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Ballot Proposals A and C: How Do You Spell Property Tax Relief?

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In November the voters will have the opportunity to vote on two property tax relief proposals. One, Proposal A, *places a limit on residential property assessments. The other,* Proposal C, *reduces school operating taxes and limits assessment increases on each parcel of property; this measure is commonly called "Cut and Cap." There have been a number of analyses of the two property tax proposals.*[1] *We do not wish to plow the same ground; therefore, we are not including an exhaustive analysis of the measures' provisions. This paper will briefly describe Proposal A, but its focus will be Proposal C. The views of both sides on key questions about Proposal C are presented, followed by our view on each question. A key section of the paper is an analysis of the distributive effects of Proposal C, using estimates that we developed of the amount of tax relief it would provide to residents of every school district in the state.*

PROPOSAL A

Proposal A contains three provisions.

- It would limit annual assessment increases on homestead parcels (excluding second homes) to 5 percent or the rate of inflation, whichever is less. The property would be assessed at 50 percent of market value when sold.
- The "Headlee" property tax limitation would be modified. Currently, the millage rate in a jurisdiction must be rolled back if the increase in assessments on all property, excluding new and improved property, exceeds the rate of inflation. Under Proposal A the rollback would be calculated separately for two (or perhaps three) classes of property: (1) residential[2] and agricultural and (2) all other.
- In 1993 only, the allowable increase in property tax assessments would be the combined increase in inflation for 1991 and 1992, rather than the one year currently allowed by the Headlee amendment.

In our opinion, this is a relatively harmless proposal, although it raises some interesting administrative, legal, and equity questions. The main advantages of the proposal are that

1 See Scott Schrager, Cut and Cap Property Tax Plan, House Taxation Committee memo, September 11, 1992; Patrick Anderson, *Analysis of Proposals on the 1992 Ballot*, Mackinac Center, September 1992; Ruth Beier, *An Analysis of Two Property Tax Ballot Proposals*, Institute for Public Policy and Social Research, Michigan State University, August 1992; Jay Wortley and George Towne, *Property Tax Reform Proposals in Michigan*, Senate Fiscal Agency, July 8, 1992; and Citizens Research Council, *State Ballot Proposals A and C—Proposed Property Tax Amendments*, Council Comments #1012, September 1992.

2 The assessment limit applies only to the principal residence, not to second homes and resort property.

- for local taxing units, revenue losses would be minimal because assessments in most jurisdictions are likely to increase less than 5 percent (excluding new and improved property) for the next few years;
- for locals, the change in the Headlee amendment provisions would reduce millage rollbacks in 1993; and
- for taxpayers, dividing property into two (or three) classes would increase the chance of millage rollbacks on homestead property.

The main disadvantages of the proposal are that

- the proposal would provide little tax relief for homeowners except in periods of high inflation;
- the proposal would create two (or three) classes of property, all being taxed at different millage rates; and
- millage rates on business property could fall below millage rates on residential and agricultural property because commercial and industrial assessments would not be capped, increasing the likelihood of Headlee millage rollbacks, whereas the cap on residential and agricultural property largely would eliminate rollbacks on this property.
- Local governments would be hard pressed to fund services during periods of high inflation.

PROPOSAL C

Proposal C, also known as Cut and Cap, contains three provisions.

- It would reduce school operating taxes by 30 percent. The reduction would be phased in over five years, beginning in 1993 and reaching full implementation in 1997.
- It would cap annual assessment increases for every parcel of property at 3 percent or the rate of inflation, whichever is less.
- It would guarantee that schools will be reimbursed for lost revenue from the 30 percent cut. (No reimbursement is promised to schools or local governments for revenues lost as a result of the assessment cap.)

On the surface Proposal C appears very simple, but it raises a number of complex questions.

Who Would Benefit from Cut and Cap?

Proponents of Proposal C argue that it would give all homeowners across-the-board tax relief and that most also would benefit from the assessment cap (only those whose assessments increase less than 3 percent each year would not).

Cut and Cap opponents claim that most of the cut would go to businesses and owners of expensive homes. Furthermore, they maintain that the cap generally would most help affluent homeowners in fast-growing suburban areas while doing little for homeowners in slow-growing central cities. They also point out that most senior citizens and renters would receive no relief, and first-time homeowners would be losers relative to persons who currently own a home and remain in it for the average length of time. Scott Schrager, in a staff memo to the Michigan House of Representatives Taxation Committee, argues that owners of waterfront property and property in neighborhoods with increasing market values would be winners, and owners of property in neighborhoods with slower market growth would be losers. He also points out that the assessment limit likely would transfer the tax burden to business property, particularly industrial property. This occurs because business property assessments tend to increase less rapidly than other property assessments, thus they are less affected by a cap.

In addition, the benefit business taxpayers currently reap from Headlee millage rollbacks, even though their own assessment increases generally do not exceed the rate of inflation, would diminish, because if Cut and Cap passes, rollbacks under the Headlee amendment would not occur very often.

