

## SETTING PUBLIC SERVICE PRIORITIES FOLLOWING SUCCESSFUL TAX AND SPENDING LIMITING INITIATIVES

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Dissatisfaction with taxation is apparently part of our heritage. History tells us of the Boston Tea Party, which was a reaction to taxation *without* representation. However, our taxation *with* representation is not, sometimes, without radical reaction.

### Development of Property Tax Limitations

The actions of voters to limit taxation is not new in Michigan. During the depression of the early 1930's about one-half of all Michigan property was tax delinquent and subject to tax sale [5]. Unrestricted taxation and perceived inaction by the legislature forced the electorate to do something to save their homes and other property. A property tax limitation proposal was adopted on November 8, 1932, which limited property taxes to 1.5 percent (15 mills) of the value of the property.

In 1933 a 3 percent statewide sales tax was enacted. These revenues permitted the state of Michigan to reduce its property tax reliance so that in 1935 the state government levied its last general property tax levy [5]. Later the sales tax was increased to 4 percent.

In 1932, before the constitutional limitation was adopted, the average property tax rate was 3.28 percent (32.80 mills on the full property value). In 1934 after the adoption, the average tax rate dropped to 2.3 percent (23 mills). The tax base was supposed to be full property value. Because the average debt levies of 0.8 percent (8 mills) were excluded from the limitation, the average levy exceeded the 1.5 percent (15 mills) limitation. But tax rates dropped 25 percent in a two-year period. This situation, combined with the reduced property values, really made the collectable tax revenues lower. However, the impact on local governments was not as severe as it could have been. Local public services in the middle 1930's were financed by the current payments on delinquent taxes due in prior years combined with the current taxes paid with assistance of various federal loan programs. Also, permits and fees were increased to cover the actual costs of services. For example, usage fees were adjusted to cover not only the

water, but also sewer, garbage collection, and costs of other services. With users paying for the local services, there was greater accountability for use of moneys and increased government efficiency [5].

Financial restructuring was forced upon local governments because long-range borrowing was nearly eliminated. A provision in the 1932 constitutional amendment kept taxes from being increased beyond the 1.5 percent (15 mills) and limited millage increases to a maximum of five years. And the increase had to be adopted by two-thirds of the *qualified electors*. It was this last requirement that made elections asking for additional millage certain to fail. It was not reasonable to expect two-thirds of the electorate even to go to the polls. This was later clarified to be two-thirds of the electors voting on the question [7].

Cities and villages were not required to come under the 1.5 percent (15 mills) limitation. The few cities that did choose to come "within" the limitation had 1938 property tax rates less than one-half the 1930 tax rates, while most of the cities staying "outside" the 1.5 percent (15 mills) limit kept their 1938 tax rates nearly identical to the 1930 tax rate. Some cities eliminated subsidies to publicly owned properties and made charges for services to public properties. Examples of this included charges in lieu of taxes and hydrant rental fees to the city water department. These actions caused higher water rates to the customers.

In a 1933 state supreme court decision regarding the case of the School District of Pontiac v. City of Pontiac, the court defined the priorities of the limitation as follows:

1. Debt payments were excepted from the limitation.
2. The limitation could be increased up to the maximum of 5 percent (50 mills) only by a two-thirds vote of the electors.
3. Home rule act cities had charter provisions limiting taxes not to exceed 2 percent of the assessed value. So they were not included in the limitation. This was later expanded to non-home rule cities and villages.
4. The constitutional amendment had no provision for distribution of the 1.5 percent (15 mills) limit between the state and among the several local units of government. Legislative action was needed to take care of this deficiency [6].

After the Pontiac decision, the Michigan legislature swiftly enacted the Property Tax Limitation Act of 1933. This act complied with the court's interpretation and excluded cities and villages from the allocation of the limited tax levy. In order to coordinate priorities, an allocation board was created in each county. These boards were given the responsibility of dividing the 1.5 percent (15 mills) based upon the budget requirements as presented by each school district, township and the county. Allocation boards still function each year in one-fourth

of Michigan counties. About three-fourths have fixed the allocation by countywide election.

Membership on an allocation board is usually composed of a majority of individuals motivated by school interests, although the county and townships are also represented. With this composition, the priorities of schools often win out. In most counties the schools are allocated 8 or 9 mills, the county 5 or 6 mills and the townships 1 mill. Northern counties have larger allocations for the county with a corresponding reduction to schools. They have large budgets for highway maintenance, especially snow removal.

