

Special Advisory

THE STATE CONSTITUTIONAL REVENUE LIMIT: HAS IT BEEN EXCEEDED?

Dilemma

Based on one interpretation, there is evidence that FY 1984-85 state revenues may have exceeded the limit established by the Headlee amendment to the Michigan constitution. If so, state officials may be faced with a refund of \$181 million to last year's taxpayers. However, there are several legitimate issues about what should be counted as state revenue.

The State Treasurer and the State Budget Director are arguing that the limit has not been exceeded because certain one-time revenue items not in existence in FY 1978-79, the base year on which the revenue limit was calculated, should not be counted. There is some basis for this argument. While the revenues listed in the official budget document are in excess of the constitutional revenue limit, the figures in the budget document are preliminary and the final numbers in the State financial report may yield a different result.

Preliminary calculations for the current year, FY 1985-86, indicate that estimated revenues will fall about \$150 million short, but a strong surge in the economy could push revenues above the limit again. There is no danger, however, of revenues exceeding the limit if the income tax rate is rolled back or if a refund for 1984-85 is made to taxpayers and debited against FY 1985-86 revenues.

Analysis

In 1978, the voters approved an amendment to the state constitution (Article 9, Section 26) that, among other things, placed a limit on the amount of revenue the State could raise and spend. This amendment has come to be known as the Headlee amendment.

The limit was originally set on the basis of FY 1978-79 state revenue as a share of calendar year 1977 Michigan personal income. Certain adjustments are allowed for federal aid, taxes approved for payment of principal and interest on voter approved bonds, loans to school districts, and credits for taxes paid.

The limit was originally calculated to be 10.01 percent of personal income, but this specific limit has not been established by law. This could

be important because efforts to duplicate the original limit have yielded a slightly lower limit of 9.99 percent.¹

Revenues are not to exceed 10.01 percent (or 9.99 percent) of personal income in the prior calendar year. (This is interpreted to mean the calendar year prior to the beginning of the fiscal year.) The law provides that if the revenue limit is exceeded by 1 percent or more, there shall be a pro rata refund of excess revenues. The refund shall be based on the revenues collected from the state income tax and single business tax.

As originally calculated, the revenue limit for FY 1984-85 is 10.01 percent times 1983 calendar year Michigan personal income of \$103,980 million, or \$10,408.4 million. Total revenues for FY 1984-85, after allowable adjustments, are calculated to be \$10,589.4 million.² Based on this calculation, it appears that the revenue limit has been exceeded by \$181 million.

However, there are three issues concerning the calculation of the revenue limit that could lead to a different result.

1. One can argue that additional revenues that were not a part of the revenue base in FY 1978-79 should be excluded. Examples are one-time proceeds from bond sales and child support payments collected by the court that were treated as an expenditure deduct in FY 1978-79, but as a revenue in FY 1984-85. This argument is based on language in the constitution that reads as follows:

Total State Revenues includes all general and special revenue, excluding federal aid, as defined in the budget message of the governor for fiscal year 1978-79.

There may be as much as \$175 million in revenue in FY 1984-85 from sources not present in FY 1978-79. If these revenues are excluded, the revenue limit would not³ be exceeded, or at least it would not be exceeded by more than 1 percent.

However, if these types of one-time revenues are excluded in FY 1984-85 they should also be excluded in FY 1978-79, which would require a recalculation of the revenue limit.

The law implementing the revenue limit added the following to the above language:

¹If the limit is calculated as 9.99 percent, the dollar limit would be reduced by \$20.8 million.

²Revenue for FY 1984-85 as reported in the Governor's budget message for FY 1986-87 is \$13,819.3 million. From this amount one must subtract \$3,204.9 million in federal aid and \$64.6 million for debt services and add \$39.6 million for credits not related to tax liabilities.

³If the dollar revenue limit is exceeded by less than 1 percent, a refund is not required and the excess may be transferred to the budget stabilization fund.

. . .and any revenue from taxes or fees enacted at a later time which are levied by the state subject to the budget process of the state. . .

One can also argue that the phrase "any revenue from taxes or fees enacted at a later time which are levied by the state," closes this "loophole" and covers these new revenue items. However, this is not constitutional language, and only indicates legislative intent.

2. The provision in the implementing law that revenues must be subject to the budget process of the State could be interpreted to mean that the funds allocated to the State Accounting and Fiscal Responsibility Account (\$194.6 million in FY 1984-85) and the Working Capital Reserve Account should be excluded because these funds cannot be budgeted unless specific conditions are met. There are also other revenues not subject to the budget process of the State. This language, however, is not in the constitution.
3. There is some question as to the treatment of lottery fund revenues. When the original revenue limit was calculated, total lottery revenues were counted as revenue. It can be argued that the lottery fund is an enterprise fund with 45 percent of the receipts paid out as prizes. The prize money is not available to be spent on state programs and perhaps should not be counted as state revenue. If only the profit to the State is counted as revenue, the revenue limit would be 9.65 percent, rather than 10.01 percent, and FY 1984-85 revenues would be only \$15 million above the limit, and a refund would not be required.

If the revenue limit has been exceeded by \$181 million, we calculate that the State will be required to refund to the taxpayers approximately 3.9 percent of the revenue collected from the personal income tax and the single business tax in FY 1984-85. Seventy percent will go to income taxpayers and 30 percent to single business taxpayers. The language in the constitution likely precludes using the rollback of the income tax rate this year to meet this requirement, as the intention appears to be to return the excess revenue to the taxpayers who paid these taxes. Strict compliance may require the Department of Treasury to mail refund checks to all taxpayers who paid single business or personal income taxes in FY 1985. This will involve considerable administrative cost.

Ramifications

What are the implications of this issue? First, if the limit has been exceeded, it jeopardizes the rollback of the income tax rate. Second, it adds a new dimension to the political debate over the 1983 income tax increase that generated the revenue that put the State at or near the Headlee limitation. Third, the debate about what should be counted as revenue, no matter how valid the arguments, will contribute to government's credibility problems. Fourth, the issue will likely have to be resolved by the Legislature or the courts. Fifth, political advantages in this campaign year could shift depending on how this issue unfolds. Finally, it is clear to us that the law implementing the constitutional revenue limit needs to explicitly define what are to be counted as revenues and to delineate the procedures that are to be followed.