Our analysis indicates that in 1996–97, $1,662 million, or 45.3 percent of the relief, will accrue to the richest 10 percent of the school districts (based on adjusted gross income per household), while the poorest 50 percent of the districts will receive only 13.9 percent of the relief (see Exhibit 1). We do not have total population numbers for each school district, but we do know the number of pupils. While the richest 10

EXHIBIT 1

Gross Tax Relief Under the "Cut and Cap" Ballot Proposal, By Income Deciles, FY 1993–94 to FY 1997–98 (dollars in millions)

Income Decile[a]	1993–94	1994–95	1995–96	1996–97	1997–98
School Operating Tax Relief					
1	$341.6	$530.8	$741.8	$976.8	$1,238.4
2	152.0	232.8	322.0	420.3	528.6
3	106.2	159.2	216.9	279.4	347.3
4	67.1	99.8	135.0	172.9	213.8
5	50.2	75.5	102.6	131.8	163.1
6	51.9	78.0	105.8	135.1	166.2
7	23.9	36.2	49.1	62.8	77.4
8	46.3	70.1	94.8	120.3	146.7
9	17.8	27.0	36.6	46.8	57.4
10	11.0	16.6	22.6	28.8	35.4
Total	$868.0	$1,326.0	$1,827.0	$2,375.1	$2,974.5
Local Tax Relief					
1	$117.9	$180.7	$251.9	$332.5	$423.3
2	45.0	66.7	90.9	117.9	148.1
3	20.4	27.5	35.4	44.0	53.4
4	10.7	13.3	16.1	19.1	22.3
5	7.0	9.3	11.9	14.6	17.7
6	5.3	6.7	8.2	9.8	11.5
7	2.3	3.0	3.9	4.8	5.7
8	1.6	2.2	2.9	3.6	4.4
9	0.9	1.2	1.4	1.7	2.0
10	0.8	0.9	1.1	1.3	1.5
Total	$211.7	$311.6	$423.7	$549.4	$690.0
Total Tax Relief					
1	$459.4	$711.5	$993.7	$1,309.3	$1,661.7
2	197.0	299.5	412.9	538.3	676.8
3	126.5	186.7	252.2	323.5	400.8
4	77.8	113.1	151.1	192.0	236.1
5	57.2	84.8	114.5	146.4	180.8
6	57.2	84.7	115.0	144.9	177.7
7	26.2	39.2	53.0	67.6	83.1
8	47.8	72.3	97.7	123.9	151.1
9	18.7	28.2	38.1	48.5	59.4
10	11.8	17.6	23.7	30.1	36.9
Total	$1,079.7	$1,637.6	$2,250.8	$2,924.5	$3,664.9

SOURCES: Estimates by Public Sector Consultants, Inc., based on data provided by the Michigan departments of Education and Treasury.

NOTE: These estimates assume no millage rollbacks or millage increases.

[a]Income deciles are listed from highest income levels (1) to lowest income levels (10). Income is measured by the average adjusted gross income in each school district. There are between 55 and 57 districts in each decile.

percent of the districts receive 45.3 percent of the relief, they have only 16.9 percent of the students (see Exhibit 2). The poorest 50 percent of the districts have 39.8 percent of the students but receive only 13.9 percent of the relief. (Some examples of specific districts in each income decile are shown in Exhibit 3.)

Unfortunately, we do not have the data needed to calculate the reduction in state property tax credits in each district. This calculation likely would skew the distribution even more in favor of the richer districts, as the credits are based on income, and higher income districts receive a proportionately smaller amount of credits than do poorer districts. Therefore, the richer districts will experience a smaller reduction in state tax credits than poorer districts, increasing their share of the net tax relief. This would be offset somewhat by the reduction in federal deductions claimed (as property taxes are deductible for federal tax purposes), which would increase federal tax payments. This increase in federal taxes would be greater in richer districts, where taxpayers are more likely to itemize deductions and also pay a higher marginal tax rate than in poorer districts. However, the loss of state tax credits will be several times larger than the increase in federal income taxes.

How one would be affected by the tax relief measures depends on age, income, federal tax bracket, total and school millage rates, value of home, and assessment growth. Exhibits 4, 5, and 6 present examples of the amount of property tax relief that would be realized by middle-income, high-income, and senior citizen households; it is assumed that household income, home value, and federal tax bracket differ for each but that assessment growth, income growth, and inflation are the same. The gross amount of relief is shown as is net relief after state property tax credits are lost and federal income tax deductions are considered. (Note: These examples will overstate relief for households in slow-growth localities and understate relief for households in fast-growth areas.)

It is clear from the examples that Proposal C would provide more relief to high-income homeowners than to middle- or low-income homeowners. For example, in a district levying 58 mills, a homeowner living in a $200,000 home with a $100,000 annual income (in 1991) would receive net relief in 1997 of $1,413, or

EXHIBIT 2

Percentage of Total Property Taxes, Credits, SEV, and Enrollment in Income Deciles

	Percentage of				
Income Decile[a]	**Total Enrollment**	**SEV (1997–98)**	**Total Credits (1990)**	**Total Taxes (1990–91)**	**Credits as a Percentage of Total Taxes**[b]
1	16.9%	36.9%	25.3%	28.2%	8.4%
2	11.9	16.2	16.3	14.7	10.4
3	11.3	12.8	13.5	13.1	9.6
4	10.9	7.8	12.0	9.4	11.9
5	9.2	6.4	7.8	7.2	10.1
6	10.1	6.3	8.7	8.7	9.4
7	5.6	3.4	4.3	3.9	10.4
8	16.9	5.9	8.1	9.8	7.7
9	4.6	2.6	2.6	3.1	7.7
10	2.6	1.7	1.4	1.9	7.0
Total/Average	100.0%	100.0%	100.0%	100.0%	9.3%

SOURCE: Calculations by Public Sector Consultants, Inc., based on data from the office of Revenue and Tax Analysis, Michigan Department of Treasury (1992), and Michigan Department of Education.

