Table 5

ESTIMATED K-12 SCHOOL OPERATING REVENUES FROM STATE AND LOCAL SOURCES FOR LOCAL SCHOOL DISTRICTS AND INTERMEDIATE SCHOOL DISTRICTS (millions)

	Estimated FY 1993-94		Estimated FY 1994-95 After Proposal A	
	Amount	% of Total	Amount	% of Total
Local Revenue				
Property Taxes Retained by Local Districts	$6,175	62.9%	$2,053	20.1%
State Revenue				
State Education Property Tax	0.0	0.0%	1,061	10.3%
Other State Funds	3,644	37.1%	7,130	69.6%
Subtotal of State Revenue	3,644	37.1%	8,191	79.9%
Statewide Total Revenue*	$9,819	100.0%	$10,244	100.0%

* Excludes Federal funds, local revenues levied for capital projects, and transitional payments.

Source: SFA estimate.

E. MICHIGAN'S TAX STRUCTURE

Property Taxes

Property taxes are structured differently from state to state. In Michigan, all property that is subject to the general property tax is assessed at 50% of its true market value. While each piece of property is not physically inspected every year, each individual piece of property is reassessed annually based on studies of properties that have sold during the previous year in that particular area and whether any improvements were made to the property. When property owners receive notice of the new assessed value of their property, they may challenge that assessment if they believe it is incorrect. A property owner may appeal the assessment first to a local board of review and then, if the property owner is still not satisfied with the assessment, to the State Tax Tribunal.

The property tax liability is determined by multiplying the assessed value by the property tax rate. The property tax rate is expressed in mills. A mill is equal to $1 for every $1,000 of assessed value. Therefore, a property tax rate of 50 mills is equal to $50 for every $1,000 of assessed value.

Michigan's property tax structure is illustrated in Table 6. The homeowner's property is estimated to have a market value of $100,000 and its assessed value is equal to 50% of this, or $50,000. The total property tax rate is equal to 57 mills, which includes the property taxes assessed by all the taxing districts in whose jurisdiction this property is located, including the city (or village or township) and county governments, local school district, intermediate school district, and special districts such as ones for a community college or a public transportation authority. As a result, the property tax liability on this particular piece of property is $2,850 ($50,000 x .057).

Table 6

Example of Michigan's Property Tax Structure

House Market Value	$100,000
Assessed Value (50%)	50,000
Tax Rate	57 mills
Property Tax	$ 2,850

Changes to the Tax Structure

The various tax changes that comprise the reform in school financing made a significant impact on Michigan's overall tax structure. The major changes in taxes occurred in the sales/use, individual income, and property taxes. Table 7 on the following page compares the changes that were made in the relative burdens among these three major taxes. Basically, there was a major shift away from the property tax, a slight move away from the income tax, and a significant increase in the reliance on the sales/use tax as a revenue source.

Table 7

Michigan's State & Local Government Tax Burden Before and After School Finance Reform			
	Sales/Use Tax	Income Tax	Property Tax
Burden per $1,000 of Personal Income:			
Before Reform	$18.79	$26.74	$44.60
After Reform	28.18	25.58	30.89
Michigan Burden as % of U.S. Average Burden:			
Before Reform	69.7%	105.9%	128.9%
After Reform	103.3%	101.3%	89.3%
Michigan's State Rank:			
Before Reform	40	28	10
After Reform	21	29	29

Source: U.S. Department of Commerce, Bureau of the Census, Government Finances 1990-91 and SFA data.

Sales Tax Burden

Before school finance reform, Michigan had a relatively low reliance on the sales and use taxes as sources of revenue. Michigan's sales and use tax rates of 4% were the lowest among the 45 states that assess these taxes. In addition, over half of the states allow local governments, usually cities or counties, to impose their own sales tax, but Michigan does not. As a result, the Michigan sales tax burden, as measured by sales tax revenue per $1,000 of personal income, was 30.3% below the national average before school finance reform. It is estimated that the 50% increase in the sales and use tax rates under school finance reform will increase the Michigan sales tax burden to a level slightly above the national average.

Income Tax Burden

Michigan's individual income tax burden per $1,000 of personal income was about 6.0% above the national average based on 1991 data, which put Michigan 28th among the 42 states that have a broad-based income tax. It is estimated that the cut in the tax rate from 4.6% to 4.4% will lower Michigan's income tax burden to a level almost equal to the national average.

Property Tax Burden

Prior to school finance reform, Michigan's property tax burden was relatively high compared with most other states. According to 1991 Census data, Michigan's property tax burden, after adjusting for the homestead property tax credits paid by the State to eligible homeowners, was 28.9% above the national average. This put Michigan's property tax burden 10th highest among the states. It is estimated that the significant reductions in school property taxes that are part of the school finance reform will reduce Michigan's property tax burden below the national average by about 10.7%. This will place Michigan's property tax burden 29th among the states.

Overall Change in Taxes

Table 8 on the following page lists the various changes in taxes that are occurring under school finance reform. Public Act 145 of 1993 (Senate Bill 1) exempted all property from school property taxes. It is estimated this would have reduced gross property taxes by $7.0 billion or $6.1 billion after adjusting for the offset in lower property tax credits. The school finance reform plan approved by the voters in March 1994 increased a number of State taxes and created some new taxes, including a State education property tax and a State real estate transfer tax. In addition, some of the local school property taxes were reinstated. In total, the various tax changes that are part of school finance reform are expected to generate an estimated $5.5 billion in FY 1994-95. Compared with the original elimination of school property taxes, the net change in Michigan taxes is a reduction of $603 million.

This change in Michigan taxes also will have an impact on the Federal income tax liability paid by individuals who are able to itemize their deductions. Under the Federal income tax, state and local property taxes are an itemized deduction, but sales taxes are not. Under Michigan's school finance reform there is a shift away from the property tax to the sales tax. As a result of this tax shift, Michigan taxpayers will realize a reduction in their Federal itemized deductions, which will translate into higher taxable income. This will generate an increase in the Federal income tax paid by Michigan residents of an estimated $322 million. As a result, it is estimated that school finance reform will generate an overall net reduction in State, local, and Federal taxes of $281 million in FY 1994-95.

Table 8

School Finance Reform
Net Tax Impact - FY 1994-95
(millions)

TAX CUT UNDER P.A. 145 of 1993 (S.B. 1):	Total	Individuals	Business
Schools			
K-12	$5,915	$3,987	$1,928
Intermediate School Districts (ISD)	502	338	164
Industrial & Commercial Facilities Tax	143	0	143
Subtotal	6,560	4,325	2,235
State Government (Utility Property Tax)	100	0	100
Local Governments(Freeze & Ad. Fee)	167	110	57
Local Governments(TIF)	150	0	150
Gross Property Tax Cut	6,977	4,435	2,542
Property Tax Credit Offset	(850)	(850)	0
Net Property Tax Cut	$6,127	$3,585	$2,542
% Distribution		58.5%	41.5%
NEW REVENUE			
New State Revenues:			
Sales/Use Tax increase - 2%	$1,930	$1,351	$ 579
No Sales Tax increase on Residential Utilities	(70)	(70)	0
Income Tax Decrease - 4.6% to 4.4%	(262)	(262)	0
Real Estate Transfer Tax on All Property - 0.75%	109	76	33
Property Tax on All Property - 6 mills	1,075	710	366
Tobacco Tax Increase - 50 cents/pk	343	343	0
Sales Tax on Tobacco Tax	17	17	0
Interstate Telephone Use Tax	54	18	36
Property Tax Credit on Reinstated Prop. Tax	(113)	(113)	0
Renters' Property Tax Credit Increase	(40)	(40)	0
Industrial & Commercial Facilities Tax Reinstated	173	0	173
Utility Property Tax	76	0	76
	$3,292	$2,030	$1,262
Local Property Taxes:			
ISD Property Tax Reinstated	$ 503	$ 332	$ 171
Property Tax on Non-homesteads - 18 mills	1,312	315	997
Voted Holdharmless Mills for Schools	231	152	79
Industrial & Commercial Facilities Tax Reinstated	7	0	7
Local Gov't Property Tax - No Assessment Lag	102	67	35
Local School Taxes Captured By TIFs	55	7	48
Other (Collection Fee)	22	15	7
	$2,232	$888	$1,344
Total New Taxes	$5,524	$2,918	$2,606
% Distribution		52.8%	47.2%
Net Change In Taxes	($603)	($667)	$64
ADDENDUM:			
Senate Fiscal Agency estimate of net impact after change in Federal income tax			
Estimated Federal Income Tax Increase for Itemizers and Business	$322	$339	($17)
Net Tax Change After Federal Impact	($281)	($328)	$47