[a]Income deciles are listed from highest income levels (1) to lowest levels (10). Income is measured by the average adjusted gross income in each school district. There are between 55 and 57 districts in each decile.
[b]Computed as total credits in each decile divided by total taxes in each decile.

EXHIBIT 3

Property Tax Relief and Other Selected Data for the High SEV and Median Income District Within Each Income Decile

Income Decile	Sort Criteria	District	AGI[a]	Enrollment	SEV (in millions)	Gross Property Tax Relief: School Operating 1993–94	School Operating 1997–98	Local 1993–94	Local 1997–98	1997–98 Relief as a Percentage of 1991 Taxes
1	High SEV	Ann Arbor	$41,841	14,347	$2,920.2	$20,857,887	$73,846,469	$11,008,967	$37,913,122	60.2%
	Median AGI	Pineview	40,436	103	11.0	36,674	120,552	0	898	22.2
2	High SEV	Dearborn City	33,966	13,263	2,668.7	14,545,021	49,105,467	6,835,180	20,821,012	45.2
	Median AGI	Berlin Twp. #3	34,426	46	4.2	18,803	60,541	843	1,425	29.2
3	High SEV	Warren	31,186	13,830	2,563.5	13,967,600	43,770,526	2,645,770	5,165,838	30.3
	Median AGI	Plainwell	30,753	2,689		768,321	2,444,638	76,661	124,144	25.8
4	High SEV	Grand Rapids City	28,056	31,170	2,022.2	12,827,674	40,297,604	2,259,932	4,538,213	31.3
	Median AGI	Fowlerville	28,713	2,561	128.5	839,517	2,761,801	197,576	545,851	40.5
5	High SEV	Port Huron	27,950	13,472	666.9	3,314,663	10,376,198	480,357	749,415	26.0
	Median AGI	Marquette City	27,314	5,020	377.1	3,609,722	13,436,794	1,506,386	5,684,811	83.6
6	High SEV	Lansing	26,591	23,164	1,481.2	6,911,162	23,462,999	69,789	471,110	19.0
	Median AGI	Lawrence	25,761	789	38.6	242,406	785,656	65,421	167,747	35.8
7	High SEV	Battle Creek	24,568	9,396	421.2	1,807,353	5,870,902	0	52,892	18.7
	Median AGI	Concord	24,500	970	45.2	179,490	609,627	0	7,449	19.5
8	High SEV	Detroit	23,235	181,032	5,382.3	23,252,779	72,206,265	0	487,504	13.8
	Median AGI	Oscoda	23,023	3,482	240.9	885,562	2,791,256	79,762	126,117	30.0
9	High SEV	Muskegon	21,515	7,910	341.0	1,966,834	6,223,486	239,058	381,399	25.7
	Median AGI	Pine River	21,192	1,400	86.1	324,932	1,102,530	0	10,299	22.8
10	High SEV	Houghton Lake	19,321	1,990	250.5	852,884	2,854,287	22,808	59,486	23.8
	Median AGI	Ellsworth	17,837	280	26.8	128,418	411,155	8,504	14,054	27.5
Statewide Average/Total			$27,899	1,668,787	$138,489.1	$867,972,226	$2,974,460,626	$211,733,880	$690,041,128	41.6%

SOURCE: Calculations by Public Sector Consultants, Inc., based on data from the Michigan Department of Treasury.

[a]Adjusted gross income.
NA: not applicable.

EXHIBIT 4

Proposals A and C: Effect of Tax on a Middle-Income Homeowner, Selected Millage Rates, 1992–97

	1992	1993	1994	1995	1996	1997
Example 1: School Mills=42, Total Mills=70						
Under Proposal A						
Gross reduction	$159	$205	$254	$308	$366	$429
Less:						
State tax credit	96	123	153	185	220	258
Federal tax deduction	10	12	15	18	22	26
Net tax cut	$53	$70	$86	$105	$124	$145
Percent reduction	3.2%	3.7%	4.3%	5.0%	5.6%	6.2%
Under Proposal C						
Gross reduction	$0	$213	$362	$521	$691	$873
Less:						
State tax credit	0	128	217	313	415	524
Federal tax deduction	0	13	22	31	41	52
Net tax cut	$0	$72	$123	$177	$235	$297
Percent reduction	0.0%	2.8%	4.5%	6.2%	7.7%	9.3%
Example 2: School Mills=36, Total Mills=58						
Under Proposal A						
Gross reduction	$132	$170	$211	$255	$303	$356
Less:						
State tax credit	79	102	126	153	182	213
Federal tax deduction	8	10	13	15	18	21
Net tax cut	$45	$58	$72	$87	$103	$122
Percent reduction	2.7%	3.3%	4.0%	4.6%	5.2%	6.0%
Under Proposal C						
Gross reduction	$0	$181	$306	$441	$585	$738
Less:						
State tax credit	0	108	184	265	351	443
Federal tax deduction	0	11	18	26	35	44
Net tax cut	$0	$62	$104	$150	$199	$251
Percent reduction	0.0%	2.9%	4.6%	6.3%	7.9%	9.5%
Example 3: School Mills=28, Total Mills=48						
Under Proposal A						
Gross reduction	$109	$140	$174	$211	$251	$294
Less:						
State tax credit	66	84	105	127	151	177
Federal tax deduction	7	8	10	13	15	18
Net tax cut	$36	$48	$59	$71	$85	$99
Percent reduction	2.1%	2.7%	3.2%	3.8%	4.3%	4.8%
Under Proposal C						
Gross reduction	$0	$143	$244	$351	$466	$589
Less:						
State tax credit	0	86	146	211	280	332
Federal tax deduction	0	9	15	21	28	38
Net tax cut	$0	$48	$83	$119	$158	$219
Percent reduction	0.0%	2.8%	4.4%	6.0%	7.6%	10.0%

ASSUMPTIONS: Income (1991)=$35,000; home value (1991)=$70,000; federal tax bracket=15 percent; SEV growth=6.5 percent in 1992 (if not frozen) and 5.5 percent thereafter (if not limited); income growth=5 percent; inflation=4 percent.

SOURCE: Public Sector Consultants, Inc.

EXHIBIT 5

Proposals A and C: Effect of Tax on a High-Income Homeowner, Selected Millage Rates, 1992–97

	1992	1993	1994	1995	1996	1997
Example 1: School Mills=42, Total Mills=70						
Under Proposal A						
Gross reduction	$455	$585	$726	$880	$1,046	$1,227
Less:						
State tax credit	0	0	0	0	0	0
Federal tax deduction	150	193	240	290	345	405
Net tax cut	$305	$392	$486	$590	$701	$822
Percent reduction	4.4%	5.0%	5.9%	6.7%	7.6%	8.4%
Under Proposal C						
Gross reduction	$0	$608	$1,033	$1,488	$1,975	$2,494
Less:						
State tax credit	0	0	0	0	0	0
Federal tax deduction	0	201	341	491	652	823
Net tax cut	$0	$407	$692	$997	$1,323	$1,671
Percent reduction	0.0%	5.5%	8.9%	12.1%	14.5%	18.3%
Example 2: School Mills=36, Total Mills=58						
Under Proposal A						
Gross reduction	$377	$485	$602	$729	$867	$1,017
Less:						
State tax credit	0	0	0	0	0	0
Federal tax deduction	124	160	199	241	286	335
Net tax cut	$253	$325	$403	$488	$581	$682
Percent reduction	4.1%	5.0%	5.9%	6.7%	7.6%	8.4%
Under Proposal C						
Gross reduction	$0	$516	$875	$1,260	$1,670	$2,109
Less:						
State tax credit	0	0	0	0	0	0
Federal tax deduction	0	170	289	416	551	696
Net tax cut	$0	$346	$586	$844	$1,119	$1,413
Percent reduction	0.0%	5.7%	9.1%	12.4%	15.6%	18.6%
Example 3: School Mills=28, Total Mills=48						
Under Proposal A						
Gross reduction	$312	$401	$498	$603	$718	$841
Less:						
State tax credit	0	0	0	0	0	0
Federal tax deduction	103	132	164	199	237	278
Net tax cut	$209	$269	$334	$404	$481	$563
Percent reduction	4.1%	5.0%	5.9%	6.7%	7.6%	8.4%
Under Proposal C						
Gross reduction	$0	$408	$696	$1,003	$1,332	$1,683
Less:						
State tax credit	0	0	0	0	0	0
Federal tax deduction	0	135	230	331	439	555
Net tax cut	$0	$273	$466	$672	$893	$1,128
Percent reduction	0.0%	5.4%	8.7%	11.9%	15.0%	18.0%

ASSUMPTIONS: Income (1991)=$100,000; home value (1991)=$200,000; federal tax bracket=33 percent; SEV growth=6.5 percent in 1992 (if not frozen) and 5.5 percent thereafter (if not limited); income growth=5 percent; inflation=4 percent.

SOURCE: Public Sector Consultants, Inc.

EXHIBIT 6

Proposals A and C: Effect of Tax on a Senior Citizen Homeowner, Selected Millage Rates, 1992–97

	1992	1993	1994	1995	1996	1997
Example 1: School Mills=42, Total Mills=70						
Under Proposal A						
Gross reduction	$171	$219	$272	$330	$392	$460
Less:						
State tax credit	0	0	0	0	0	0
Federal tax deduction	0	0	0	0	0	0
Net tax cut	$171	$219	$272	$330	$392	$460
Percent reduction	6.1%	7.4%	8.7%	10.1%	11.3%	12.6%
Under Proposal C						
Gross reduction	$0	$228	$387	$558	$741	$935
Less:						
State tax credit	0	0	0	0	0	0
Federal tax deduction	0	0	0	0	0	0
Net tax cut	$0	$228	$387	$558	$741	$935
Percent reduction	0.0%	8.2%	13.2%	18.1%	22.8%	27.3%
Example 2: School Mills=36, Total Mills=58						
Under Proposal A						
Gross reduction	$141	$182	$226	$273	$325	$381
Less:						
State tax credit	0	0	0	0	0	0
Federal tax deduction	0	0	0	0	0	0
Net tax cut	$141	$182	$226	$273	$325	$381
Percent reduction	6.1%	7.4%	8.8%	10.0%	11.3%	12.6%
Under Proposal C						
Gross reduction	$0	$193	$328	$472	$626	$791
Less:						
State tax credit	0	0	0	0	25	86
Federal tax deduction	0	0	0	0	0	0
Net tax cut	$0	$193	$328	$472	$601	$705
Percent reduction	0.0%	8.4%	13.5%	18.5%	22.3%	24.8%
Example 3: School Mills=28, Total Mills=48						
Under Proposal A						
Gross reduction	$117	$150	$187	$226	$269	$315
Less:						
State tax credit	117	100	63	26	0	0
Federal tax deduction	0	0	0	0	0	0
Net tax cut	$0	$50	$124	$200	$269	$315
Percent reduction	0.0%	2.5%	5.8%	8.9%	11.3%	12.6%
Under Proposal C						
Gross reduction	$0	$153	$261	$376	$499	$631
Less:						
State tax credit	0	153	261	313	363	417
Federal tax deduction	0	0	0	0	0	0
Net tax cut	$0	$0	$0	$63	$136	$214
Percent reduction	0.0%	0.0%	0.0%	3.0%	6.1%	9.1%