Source: SFA estimates and Consensus Revenue Estimates.

II. SCHOOL FINANCE REFORM

The following is a discussion of the constitutional and statutory provisions of the school finance reform package to date: This includes the amendments to the State Constitution embodied in Proposal A as approved by the voters on March 15, 1994; the statutory measures that took effect as a result of the approval of Proposal A; and statutory provisions that were adopted both before and after the approval of Proposal A to effect the reform package. (See Table 9 on page 18 for a listing of school finance reform legislation.)

A. STATE REVENUES

Sales and Use Tax Changes. By constitutional amendment, the sales and use taxes were increased from 4% to 6%, effective May 1, 1994; proceeds of the additional taxes are dedicated to the State School Aid Fund. The use tax is applied to interstate telephone communications; however, the 6% rate does not apply to 800 prefix services, international calls, private networks, or wide area telecommunications services. The additional 2% sales and use tax rate does not apply to residential use of electricity, natural or artificial gas, or home heating fuels. These changes in the sales and use taxes are expected to generate $767 million in FY 1993-94 and $1,914 million in FY 1994-95.

Income Tax Decrease. The income tax rate was decreased by 0.2% from 4.6% to 4.4% effective May 1, 1994. This will reduce State revenue by an estimated $102 million in FY 1993-94 and $262 million in FY 1994-95. Beginning October 1, 1994, 14.4% of gross income tax collections, before refunds, will be dedicated to the School Aid Fund. This will transfer an estimated $864 million from the General Fund to the School Aid Fund in FY 1994-95.

Real Estate Transfer Tax. A State real estate transfer tax was established at a rate of .75% of the value of property that is transferred. The tax will apply to the transfer of all real property not specifically exempted at the time of transfer. The tax will be effective January 1, 1995. The proceeds of the tax, which are estimated at $109 million in FY 1994-95, are dedicated to the School Aid Fund.

State Education Tax. Beginning in 1994, a State property tax of six mills will be imposed on all real and personal property currently subject to the general property tax. The revenue is dedicated to the School Aid Fund. Since the tax is a State tax, it is not subject to voter approval, although the revenue generated by the tax is subject to the State revenue limit. The tax will be collected under the provisions of the General Property Tax Act at the same time as other taxes levied by a school district for operating purposes. If a district is not going to levy a summer tax but had levied one in 1993, however, the local tax collecting unit must collect one half of the State education tax in the summer if it is collecting a tax for any taxing unit that summer. The State education tax is expected to generate $490 million in FY 1993-94 and $1,075 million in FY 1994-95.

Local treasurers are required to collect the State education tax and remit it to their respective county treasurers, who are required to account for and deliver the tax to the State.

Renter's Credit Increase/Homestead Credit. The share of rent considered to be property taxes paid was increased from 17% to 20%, providing a larger homestead property tax credit to renters. This change is expected to increase the property tax credits paid to renters by $40 million in FY 1994-95. No other provisions regarding the calculation of the homestead property tax credit were changed. Since the calculation of the credit is based in large part upon the amount of property taxes paid, and in most cases taxpayers will be paying lower property taxes, the credit will be reduced or become unavailable for many persons who previously claimed it. As a result, State payments to taxpayers for the credit will be reduced by an estimated $747 million in FY 1994-95.

Tobacco Tax Increase. Effective May 1, 1994, the tax on cigarettes of 12.5 mills (25 cents per pack) was repealed and a new tax of 37.5 mills (75 cents per pack) was imposed. Of the per-pack proceeds, 63.4% is credited to the School Aid Fund, 25.3% to the General Fund, 4% to the Health and Safety Fund, and 1.3% to local health departments; and 6% is dedicated to improving State residents' health care. In addition, a tax of 16% of the wholesale price is imposed on cigars, nonsmoking tobacco, and smokeless tobacco; all of the proceeds are credited to the School Aid Fund. The tax increase on cigarettes and the new tax on other tobacco products are expected to increase revenues by $343 million in FY 1994-95.

B. LOCAL REVENUES

1. Local School Operating Property Taxes

Nonhomestead Millage. A school district may levy with voter approval up to 18 mills or the number of local school operating mills levied in 1993, whichever is less, on nonhomestead property only. These funds are retained by the local school district to fund a portion of the foundation allowance. (For an explanation of the foundation allowance, see "The 1994-95 School Aid Act", on page 19.) An estimated $1,312 million will be generated by this local property tax on nonhomestead property in the 1994-95 school year.

Supplemental/Hold Harmless Millage. A school district with a foundation allowance above $6,500 per pupil in FY 1994-95 may, with voter approval, levy in 1994 the number of mills necessary to reach the 1994-95 foundation allowance. The revenue raised from hold harmless millage is retained locally to fund that portion of the foundation allowance above $6,500 per pupil. The mills are levied first on homestead and qualified agricultural property up to 18 mills or the number of school operating mills levied in 1993, whichever is less. Hold harmless millage authorized above that level is levied uniformly on all taxable property. The limit on the number of mills that may be levied on homestead and nonhomestead property in each district is determined by the Department of Treasury. An estimated $231 million will be raised by hold harmless property taxes in the 1994-95 school year.

Under current law, the 1994 hold harmless millage certified by the Department of Treasury becomes a limit on the hold harmless mills that may be levied in future years. A district may levy in future years the lesser of the millage the district is certified to levy in 1994, or the number of mills necessary to reach the lesser of either the dollar amount of increase in the basic foundation allowance or the percentage increase in the general price level.

Exemptions from levying hold harmless millage are provided for districts that had fewer than 350 pupils in 1993-94 or that need to levy less than 0.5 hold harmless mill to reach their foundation allowance.

Voter Approval of Nonhomestead and Hold Harmless Millage. A district with existing school operating millage that has not expired may use that authorization to levy the nonhomestead and hold harmless millage. A new vote must be held when the millage expires.

Enhancement Mills. For taxes levied in 1994 through 1996, a local school district may levy up to three mills for operating purposes if approved by the voters in an election held after 1993. This millage may be levied in addition to the nonhomestead millage and hold harmless millage used to fund the local share of the foundation allowance. Beginning in 1997, a regional enhancement property tax of up to three mills may be levied by an ISD, to enhance other State and local funding for local school operations, if approved by the voters in the ISD. A regional enhancement millage may be levied for up to 20 years, as specified in the ballot question; the question must be presented to the voters as a separate question. Revenue from an approved regional enhancement millage must be distributed to each school district in the ISD in proportion to the number of students in the local school district.

2. ISD Property Taxes

For 1994, intermediate school districts may levy property taxes for operating purposes, vocational-technical education, and special education up to the amount allocated or levied for that purpose in 1993. Beginning in 1995, for operating purposes, an ISD board may levy up to 1.5 times the number of mills that were allocated to it in 1993 for operating purposes; for special education purposes, an ISD board may levy up to 1.75 times the number of mills it was authorized to levy in 1993 for special education. Further, beginning in 1995, the number of mills an ISD may levy for vocational-technical programs will be one mill if the ISD did not levy millage for vocational-technical programs in 1993, and it obtains voter approval; if the ISD did levy millage for vocational-technical programs in 1993, it may levy up to 1.5 times the mills that were authorized for that purpose in 1993. Regarding millage for vocational-technical and special education, obtaining the approval of ISD electors will be required only after a previous authorization for such mills has expired. An ISD may not hold more than two elections in a calendar year concerning authorization of millage for special education or vocational-technical programs. Intermediate school district property taxes are expected to generate $503 million in the 1994-95 school year.

3. Allocated Mills

The Property Tax Limitation Act outlines the procedure to implement Article 9, Section 6 of the State Constitution, which provides that the total amount of general ad valorem taxes imposed on real and personal property in any one year may not exceed 15 mills, although the 15-mill limitation may be increased to 18 mills by a separate tax limitation vote of a county's electors. Pursuant to the Act, counties that levy 15 mills allocate them among local units through an allocation board, and counties authorized to levy up to 18 mills do so by separate tax limitations approved by a county's electors. Under the school finance reform package, the allocation of mills to a local school district is prohibited.

The number of mills that may be allocated within the 15-mill limit by a county tax allocation board, to local units other than local school districts, must be reduced by the number of mills in excess of the six mills levied under the State Education Tax Act as allocated to a local school district (other than mills allocated to the Detroit school district for the public library commission) for school operating purposes in 1993.

The number of mills allocated to a local school district under a separate tax limitation vote approved before 1994 must be reduced by the number of mills levied by the State. For a separate tax limitation vote held after 1993, the number of mills that may be allocated must be reduced by the number of mills allocated to a local school district for school district operating purposes in 1993 *or* the number of mills levied by the State, whichever is greater.

4. Community College District

The board of a school district operating a community college may levy taxes for operation of the college at a maximum rate equivalent to the mills authorized under the School Code in 1993 for operating the college. With voter approval, the school board may renew the millage and/or levy additional millage for the college's operation.

5. Sinking Funds

If approved by the voters, school districts may levy up to five mills for up to 20 years for the purpose of creating a sinking fund, to be used for the purchase of real estate for sites for, and the construction or repair of, school buildings. An audit of a school district's sinking fund, including a review of its uses, must be conducted annually, and the audit report must be sent to the Department of Treasury. If the Department determines that the fund has been used for a purpose other than those authorized, the school district must repay the amount misused to the sinking fund from the district's operating funds; the district may not levy a sinking fund tax after the Department makes a determination that the sinking fund was misused.

6. School District Libraries

Beginning in 1994, school districts are prohibited from levying a new millage to establish or maintain a public library, or renewing a current millage authorization for a library. Existing millages will remain in effect until they expire. The Department of Education reports that there are 15 districts currently that levy property taxes for a public library. Mills levied for the operation of a public library, in a district with an existing millage, are not considered school operating mills if the mills were not included in the operating millage reported by the district in 1993. Districts had the option, however, of whether to include or exclude library millage as part of their maximum authorized school operating millage.

7. Bonds

Beginning with bonds issued after May 1, 1994, a school district may borrow money and issue bonds to defray all or part of the costs of purchasing, erecting, completing, or renovating school buildings or other school facilities. The proceeds of bonds issued for these purposes may be used for capital expenditures and to pay for the cost of issuing the bonds, but may not be used for maintenance costs. Bonds for an asset with a useful life of less than 30 years may not be issued for a term that is longer than the life of the asset. A school district may not borrow money and issue notes or bonds to defray all or part of the costs of upgrades to operating system or application software; media, including diskettes, compact discs, video tapes, and disks, unless used for storage of initial operating system software or customized application software as permitted; and, training, maintenance, or upgrades of software support. Beginning with bonds issued after May 1, 1995, these bonds may not appreciate in principal amount or be sold at a discount rate of more than 10%. The board of a school district or intermediate school district may not contract for legal representation by an attorney or law firm in connection with borrowing money and issuing bonds unless it obtains from the attorney or law firm, before entering into a contract, disclosure of whether the attorney or law firm also represents the underwriter of the bonds or any party involved in the bond issue. If disclosure indicates such representation, a majority vote of a board is needed for entering into the contract.

8. Deficit Bonds

After January 1, 1994, a school district may not issue operating deficit bonds unless the deficit was created as a result of a tax tribunal order or a court order.

C. HOMESTEAD AND AGRICULTURAL PROPERTY EXEMPTIONS

"Homestead" and "qualified agricultural property" are exempt from school operating millage levies. This exemption does not apply to enhancement mills and hold harmless mills. "Homestead" is defined as that portion of a dwelling or unit in a multiple-unit dwelling subject to ad valorem taxes and owned and occupied as a "principal residence" by an "owner" of the dwelling or unit. It also includes all of an owner's unoccupied property classified as residential that is adjoining or contiguous to the dwelling; contiguity is not considered broken by a road or right-of-way. The term includes any portion of a principal residence rented or leased to another person as a residence, as long as that portion is less than 50% of the total square footage of living space in the residence. The term also applies to a life care facility registered under the Living Care Disclosure Act and property owned by a cooperative housing corporation and occupied as a principal residence by tenant stockholders.

The term "owner" applies to a person who owns property or is purchasing property under a land contract; a partial owner of property; an owner as a result of being a beneficiary of a will or trust or as a result of intestate succession; a person who owns or is purchasing a dwelling on leased land; a person holding a life lease in property previously sold or transferred to another; and a grantor who has placed the property in a revocable trust or a qualified personal residence trust.

"Principal residence" means the one place where a person has his or her true, fixed, and permanent home to which, whenever absent, he or she intends to return and that will continue as a principal residence until another principal residence is established.

"Qualified agricultural property" is unoccupied property and related buildings classified as agricultural, or other unoccupied property and related buildings devoted primarily to agricultural use. Related buildings include a residence occupied by a person employed in or actively involved in the agricultural use, provided that the person does not claim a homestead exemption on other property. Property used for commercial storage, processing, distribution, marketing, or shipping operations, or other commercial or industrial purposes is not considered qualified agricultural property. A parcel of property is considered to be devoted primarily to agricultural use only if more than 50% of the parcel's acreage is devoted to agricultural use. An owner may not receive an exemption for that portion of the total State equalized valuation of property that is used for a commercial or industrial purpose, or that is a residence not considered a related building.