ASSUMPTIONS: Income (1991)=$20,000; home value (1991)=$75,000; federal tax bracket=0 percent; SEV growth=6.5 percent in 1992 (if not frozen) and 5.5 percent thereafter (if not limited); income growth=5 percent; inflation=4 percent.

SOURCE: Public Sector Consultants, Inc.

18.6 percent of his/her gross property tax bill. In the same district, a homeowner living in a $70,000 home and earning $35,000 annually (in 1991) would receive net relief of $251, or 9.5 percent of his/her gross property tax bill. However, the latter homeowner also will receive a state tax credit of $164, while the higher-income person is not eligible for the credit.

Only senior citizens currently receiving the maximum homestead credit and those seniors whose incomes exceed $73,650 would receive any benefit from proposal C.[3] As shown in Exhibit 6, in a district levying a total of 58 mills, a senior citizen homeowner living in a $75,000 home and earning $20,000 annually would receive tax relief of $705 (in 1997), or 24.8 percent of income. However, a senior citizen living in a 48 mill district would receive no net relief until 1995, because the reduction in property taxes would be offset by a reduction in the state credit.

What Would Be the Effect on State and Local Budgets?

Proposal C proponents argue that there will be sufficient growth in state revenue to cover the obligation the measure would put on state government to reimburse schools for the 30 percent cut, although they generally concede that a vote for Cut and Cap amounts to a vote to downsize state government. On the local side, Patrick Anderson, in a report prepared for the Mackinac Center, argues that locals would enjoy strong revenue growth despite the cap because (1) the cap would reduce Headlee rollbacks, allowing higher millage rates; (2) tax capitalization would generate a large increase in property values, increasing SEV when property is sold; (3) revenue growth will exceed inflation because of the addition of new and improved property, the assessment of which would not be capped; and (4) voters still would be able to vote higher millage rates. (An additional factor is that assessments would be allowed to increase to 50 percent of market value when property is sold.)

Opponents of Cut and Cap argue that it would strain both state and local government budgets. Ruth Beier, in an analysis prepared for the Michigan State University Institute for Public Policy and Social Research, argues that assessment limits without reimbursement put undue strain on areas experiencing economic growth because SEV grows faster in such areas than in stagnant areas; moreover, those areas also tend to have growing populations and may have trouble keeping up with the infrastructure improvements needed to support the business activity and increased population. Beier concludes that Michigan residents most likely would experience a reduction in municipal services and a decline in the quality of existing local infrastructure.

Schrager argues that local governments could be hurt for another reason. Article IX, Section 30 of the state constitution requires that 41.6 percent of state spending from state sources be allocated to local governments, and there is debate about whether the state currently is in compliance. Because the reimbursement to school districts for their revenue loss would be considered state spending for local governments, under Proposal C the state definitely would be well above the required 41.6 percent and could reduce other payments to local governments without violating the Section 30 requirement.

The magnitude of the effect of Cut and Cap on the state budget depends in large part on how fast state revenue increases. Proposal opponents argue that recent trends indicate that revenue growth is likely to be slow and point out that there also is upward pressure on state spending, particularly for health care and retirement costs. They argue that if Proposal C passes, significant cuts in some state programs will be required unless additional revenues are raised.

Our view is that Cut and Cap would strain government budgets, particularly at the state level. Although most local taxing units would not suffer much pain as long as the rate of inflation remains low (and we expect

3 The credit would phase out at income levels of $73,650 to $83,650; for each $1,000 increase in income (above $73,650), the credit would be reduced 10 percent.

it to average 3–4 percent over the next few years), if it ever were to increase to the double digit levels of the late 1970s and early 1980s, the cap would become almost intolerable. Even in a period of low inflation, some local units would be forced to tighten their belts, particularly out-of-formula school districts in such high growth areas as Oakland and Washtenaw counties. (*Out of formula* means that a district raises more money locally than the state guarantees to provide per pupil; such districts receive no per-pupil funding under the state school aid formula.) We have calculated that the 3 percent cap actually would limit assessment growth to about 2.5 percent (plus new property), because some properties will grow less than 3 percent, pulling down the average growth rate. However, with the approval of their voters many of these districts could raise millage rates. Only districts up against the 50-mill limit imposed by the state constitution would be prevented from raising additional revenue. (The total gross cost to local governments of the Cut and Cap proposal is summarized in Exhibit 7.) These numbers assume no millage rollbacks in 1993–94. However, it is likely that rates will be rolled back in many jurisdictions, as assessments will increase an average of about 10 percent and inflation is expected to increase only 3.5 percent.

EXHIBIT 7

Estimated Gross Tax Relief Under the "Cut and Cap" Proposal, FYs 1993–94 to 1997–98
(dollars in millions)

	FY 1993–94	FY 1994–95	FY 1995–96	FY 1996–97	FY 1997–98
Property Values					
Estimated SEV	$169,634	$180,629	$192,549	$205,481	$219,524
"Capped" SEV	160,016	166,424	173,187	180,336	187,903
Effect on School Operating Revenues					
School revenues without relief	5,780	6,150	6,551	6,985	7,457
Relief attributable to the "cap"	322	475	646	838	1,053
Relief attributable to the "cut"	546	851	1,181	1,537	1,921
Relief attributable to "cut and cap"	868	1,326	1,827	2,375	2,974
Effect on Local Revenues					
Local revenues without relief	3,959	4,204	4,470	4,757	5,069
Local tax relief from "cap"	212	312	424	549	690
Effect on Total Revenues					
Total revenues without relief	9,739	10,354	11,020	11,743	12,526
Total tax relief from "cap"	534	786	1,070	1,388	1,743
Total tax relief from "cut"	546	851	1,181	1,537	1,921
Total tax relief from "cut and cap"	1,080	1,638	2,251	2,924	3,664

SOURCE: Estimates by Public Sector Consultants, Inc., based on data from the Michigan Department of Treasury.

NOTE: These estimates assume no millage rollbacks or millage increases.

If millages are rolled back in half the districts, the FY 1993–94 cost will be reduced by about $300 million, and the FY 1997–98 cost will be about $350 million less. At the same time, this would reduce the cost to the state by about $100 million.

It is also possible that local governments would be forced to raise millage rates, which would increase the cost of the cap. However, the cost to the state would not increase because reimbursment is based on 1991 millage rates.

The effect on the state budget would be more severe than that on most local governments. As shown in Exhibit 8, we estimate that the required reimbursement of school districts would take about 92 percent of the expected increase in state revenues in FY 1993–94 and about 50 percent in the following four years. *Even* *if Proposal C is not approved* we project a potential budget deficit of more than $850 million in FY 1993–94. Adding the cost of Cut and Cap would increase the deficit to nearly $1.3 billion, or more than 10 percent of general fund/general purpose and school aid fund revenue. (See Exhibit 9.) This may not seem too much to cut from the budget, but it is made more difficult by the large reductions already taken in the last few years. Most of the "easy" cuts have been made. Additional cuts will be more painful and politically unpopular, because over 75 percent of the budget is allocated to education, social services, health, and corrections (see Exhibit 10). When fully phased in, in 1997–98, the proposal will cost the state about $1.4 billion.

Should Property Taxes Be Reduced?

Both sides of the proposals A and C debates agree that Michigan property taxes are too high. The evidence on this point is clear. FY 1989–90 property taxes in Michigan were 4.7 percent of Michigan personal income, 32.2 percent above the national average and 11th highest among all states. (See Exhibit 11.) Property taxes in Michigan are the highest in the Great Lakes region and 58.7 percent higher than in Indiana, which has the lowest taxes in the region. It must be kept in mind, however, that these numbers do not reflect the Michigan homestead property tax credit, which is the most generous in the nation. The homestead credit program annually rebates more than $800 million to homeowners and renters, which amounts to 15–16 percent of total

EXHIBIT 8

Effect of Cut and Cap Proposal on State Budget, FY 1992–93 to FY 1997–98
(dollars in millions)

Fiscal Year	GF/GP and SAF[a] Revenue	Dollar Increase	Cost of Cut and Cap to State Government	Dollar Increase	Percentage of Revenue Growth
1992–93	$9,925	$525	$0	$0	0.0%
1993–94	10,375	450	416	416	92.4
1994–95	10,850	475	652	236	49.7
1995–96	11,350	500	916	264	52.8
1996–97	11,900	550	1,210	294	53.5
1997–98	12,475	575	1,500	290	50.4

SOURCES: Public Sector Consultants, Inc., and Senate Fiscal Agency.

NOTE: The cost of Cut and Cap assumes no reimbursements to general local governments for the 30 percent property tax cut and no reimbursement to general governments or schools for the 3 percent cap.

[a]GF/GP=General fund/general purpose. SAF=School Aid Fund.

EXHIBIT 9

Projected Budget Balances (dollars in millions)

	FY 1991–92	FY 1992–93	FY 1993–94
Beginning balance	-$169.4	-$0.0	-$277.4
Baseline revenue	7,180.0	7,550.0	7,965.0
One-time revenue	265.9	288.6	0.0
Tax reduction	0.0	-20.0	-25.0
Subtotal	$7,276.5	$7,818.6	$7,662.6
Initial appropriations	$7,554.6	$7,981.0	$8,300.0
Shortfall—school aid revenue	103.4	15.0	0.0
Supplementals	163.7	0.0	0.0
Potential supplementals/overexpenditures	22.8	100.0	0.0
Reductions/adjustments	-568.0	0.0	0.0
Medicaid—Replace hospital voluntary contributions	0.0	0.0	230.0
Subtotal	$7,276.5	$8,096.0	$8,530.0
Cost of Cut and Cap	$0.0	$0.0	$416.0
Year-end balance	$0.0	-$277.4	-$1,283.4

SOURCE: Public Sector Consultants, Inc.