As provided in the General Property Tax Act, the reform package contains an extensive, detailed process under which the owner of a homestead or qualified agricultural property obtains or is granted an exemption from local school operating property taxes. In short, the owner of a homestead must file an affidavit by May 1 with the local tax collecting unit where the property is located. (A husband and wife filing a joint Michigan income tax return are entitled to only one homestead exemption.) A new claim of exemption must be filed in 1999 and every four years thereafter. For 1994, a person who did not file for an exemption may claim an exemption by mail or in person with the July or December board of review in the local unit. Also for 1994, a partial exemption is permitted for owners who acquired a homestead after April 29; they must have filed by October 1. The owner of property classified as agricultural does not have to file an affidavit unless requested to do so by the local assessor. The local assessor has to determine if agricultural property qualifies for an exemption. For property not classified as agricultural, an owner must file a claim for a qualified agricultural property exemption by May 1. As with homesteads, a new claim will have to be filed in 1999 and every four years thereafter. Further, in 1994, an owner may claim an exemption for agricultural property at the July or December board of review.

Regarding a claim for a homestead exemption, the Department of Treasury is required to determine if property is the homestead of the owner claiming the exemption. The Department may review the validity of exemptions in the current year and for the three immediately preceding calendar years. If the Department determines that the property is not the owner's homestead, it must send a notice of the determination to the owner and to the local unit stating its reasons, and notify the owner of the right to appeal. The Department may issue a notice denying a claim if an owner fails to respond within 30 days of receipt of a request for information. An appeal to the Department must be conducted according to the provisions for an informal conference found in the Revenue Act.

When notified by the Department of a denial of a claim, a local assessor must remove the exemption and either correct the current tax roll or place on the next tax roll previously unpaid taxes with interest and penalties. No interest or penalties may be assessed for any period before February 14, 1995.

Property owners and assessors may appeal a final Department decision to the Residential and Small Claims Division of the Michigan Tax Tribunal within 35 days of the decision. An owner does not have to pay the taxes in dispute in order to appeal or receive a final determination; however, interest and penalties will accrue and be computed based on the interest and penalties that would have accrued from the date the taxes were originally levied as if there had been no exemption.

D. OTHER ISSUES

Assessment Limit. The changes in the State Constitution approved by the voters on March 15, 1994, included a limit on annual assessment increases. For 1995 and thereafter, annual assessment increases on each parcel of property (adjusted for additions and losses) will be limited to the lesser of 5% or the rate of inflation. When property is subsequently transferred (as defined by law), the assessed value will revert to 50% of true cash value.

School Operating Tax Increases. The Constitution now requires the approval of three-quarters of the members elected to and serving in the Senate and House of Representatives for a law that increases the statutory limits, in effect on February 1, 1994, on the maximum amount of local property taxes that may be levied for school operating purposes.

Funding Guarantee. The State is required to guarantee that total State and local per pupil revenue for school operating purposes for each local school district (adjusted for consolidations, annexations, or other boundary changes) is not less than a local district's 1994-95 total State and local per pupil school operating revenue. The guarantee will not apply in a year in which a local school district levies a millage rate for school operating purposes less than it levied in 1994 (unless the lower rate is due to a Headlee rollback). The guarantee is required by the Constitution.

Tax Increment Financing. The school finance reform package allows tax increment finance authorities, downtown development authorities, and local development financing authorities to capture local school taxes and the State education tax for eligible obligations and eligible advances (incurred or made before August 19, 1993) and other protected obligations (generally, for projects that were in a plan approved before August 19, 1993). School taxes may be captured in the amount necessary to repay these advances and obligations before the capture of tax revenue from nonschool sources. An estimated $108 million of school property taxes levied in 1994 will be captured.

If the total amount of captured revenue is insufficient to repay eligible advances or pay eligible obligations, the State is required to make up the amount that would have been captured under the former system.

Plant Rehabilitation and Industrial Facility (PA 198) Abatement. Under the school finance reform package, the industrial facility tax for a new facility that received an exemption before 1994 is to be based on one half of the mills levied in 1993 for school operating purposes, and one half of the mills levied for other purposes; these facilities, therefore, will not experience a tax cut. The reform package made no change in the calculation of the industrial facility tax for a replacement facility that received a tax exemption certificate before 1994.

For exemptions effective after 1993, the industrial facility tax for new facilities is one half of the mills levied by all taxing units other than mills levied under the State Education Tax Act, plus the six-mill State education tax. The State Treasurer may grant a 50% or 100% abatement on the State education tax, however, if the Treasurer finds that an abatement is necessary to reduce unemployment, promote economic growth, and increase capital investment in the State. There is no change for replacement facilities receiving exemptions after 1993.

Industrial Park/Commercial Facilities Tax. The technology park facilities tax and the commercial facilities tax are to be calculated by adding one half of the mills levied in a year by all taxing units, other than mills levied for school operating purposes or for the State education tax, plus one half of the mills levied for school operating purposes in 1993.

Table 9

SCHOOL FINANCE REFORM		
Bill	1993 Public Act	Issue
S.J.R. S		● Sales and use tax increase ● Assessment limit ● School operating tax increase ● Funding guarantee
H.B. 4279	P.A. 312	● School Code: ISD & school district property taxes
H.B. 5009	P.A. 322	● Tax increment finance authorities
H.B. 5010	P.A. 323	● Downtown development authorities
H.B. 5097	P.A. 324	● Iron ore tax
H.B. 5102	P.A. 325	● Sales tax increase
H.B. 5103	P.A. 326	● Use tax increase ● Interstate telephone tax
H.B. 5104	P.A. 327	● Tobacco tax
H.B. 5106	P.A. 328	● Income tax ● Renter's credit
H.B. 5110	P.A. 330	● Real estate transfer tax
H.B. 5111	P.A. 331	● State education tax
H.B. 5112	P.A. 314	● Property tax allocation to school districts
H.B. 5115	P.A. 313	● Summer property taxes
H.B. 5116	P.A. 332	● Tax on railroad, telephone, and telegraph property
H.B. 5118	P.A. 333	● Local development finance authorities
H.B. 5120	P.A. 334	● Industrial facilities tax abatement
H.B. 5123	P.A. 336	● State School Aid Act
H.B. 5129	P.A. 338	● Technology park facilities tax
H.B. 5224	P.A. 340	● Commercial facilities tax
	1994 Public Act	
S.B. 999	P.A. 3	● Real estate transfer tax reduction
H.B. 5340	P.A. 30	● Homestead exemption filing deadline
H.B. 5308	P.A. 111	● Sales tax: residential utility exemption
S.B. 164	P.A. 278	● School bonds
S.B. 1123	P.A. 187	● State education tax: summer levy
S.B. 882	P.A. 189	● Delinquent education property taxes ● Millage rate ballot questions
S.B. 1153	P.A. 190	● Allocated mills
H.B. 4284	P.A. 280	● Downtown development authorities
H.B. 4285	P.A. 281	● Tax increment finance authorities
H.B. 4286	P.A. 282	● Local development finance authorities
H.B. 4567	P.A. 266	● Tax abatements: plant rehabilitation and industrial facilities
H.B. 5018	P.A. 253	● General property tax amendments
H.B. 5313	P.A. 254	● Tax Tribunal: homestead exemption appeal
H.B. 5329	P.A. 136	● School Code: homestead and agricultural property exemption
H.B. 5341	P.A. 224	● Real estate transfer tax
H.B. 5345	P.A. 237	● Property Tax Act: homestead and agricultural property exemption
H.B. 5445	P.A. 258	● ISD millages/Hold harmless mills
H.B. 5463	P.A. 283	● School aid

III. THE FY 1994-95 SCHOOL AID ACT

The school finance reforms made a major change in the way State aid will be distributed to local school districts. The tax effort equalization formula was eliminated and replaced with a new foundation allowance approach to school funding. While some categorical payments will continue for programs such as special education, most district revenue will come from the foundation allowance.

This section discusses the foundation allowance, how it is determined and how it is funded, and the major appropriations of the FY 1994-95 School Aid Act, based on Public Act 336 of 1993 and Public Act 283 of 1994.

A. THE FOUNDATION ALLOWANCE

The foundation allowance is a per-pupil revenue amount that a district may receive. It is funded from a combination of limited local property tax revenues and State aid. The foundation allowance per pupil is calculated for each district based on a formula in the School Aid Act. The starting point is the amount of eligible base revenue that a district received per pupil in the 1993-94 school year. Generally, base revenue includes local school operating revenues, State formula aid payments, State retirement payments made on behalf of local districts, and revenue for certain categorical programs. The base amount is then increased as permitted by law to determine the foundation allowance for FY 1994-95.

For a district with base revenue of less than $4,200 per pupil, the FY 1994-95 foundation allowance is the base revenue plus $250 or $4,200 per pupil, whichever is greater. For a district with base revenue of more than $6,500 per pupil, the foundation allowance is the base revenue plus $160. The foundation allowance for districts with base revenue above $4,200 and less than $6,500 is determined by the following formula:

$$\begin{array}{c}\text{Foundation}\\ \text{Allowance}\\ \text{Per Pupil}\end{array} = \begin{array}{c}\text{Base}\\ \text{Revenue}\\ \text{Per Pupil}\end{array} + \$250 - \left[\$90 \times \frac{(\text{Base Revenue Per Pupil} - \$4{,}200)}{\$2{,}300}\right]$$

The allowable increase declines as base revenue per pupil increases. For a district with a $4,200 base, the $250 increase per pupil represents a 4% increase from base revenue to the foundation allowance. At $6,500 per pupil, the $160 increase is a 2.5% change from base revenue to the foundation allowance. The percentage increase is smaller for districts above $6,500 per pupil, which are limited to the $160 per pupil increase.

1. Financing the Foundation Allowance

The foundation allowance is funded from a combination of State aid and local property tax revenue. In order to receive the full foundation allowance, a district must levy local school operating millage on nonhomestead property of 18 mills or the number of school operating mills levied in 1993, whichever is less. For districts with a foundation above $6,500 per pupil, all revenue above $6,500 per pupil must be raised locally through additional millages known as supplemental or hold harmless mills. The first 18 mills of hold harmless millage are levied on homestead and qualified agricultural property only. Hold harmless millage in excess of 18 mills is levied uniformly on all property subject to taxation. The local school operating millages, including hold harmless millage, that may be levied are calculated by the Department of Treasury and certified to each school district. Exemptions from levying hold harmless millage are provided for districts that had fewer than 350 pupils in 1993-94 or that need to levy less than 0.5 hold harmless mill to reach their foundation allowance. Districts eligible for these exemptions will receive a State payment for the amount of hold harmless revenue needed.

The State share of the foundation allowance is calculated differently for districts above and below $6,500 per pupil. For districts with a foundation allowance of $6,500 or less in FY 1994-95, the State payment is the difference between the foundation allowance and the local revenue on 18 mills levied on nonhomestead property or the number of mills levied in 1993, whichever is less. For districts with a foundation allowance of more than $6,500 in FY 1994-95, the State payment per pupil is the difference between $6,500 and the local revenue on 18 mills on nonhomestead property (or the number of mills levied in 1993, whichever is less). In a district where some school operating property taxes on the 18 nonhomestead mills are captured by a tax increment financing district with eligible protected obligations, the State payment per pupil increases by the amount of the captured revenue per pupil. If a district does not levy the 18 nonhomestead mills, the State payment is unchanged and the district does not receive the entire foundation allowance. Table 10 shows examples of how the foundation allowance works. Table 11 on the following page explains the millage rates that would be necessary to finance the foundation allowances in Table 10.

Table 10

THE STATE AND LOCAL SHARE OF THE FOUNDATION ALLOWANCE FOR SAMPLE SCHOOL DISTRICTS
FY 1994-95
(amounts per pupil)

District	(a) 1993-94 Blended Base Revenue	(b) 1994-95 Foundation Allowance	(c) Nonhomestead SEV Per Pupil	(d) Local Revenue on 18 Mills .018x (c)	(e) State Share of Foundation Allowance[1]	(f) Local Hold Harmless Revenue Needed[2]	(g) Total Local Revenue Needed (d) + (f)
A	$ 3,850	$ 4,200	$ 25,000	$ 450	$ 3,750	$ 0	$ 450
B	5,100	5,315	80,000	1,440	3,875	0	1,440
C	7,000	7,160	40,000	720	5,780	660	1,380
D	9,800	9,960	150,000	2,700	3,800	3,460	6,160

[1] The foundation allowance or $6,500 whichever is less, minus the local revenue on 18 mills.
[2] For districts with a foundation allowance above $6,500, the foundation allowance less $6,500.

Table 11

LOCAL SCHOOL OPERATING MILLAGE RATES FOR SAMPLE SCHOOL DISTRICTS FY 1994-95								
					Hold Harmless Millage		Total Local Millage	
District	1994-95 Foundation Allowance Per Pupil	Nonhomestead SEV Per Pupil	Homestead SEV Per Pupil	Local Hold Harmless Revenue Needed Per Pupil	Homestead Property	Nonhomestead Property	Homestead Property	Nonhomestead Property
A	$ 4,200	$ 25,000	$ 50,000	$ 0	0.00	0.00	0.00	18.00
B	5,315	80,000	30,000	0	0.00	0.00	0.00	18.00
C	7,160	40,000	160,000	660	4.12	0.00	4.12	18.00
D	9,960	150,000	100,000	3,460	24.64	6.64	24.64	24.64
NOTE: The State 6.0 mill education property tax will be paid on all taxable property in addition to the local millage rates shown in the table.								

The total revenue a district may receive from the foundation allowance in FY 1994-95 is determined by multiplying the foundation allowance per pupil by the average of the district's pupils in the February 1994 supplemental pupil count and the October 1994 pupil count.

2. The Foundation Allowance in Future Years

The School Aid Act provides for a basic foundation allowance of $5,000 per pupil in FY 1994-95. This amount is a reference figure for determining the foundation allowance of districts beginning in FY 1995-96. Under current law, the basic foundation allowance will be adjusted each year according to an index of per pupil revenue growth in the State School Aid Fund. The foundation allowance of districts with a foundation allowance lower than the basic foundation allowance is intended to grow at a faster rate than the foundation allowance of districts above that level, until all districts have a foundation allowance of at least the amount of the adjusted basic foundation allowance. As currently structured, the foundation allowance of districts above the basic foundation level will grow each year by the dollar amount of increase in the basic foundation allowance.

3. Eligible Base Revenue

Base revenue per pupil is calculated for FY 1992-93 and FY 1993-94. If base revenue declined in FY 1993-94, then the average of the two figures or the "blended base" is used to determine the foundation allowance. Otherwise, the FY 1993-94 base revenue is the figure used in the foundation calculation.

Base revenue includes local school operating revenues and State aid payments for formula aid and those categorical programs for which funding will now be made through the foundation allowance, that is, the "rolled-up" categoricals. The former State social security payment to local districts is among the categorical programs included in base revenue. Also included in the base revenue are State aid payments made on behalf of local districts. Thus, the amount of retirement payments made by the State on behalf of local districts to the Public School Employees Retirement Fund is built into base revenue.

Specifically, eligible base revenue consists of all of the following:

(1) Local school operating revenue.

(2) State aid paid to or on behalf of a district, except for certain programs that are excluded from base revenue by law.