EXHIBIT 10

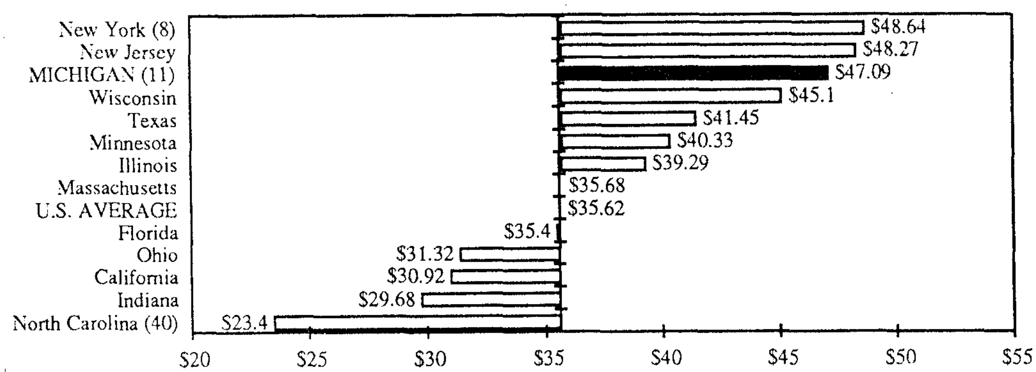
Distribution of State Expenditures from State Sources (Excluding Transportation), FY 1992–93
(dollars in millions)

Category	Amount	Percentage of Total
School aid/retirement	$3,388.8	27.5%
Social services	2,260.5	18.4
Higher education	1,601.1	13.0
Health	1,164.0	9.5
Revenue sharing	1,050.4	8.5
Corrections	984.6	8.0
General government	783.5	6.4
Regulatory	337.0	2.7
Safety and defense	278.8	2.3
Other (includes capital outlay)	458.0	3.7
Total	$12,306.7	100.0%

SOURCE: Calculations by Public Sector Consultants, Inc., from data provided by the Senate Fiscal Agency.

EXHIBIT 11

State-Local Property Tax per $1,000 Personal Income, FY 1989–90



SOURCE: U.S. Bureau of the Census, *Government Finances in 1989–90*.

NOTE: State-imposed property levies are the utility property tax, the intangibles tax, and inheritance taxes.

residential and agricultural property taxes levied in the state. There are no data available comparing states on their actual tax burden (levy minus rebate), but if there were, Michigan's rank likely would improve, although the state would still be in the heaviest taxing twenty. It also should be noted that in the last few years the property tax burden in Michigan has fallen relative to other states. (See Exhibit 12).

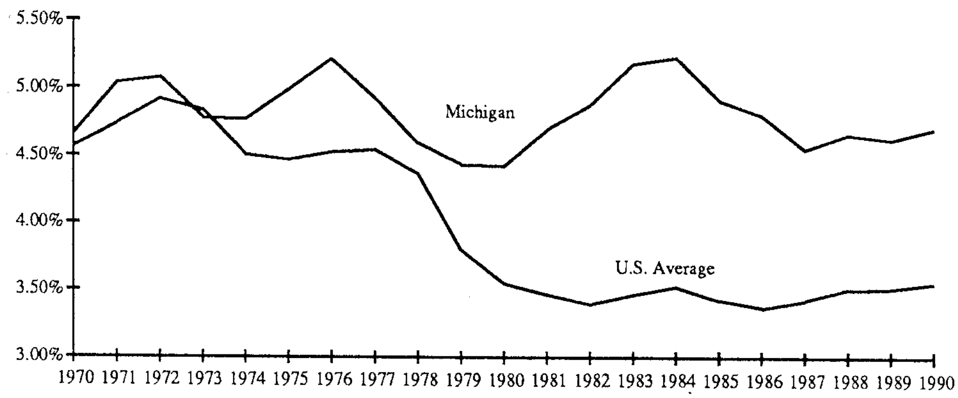
The passage of Cut and Cap would bring Michigan property taxes in line with other states. If in FY 1989–90 Michigan property taxes had been reduced 30 percent, they would have been 3.67 percent of personal income, only 5.6 percent above the national average, ranking Michigan 22d among the states, and the state's position would have improved thereafter due to the 3 percent cap on assessment increases.

Would Proposal C Cause Other Taxes to Go Up?

Proposal C proponents claim that the measure would not necessitate a tax increase, and Gov. John Engler has promised not to increase taxes to implement it. The administration's intention is to dedicate 50 percent of the growth in the state budget over the next five years to pay for the cost of reimbursing school districts.

EXHIBIT 12

State-Local Property Tax as a Percentage of Personal Income, Michigan and U.S. Average, 1970–90



SOURCE: U.S. Bureau of the Census, *Government Finances in 1989–90.*

NOTE: State-imposed property levies are the utility property tax, the intangibles tax, and inheritance taxes.

This will put tremendous pressure on the state budget, however, and the opponents of the proposal claim that a tax increase will be needed.

Our view is that the passage of Cut and Cap would force state tax increases within two years, as well as increases in local millage rates. We expect that the state hikes would not come in the income or single business levies, but rather in higher tobacco and liquor taxes, an extension of the sales tax to certain services such as amusements, and the elimination of tax "expenditures," such as industrial property tax abatements.

What Would Be the Effect on the Economy?