(3) Expenditures from fund equity as provided for in a district's local school board-adopted budget as of December 31, 1993, up to a statewide total of $200,000,000. The total of fund equity expenditures will be prorated to the $200,000,000 total on an equal percentage basis.

(4) Specific taxes levied and retained by a district, up to a statewide total of $85,000,000.

(5) Transportation expenditures paid to an ISD for transportation provided to a local district by the ISD.

(6) 50% of gifted and talented funding paid to ISDs for services provided to local districts (adjusted for recapture, if applicable).

The School Aid Act provides that base revenue includes all State payments except for those payments specifically excluded. Many of the programs excluded from the base continue as separately funded categoricals. Other programs are partially included in the base and partially excluded.

The following programs are excluded from base revenue and continue as separately funded categoricals:

- Early Childhood
- Special Education
- Special Education Transportation
- Economic Development Job Training Grants
- Education Designed for Gainful Employment (EDGE)
- Adult Education
- Bilingual Education
- Math and Science Centers
- Costs of Court-Ordered Desegregation
- Professional Development
- Gifted and Talented (50% is excluded from the base.)
- Court-Placed Pupils (Categorical funding continues for pupils placed by the court in a juvenile detention facility or child caring institution with an on-grounds education program; funding for court-placed pupils attending a local district or ISD is included in base revenue.)
- Vocational Education (except for a district that served as the fiscal agency for a vocational education consortium in 1993-94)
- For employees of center programs operated by a local school district for an ISD, social security and retirement payments made by the State for local district employees providing direct services for the ISD
- Compensatory Education payments for districts with base revenue of $6,500 or less per pupil in 1993-94 (These districts will be eligible to apply for payments from the expanded at-risk program in FY 1994-95.)

Other payments excluded from the base include the airbase closure revenue guarantee, model schools, repayment of tax base sharing funds, and transition payments. For districts with an increase in the recapture deduction from 1992-93 to 1993-94, 50% of the amount of the increase is excluded from the base. Finally, certain adjustments are excluded from the calculation of base revenue: the Federal impact aid deduction, short school year deduction, and the penalty for providing cars to school board members.

The total of eligible base revenues is divided by the pupil count as of the pupil membership count day (in 1993, the fourth Friday after Labor Day) to determine base revenue per pupil.

B. MAJOR FY 1994-95 SCHOOL AID ACT APPROPRIATIONS

Foundation Allowance. An appropriation of $7.23 billion in FY 1994-95 was made for funding the State cost of the foundation allowance and payments to public school academies. If the actual cost of the foundation allowance turns out to be less than the amount appropriated, the savings will be carried forward in the School Aid Fund. If the State cost of the foundation allowance finally is greater than the amount appropriated, then the School Aid Act provides for a proration of State payments for the foundation allowance.

At-Risk Program. The Compensatory Education categorical funding for at-risk pupils will increase from $23,520,000 in FY 1993-94 to $230,000,000 in FY 1994-95 for the expanded at-risk program. A district with a foundation allowance of less than $6,500 in FY 1994-95 is eligible to receive additional funding of 11.5% of its foundation allowance for each pupil who meets the income eligibility requirements for free lunch. The funds may be used to provide instructional programs and direct noninstructional services such as medical or counseling services for at-risk pupils. In addition, for districts or public school academies offering a school breakfast program, up to $10 per pupil of at-risk funds is to be used to operate the breakfast program. At-risk pupils eligible for the programs funded by this program are defined as those for whom the district has documentation that the pupil meets two of the following criteria:

- Is a victim of child abuse or neglect
- Is below grade level in English language and communication skills
- Is a pregnant teenager or teenage parent
- Is eligible for a Federal free or reduced-price lunch subsidy
- Has atypical attendance or behavior patterns
- Has a family history of school failure, incarceration, or substance abuse

For pupils who have a Michigan Education Assessment Program (MEAP) test result, the at-risk definition also includes a pupil who received less than category 2 on the most recent MEAP reading test, or met less than 50% of the math or science objectives, on the most recent MEAP test results for the pupil.

Early Childhood. Funding for early childhood/school readiness programs will increase from $27,564,700 in FY 1993-94 to $42,564,700 in FY 1994-95 and the payment per eligible child will increase from $2,500 to $3,000.

Professional Development. Funding for professional development of teachers will increase from $1,872,000 in FY 1993-94 to $10,000,000 in FY 1994-95. The money will be distributed as follows: $6,500,000 to districts on a per-pupil basis, with each district receiving the same amount per pupil; $1,500,000 to ISDs on a per-pupil basis, for each pupil in membership in the

ISD or a constituent district; and $2,000,000 to the Department of Education for statewide professional development initiatives.

Transitional Payments. In order to assist school districts with cash flow early in the school fiscal year, transitional payments of $800,000,000 for local school districts and $32,700,000 for ISDs were provided in FY 1993-94. Corresponding State school aid deductions will be made in FY 1994-95 so the districts will not have an increase in total revenue during their fiscal year due to the transitional payments.

The transitional payments to local districts were made on an equal per-pupil basis with payments of $200,000,000 in July 1994, $300,000,000 in August 1994, and $300,000,000 in September 1994. The ISD transitional payments were calculated as 3.33% of the ISD total operating millage for special education, vocational education, and general operating purposes. These payments were made in August and September 1994. The State aid deduction of the local district and ISD amounts will be made equally from payments in April, May, and June 1995. Transitional payments of $300,000,000 in August 1995 and $300,000,000 in September 1995 also have been appropriated for local districts. The local school district transitional payment schedule is illustrated in Table 12.

Table 12

ACCELERATED STATE PAYMENTS TO LOCAL SCHOOL DISTRICTS
IMPACT ON STATE AND SCHOOL FISCAL YEARS
(payments in millions)

State FY: Quarter	94:4	95:1	95:2	95:3	95:4
Cumulative Effect—State FY	+800 (end of State FY)	0	0	-800	-200 (end of State FY)
Payment/Deduction Schedule	July Aug. Sept. +200 +300 +300	Oct. Nov. Dec.	Jan. Feb. Mar.	Apr. May June -266.7 -266.7 -266.7	July Aug. Sept. +300 +300
School FY: Quarter	95:1	95:2	95:3	95:4	96:1
Cumulative Effect—School FY	+800	+800	+800	0 (end of school FY)	+600

Intermediate School Districts. The ISD general formula will be retained at the FY 1993-94 funding level of $22,950,000. In addition, block grant funding of $6,762,000 in FY 1994-95 was provided, replacing separate categorical funding for the following categorical programs which formerly were paid separately: School District Consolidation, Technologically Enhanced Curricula Choices (TEC Choices) Grants, Dropout Prevention, Alternative Juvenile Rehabilitation, Media Centers, ISD Schools of Choice, School Age Parents, and School Improvement Grants.

Math and Science Centers. Funding for Math and Science Centers was increased from $2,850,000 in FY 1993-94 to $6,240,000 in FY 1994-95.

IV. EDUCATION REFORM IN MICHIGAN

The K-12 education reform component of the school finance reform package contains a number of measures designed to improve the State's educational system. Among the recent changes are those pertaining to core curricula, pupil performance standards, endorsed diplomas, hours of pupil instruction, and school improvement plans. In addition, this component of the package provides for the establishment of public school academies. The following document compares education improvement issues prior to and after the enactment of recent education reform legislation. (See Table 13 on page 32 for a listing of education reform legislation.)

CORE CURRICULUM

Pre-reform: Under the School Code, to be eligible for an additional $25 per pupil in State aid, a school district must make available a core curriculum developed and recommended by the State Board of Education. A district's core curriculum may vary from the State Board's model core curriculum, however. A district must phase in the core curriculum by adopting one curricular area of the core curriculum in 1991-92, two curricular areas in 1992-93, and one additional area in 1993-94 and each succeeding State fiscal year until a core curriculum is made available in all curricular areas.

Reform: The tie-in with State aid is deleted, but a district is required to make available a core curriculum in order to be accredited. The recommended core curriculum must be "academic" and must set forth learning objectives in math, science, reading, history, geography, economics, and American government. Until the 1997-98 school year, schools may continue to vary their core curriculum from the State's recommended curriculum. By September 1, 1994, the State Board must develop and submit for public hearing proposed rules establishing a required core academic curriculum for all school districts. Beginning with the 1997-98 school year, a school district must provide the core academic curriculum developed by the State Board.

PUPIL PERFORMANCE STANDARDS

Pre-reform: Not in the School Code.

Reform: Under new provisions in the School Code, by December 31, 1995, the State Board with the assistance of the Academic Performance Standards Committee, will have to recommend pupil performance standards to measure achievement of the academic outcomes specified in the State Board model core academic curriculum, including standards for mathematics, science, and communication arts. By July 1, 1996, a school district will have to consider these standards as an essential basis for assessing subject matter competency of students and for promoting pupils to another level. Beginning July 1, 1997, a school board that wants its schools to be accredited will have to establish performance standards, which may vary from the State Board's standards.

ENDORSED HIGH SCHOOL DIPLOMA

Pre-reform: Under the 1993-94 School Aid Act, a school district must grant a State-endorsed diploma in order to receive State aid.

Reform: The 1994-95 School Aid Act continues the requirements for granting State-endorsed diplomas. These requirements are repeated in the School Code with provisions made for granting novice level scores, ensuring that assessment instruments are outcome based, and allowing any person to take a test to receive a State-endorsed diploma. Specifically, for pupils scheduled to graduate in 1994, 1995, or 1996, a pupil must pass State or local proficiency tests, be eligible to take the general education development test, or meet certain objectives on the Michigan Educational Assessment Program (MEAP) test. Beginning with pupils scheduled to graduate in 1997, if academic outcomes are achieved in the areas of communication skills, mathematics, science, and, beginning in 1999, social studies, a pupil's school district must award a State endorsement in each subject area in which the required proficiency has been demonstrated. A school district may award a high school diploma to a pupil who completes local district requirements, regardless of whether the pupil is eligible for any State endorsement. Beginning in 1995, upon payment of a reasonable fee, any person may take a State-endorsed diploma test.

EXTENDED SCHOOL YEAR

Pre-reform: The School Code and the 1993-94 School Aid Act require school districts to provide 180 days and 900 hours of instruction. Under the School Aid Act, districts may apply for one-year grants to plan for and implement the operation of an extended school year of at least 990 class hours and 200 days of instruction.

Reform: The School Code requires that there be a minimum of 900 hours of pupil instruction in the 1994-95 school year, 990 in the 1995-96 and 1996-97 school years, 1,035 in the 1997-98 and 1998-99 school years, and 1,080 in the 1999-2000 and succeeding school years. The 1994-95 School Aid Act specifies that these requirements apply to grades 1 to 12 and that, beginning in 1995-96, a full-time membership for kindergarten pupils is equal to one-half of the number of hours required for grades 1 through 12. Districts will forfeit a portion of State aid for failure to comply with either the minimum days or hours requirements. The Code also expresses an intent that districts consider extending the number of instructional days by two days per year so that by the 2009-10 school year the number of instructional days will be at least 210.

SCHOOL IMPROVEMENT PLAN

Pre-reform: A school board that wants all of its schools to be accredited under the School Code or to become eligible for additional State aid for quality programs must adopt and implement a three- to five-year school improvement plan, as outlined in the Code.

Reform: To become accredited, the Code requires a school board to adopt and implement, by September 1 each year, a three- to five-year school improvement plan, if the board wants all of the schools in the district to be accredited. Beginning in 1994, the board of an intermediate school district, by September 1 each year, must adopt and implement a three- to five-year ISD school improvement plan and continuing school improvement process for the district. An improvement plan will have to include a plan for addressing classroom needs and improvements, assurance that pupils have access to all programs offered by the ISD, a plan for teacher professional development, ways to make available opportunities for on-the-job learning, coordination of services with other existing State and local human services agencies, long-range cost containment measures, and specific recommendations on consolidation or enhanced interdistrict cooperation. By April 1, 1994, the State Board of Education must revise its existing criteria for school improvement plans to ensure that plans include at least: identification of education and skills needed by graduates, a determination of whether the existing curriculum is providing these skills, and the availability of apprenticeships and internships combined with classroom instruction.

AT-RISK STUDENTS

Pre-reform: The 1993-94 School Aid Act allocates $23,520,000 to enable eligible districts to establish or continue compensatory education programs for at-risk students enrolled in grades K-10. The Act also allocates $27,564,700 for 1993-94 for eligible districts to develop or expand early childhood compensatory education programs to improve the readiness and achievement of educationally disadvantaged children who are at least four and less than five years of age on December 1 of the school year in which the program is offered.

Reform: The 1994-95 School Aid Act provides $230,000,000 for eligible school districts and public school academies to provide additional services for at-risk students. The School Code requires a school district, beginning in 1994, to provide special assistance to students who are eligible for Chapter I Federal funds (a Federal program for low income families). The 1994-95 School Aid Act allocates $42,564,700 for school readiness grants in 1994-95 for educationally disadvantaged children.

COLLEGE/HIGH SCHOOL CREDIT

Pre-reform: The 1993-94 School Aid Act requires local districts to provide tuition and fee support for eligible 12th grade students attending degree-granting post-secondary institutions.

Reform: The School Code permits a State university, independent college or university, or community college to conduct, at a school district's facilities, courses for which a pupil may receive college and high school credit. The 1994-95 School Aid Act continues provisions regarding tuition and fee support for dual enrollment.

INSTRUCTION IN COMMUNICABLE DISEASES

Pre-reform: The School Code requires that the principal modes by which dangerous communicable diseases are spread and the best methods for restricting and preventing these diseases be taught in every public school.

Reform: This instruction must include the teaching of abstinence from sex as a responsible method of preventing an unwanted pregnancy, for restricting and preventing these diseases, and as a positive lifestyle for unmarried young people.

MULTICULTURAL EDUCATION

Pre-reform: The School Code permits the State Board to develop guidelines for expanding existing school curricula to include materials on the culture of ethnic, religious, and racial minority peoples, and the contributions of women. These guidelines must be made available for grades K-12 in every public or nonpublic school.

Reform: By the 1995-96 school year, a school district may implement a curriculum ensuring multicultural education in all grade levels, including studies on the culture and contributions of African-Americans, Native-Americans, and Asian-Americans.

GENDER EQUITY ISSUES

Pre-reform: The 1993-94 School Aid Act requires that in developing an annual education report, a district desegregate data by gender and race.

Reform: The 1994-95 School Aid Act and the School Code require that data for an annual education report be disaggregated by gender.

SITE-BASED DECISION-MAKING

Pre-reform: Not in the School Code.

Reform: A school district must ensure that decisions made at the school-building level are made using site-based decision-making that includes the participation of teachers, administrators, parents, pupils, and others in the school community.

FOURTH, SEVENTH GRADE READING LEVELS

Pre-reform: Not in the School Code.