Cut and Cap proponents argue that reducing property taxes would stimulate the economy by increasing individuals' disposable income, increasing housing values, and making Michigan a more attractive location for business. Mackinac Center spokesman Anderson estimates that disposable personal income would increase by $2 billion (about one percent of total income by 1997) and that property values would increase $19.4 billion by 1997 (4.7 percent of total property values) due to tax capitalization.[4]

Opponents argue that the stimulative effects of lower property taxes would be largely offset by the reduction in government spending or the expected increase in taxes. In addition, the bite taken by federal income taxes would increase because of reduced deductions for property taxes. Schrager estimates that federal income taxes for individuals and business would increase $154.4 million in 1993 and $476.7 million in 1997 and that Michigan homeowners would lose an estimated $155 million in state property tax credits in FY 1993–94 and $531 million in FY 1997–98. These losses would reduce total tax relief to an estimated $648 million in 1993 and $2.1 billion in 1997.

Our view is that Cut and Cap will have a very small positive effect on the economy. The net tax reduction of about $3 billion (1998) would amount only to an estimated 7.5 percent of total state and local taxes and about 1.5 percent of estimated Michigan personal income. Some of this small stimulus would be offset by a decline in government spending, which can be a more effective stimulus to the economy than a tax cut. In

4 Property taxes are reflected in the price of housing. As property taxes fall, demand for housing increases and housing values rise.

addition, we expect that the passage of Cut and Cap, when combined with slow economic growth and escalating costs for health care and retirement, would force an increase in state taxes and local millage rates, further offsetting the stimulus from the property tax cut.

The major stimulative effects could come from reduced taxes on business, which should encourage some additional investment and make Michigan a slightly more attractive business location.

Is the Assessment Cap Equitable?

Both sides agree that the assessment cap is not equitable. Because property would be reassessed at market value only at the time of sale, owners of similar homes would pay a different amount of taxes for the same level of public services. As shown in Exhibit 13, the difference can become substantial after several years. The example shows what happens in the year 2000 to two identical homes valued at $100,000 in 1992, assuming the 3 percent cap and an annual increase in market values of 6 percent. If one home is not sold and thus remains under the cap, in 2000 the owner would pay property taxes of $3,800 (assuming 60 mills); if the other home *is* sold in 2000, the new owner must pay $4,782 because the assessment was adjusted at sale to reflect its true market value. (This difference would be reduced for those who itemize federal deductions and for those who are eligible for the state homestead property tax credit). Although the U.S. Supreme Court has ruled that this disparity is constitutional (*Nordlinger* v. *Hahn*), it is certainly not fair.

EXHIBIT 13

Effect of Assessment Cap in Proposal C, 1992–2000

	Home Assessment		Taxes Paid	
Year	**Cap**	**No Cap**	**Cap**	**No Cap**
1992	$100,000	$100,000	$3,000	$3,000
1993	103,000	106,000	3,090	3,180
1994	106,090	112,360	3,183	3,371
1995	109,273	119,102	3,278	3,573
1996	112,551	126,248	3,377	3,787
1997	115,927	133,823	3,478	4,015
1998	119,405	141,852	3,582	4,256
1999	122,987	150,363	3,690	4,511
2000	126,677	159,385	3,800	4,782

SOURCE: Public Sector Consultants, Inc.

What Happens to School Finance Reform?

Cut and Cap proponents argue that the two issues—property tax relief and school finance reform—should be kept separate. Their view is that once school property taxes are reduced, changes can be made in how schools are financed.

Opponents claim that passage of Proposal C would end any chance of school finance reform. Schrager argues that Cut and Cap is, in a sense, a school finance plan because it would reimburse school districts for the reduction in their property taxes. Had the 30 percent reduction been in effect in FY 1991–92, the state would have reimbursed school districts $1.525 billion; more than half—$780 million—would have gone to out-of-formula districts, which educate only about 30 percent of the state's students. Out-of-formula districts would have received $1,557 per pupil, compared to $636 for in-formula districts, further extending the financial gap between the "have-more" and the "have-less" districts.

Our view is that passage of Cut and Cap would delay school finance reform for several years. First, some of the pressure for school finance reform comes from those wanting to reduce the property tax burden, and that pressure largely would be gone. Second, the state budget would be so tight that it would dominate legislative attention for the next few years. Third, any tax increases enacted would be needed to finance current state services, and there would be no money available to improve the equity of the school finance system.

Should You Vote for Cut and Cap?

Whether one votes for or against Proposal C probably will come down to individual circumstance. If you are a renter, a senior citizen, or a person who values services from state and local government, it probably is in your interest to vote "no." If your income is more than $73,650 annually or you own a business or live in a high tax area or one where assessments are increasing at a fast rate, it probably is in your interest to vote "yes."

The issue should not be whether you trust government, as it often is on these types of proposals. If you want your property taxes lowered and would like to reduce the size of government, vote "yes." (But keep in mind that although the proposal would not increase or impose other levies, there is no guarantee that state and local taxing units will not increase taxes to cover their lost revenue.) If you think that the relief is targeted to the wrong groups and would like government to maintain the current level of services or even provide more, you should vote "no."

Is There A Better Approach?

We believe there is a better way to reduce property taxes. As we said in September 1991 ("Property Tax Relief Revisited"), we favor a gradual reduction in school millage rates and a temporary forgiveness in assessment increases. We also believe that property tax relief should be tied to school finance reform and that any tax relief should be financed by a combination of modest budget cuts, tax increases (such as the extension of the sales tax to services), and elimination of certain tax expenditures (such as industrial tax abatements).

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