Reform: Under new provisions in the School Code, a pupil who does not score satisfactorily on the fourth or seventh grade MEAP reading test must be provided special assistance to enable the pupil to bring his or her reading skills to grade level within 12 months. (This requirement does not apply to special education pupils, pupils having a learning disability, and pupils with extenuating circumstances as determined by school officials.)

COURSE CREDIT

Pre-reform: Not in the School Code.

Reform: New provisions in the School Code require a school district to grant high school credit to a high school pupil who is not enrolled in a course but who has attained a grade of at least "C+" in a final exam or exhibited mastery through the basic assessment used in the course. A local school board must determine whether credit granted under this provision may or may not be counted toward graduation.

STUDENT PORTFOLIO

Pre-reform: The 1993-94 School Aid Act requires a district to provide and maintain a student portfolio, as prescribed in the Act, until a pupil leaves high school. The portfolio is required for students who began high school in 1992-93, students starting ninth grade in 1993-94, and, beginning in 1994-95, pupils starting eighth grade.

Reform: Provisions of the 1993-94 School Aid Act are continued and repeated in the School Code. The Code also requires written consent to be obtained before information in a portfolio is released.

SUMMARY ACCREDITATION

Pre-reform: The School Code provides for the accreditation of schools. The 1993-94 School Aid Act provides funding to implement accreditation.

Reform: Summary accreditation is added to the Code's accreditation provisions. The Department of Education is required to develop and distribute standards for determining if a school is eligible for summary accreditation, in which a school does not have to undergo a full building-level evaluation. A school that does not meet the standards but is making progress toward them will be in interim status and subject to a building-level evaluation. If a school is neither accredited nor in interim status, it is unaccredited and subject to certain measures, including closure.

MICHIGAN INFORMATION NETWORK

Pre-reform: Under the School Code, a school district may establish a district library media center to house a library media program that, among other things, provides library media services to students through delivery systems using computers, telecommunications, and interactive technology.

Reform: By June 30, 1995, the Department of Management and Budget will have to prepare a State plan for the creation of a Michigan Information Network to link electronically school districts, higher educational institutions, and State and local libraries.

SEXUAL HARASSMENT

Pre-reform: Not in the School Code.

Reform: Under new provisions in the School Code, by January 1, 1995, a school board will have to adopt and implement a written policy to prohibit and penalize sexual harassment by school district employees, board members, and pupils.

PROFESSIONAL DEVELOPMENT

Pre-reform: The 1993-94 School Aid Act allocates $1,872,000 for grants for professional development programs. A three-year plan prioritizing the use of these grants may include identifying needs in the following areas: management training for administrators, using assessment results, working with special needs pupils, upgrading teaching skills, implementing a State school health education curriculum, using computers in the educational process, career education, and using fine arts in the general curricula and school improvement process. The Act also allocates funds for the development of professional development programs in mathematics, science, computer literacy-competency, special education, structured linguistics, reading, writing, and composition. The School Code permits a school board to grant a sabbatical leave for professional improvement to a teacher who has been employed for at least seven consecutive years.

Reform: The School Aid Act provides $10,000,000 in FY 1994-95 to be allocated as follows: $2,000,000 to the Department of Education for statewide programs, $1,500,000 to ISDs in an equal amount per pupil, and $6,500,000 to school districts on an equal per-pupil basis. The School Code requires that professional development funds appropriated by the Legislature be allocated 20% to the Department, 15% to ISDs on an equal per-pupil basis, and 65% to local districts on an equal per-pupil basis. To receive funding, each school district and ISD will have to submit to the State Board an annual professional development plan. The funds may be used to provide professional development programs for administrators and teachers, a biennial education policy leadership institute, a statewide academy for school leadership established by the State Board, community leadership development, promotion of high educational standards, and sabbatical leaves for master teachers who aid in professional development.

MASTER TEACHER

Pre-reform: Not in the School Code.

Reform: Under new provisions in the School Code, for the first three years of employment in classroom teaching, a teacher will have to be assigned to one or more master teachers, college professors, or retired master teachers who will act as a mentor. The teacher also will have to receive intensive professional development induction into teaching.

TEACHER PREPARATION

Pre-reform: The School Code requires the State Board to establish requirements for the licensure and certification of teachers, including requiring persons seeking certification to pass basic skills and subject area examinations.

Reform: Beginning July 1, 1995, before a person engages in student teaching, he or she or the college or university in which the individual is or has been enrolled will have to demonstrate to the satisfaction of the school or school district that the teacher preparation program requires high academic achievement, demonstration of successful group work with children, knowledge of research-based teaching, and working knowledge of modern technology and use of computers.

SCHOOL ADMINISTRATORS

Pre-reform: The School Code requires the State Board to develop a school administrator's certificate, which must be issued to all school district and ISD school administrators.

Reform: The State Board is no longer required to issue a school administrator's certificate. A person may be employed as an administrator by a school district, public school academy, ISD, or nonpublic school, without an administrator's certificate or endorsement. Beginning in the 1994-95 school year, however, a school district may not employ administrators unless they have completed, within five years, continuing education as prescribed by State Board rule.

PUBLIC SCHOOL ACADEMIES

Pre-reform: Not in the School Code.

Reform: New provisions in the School Code provide for the organization and administration of a public school academy under the direction of a board of directors. An academy will be a public school under the State Constitution, and will be eligible to receive State aid payments. An academy may not be organized by or have an affiliation with a church or religious organization. The governing board of a school district, ISD, community college, or State public university may act as an authorizing body for granting contracts to organize and operate a public school academy. A person or entity will have to apply to an authorizing body for a contract to organize and operate a public school academy. A person or entity that is not granted a contract by a school board may petition the board to place the question of granting a contract on the ballot.

An academy is prohibited from charging tuition or discriminating in pupil admissions policies or practices on the basis of intellectual or athletic ability, measures of achievement and aptitude, status as a handicapped person, or any other basis otherwise illegal if used by a school district. An academy may offer any grade up to grade 12, including kindergarten and early childhood education, and may operate an adult basic education, high school completion, or general education development testing program. Persons who are not certificated to teach may do so in an academy offered by a State university or community college. Employees of a public school academy will be able to participate in the Public School Employees Retirement System. A person employed as a teacher in a public school academy will not be considered a teacher during that employment for purposes of continuing tenure under the teachers' tenure Act. If a teacher employed in a public school academy is on leave of absence from a school district, however, and is on continuing tenure in the school district at the time he or she begins the leave of absence, the teacher will retain continuing tenure in that school district during the period he or she is employed in the public school academy.

The School Aid Act provides that public school academies will receive an amount per pupil equal to the lesser of $5,500 or the foundation allowance of the school district in which the public school academy is located. This amount will be paid to the authorizing body that is the fiscal agent for the public school academy. If more than 25% of the resident pupils in a district are in membership in a public school academy located within that district, that public school academy will have its State allocation reduced by the local school operating revenue per membership pupil, calculated as though the resident public school academy pupils were in district membership. The local district is then required to pay the public school academy (through its fiscal agent) the local school operating revenue per membership pupil for each resident pupil in membership in the public school academy.

Table 13

EDUCATION REFORM		
Bill	1993 Public Act	Issue
S.B. 896	P.A. 362	Public school academies
H.B. 5121	P.A. 335	School Code: Education reform
H.B. 5190	P.A. 339	School improvement plans
H.B. 4366	P.A. 318	Public school academy teacher retirement
H.B. 5125	P.A. 337	Public school academy teacher tenure