In most school districts the allocated plus extra-voted millage far exceeds 15 mills, so even if the schools had all 15 allocated mills, that would not be enough. Many people believe that the needs of counties and townships can be adequately met within the 1.5 percent (15 mills) limitation because the schools can get extra-voted taxes easier than any other unit of government. But school boards still capture as much of the allocated millage as they can.

### **Period of Relaxing of Limitations**

Erosion of the original 1932 limitation has occurred through various actions:

1. The limitation of 1.5 percent (15 mills) on the assessed value has been interpreted by the state supreme court to mean the assessments as finally equalized by county and state equalization. This has generated more revenue because for the past 40 years, state equalized values (SEV) have exceeded the local assessed values.
2. Other court cases held that the 1.5 percent (15 mills) limit does not apply to special assessments and use taxes.
3. In 1948, the electorate adopted amendments that would permit the 1.5 percent (15 mills) limit to be increased to 5.0 percent (50 mills) for up to 20 years by a *simple majority* vote.
4. The 1963 state constitution provided an option to eliminate the allocation board and its division of the 1.5 percent (15 mills) by substituting a voter adopted "fixed" allocation of up to 1.8 percent (18 mills). This alternative is in place in 62 of the state's 83 counties. Many have adopted a permanent allocation at a rate less than the 1.8 percent (18 mills) but more than 1.5 percent (15 mills).
5. Multicounty school districts were given the authority by the 1963 state constitution to use the highest rate available in the county having its greatest area. This provision was included to satisfy the constitutional requirement for uniformity. It often

permits the total allocated levy rate to exceed the usual limitations in a portion of a “fractional” school district.

6. The 1963 state constitution originally said that taxes could be levied, without limitation or approval by the voters, for the payment of principal and interest on bonds or other evidences of indebtedness or for the payment of obligations in anticipation of bonds being issued. This was used to fund many building and improvement programs until a 1978 constitutional amendment required elections to approve debt service millage.
7. The 1.5 percent (15 mills) limitation does not apply to chartered local units or authorities that have other limitations set by statutes or in their charters. In addition to cities and villages, there are charter counties, charter townships, and many types of authorities, such as special education programs, downtown development, airports, hospitals, and mass transportation. The tax limitations of these units must be approved by elections.
8. When the Income Tax Act of 1967 was enacted it included liberal credits to residents local homestead property taxes and local income taxes.

In the above discussion, it is apparent that the intention of the voters in 1932 to limit property taxes to 1.5 percent (15 mills) has been radically modified by court interpretations, by legislative acts, and by the voters themselves in the adoption of the 1963 constitution. The 1983 average property tax rate was 5.277 percent (52.77 mills) which is several times the original limit. These changes have accommodated the priorities of various interest groups. Charter governments, schools, and authorities have benefited most of all from the interpretations and modifications.

### **Tightening Tax Limitations Again**

In 1978 the state constitution was amended to further limit taxation of various kinds. One provision limits total state revenues to no more than 10.01 percent of the Michigan personal income in the previous year. Since 1978, this has had a negligible impact because personal income has increased so much. The rate of increase of property taxes in each year cannot exceed the rate of increase of the consumer price index. This is called the “Headlee” rollback after the man who led the drive to amend the constitution in 1978. Some supporters of the Headlee amendment are disappointed in how little effect the limitation has had on the property taxes. One reason is that many local governments are not levying taxes at their maximum allowable rate. Another reason is that the consumer price index has increased more than the rate

of increase of property values so the computations do not require millage reductions.

In addition to limiting state revenues and local taxes, the Headlee amendment fixed the proportion (41.6 percent) of state collected revenues going to local governments. This "sleeper" provision of the tax limitation provision has created a surprising situation. Even during the recession, the state had to curtail state programs in order to maintain the local spending share of state collected revenues. Local costs cannot be absorbed by the state without carefully maintaining the 41.6 percent local to 58.4 percent state ratio. For the state to spend an additional dollar, it must raise \$1.71. To reduce local spending by a dollar, the state must lower its own spending by \$2.40 [4, p. 3].

Another requirement of the 1978 constitutional amendment is that no new extra property tax can be spread without approval by the voters. This applies to all the debt levies omitted in the 1963 constitution. Now, local governments usually request extra voted property taxes by specifying the money will be used for designated purposes such as police foot patrol, fire department equipment, garbage pickup, or additions to the water supply facilities.

Michigan's income tax homestead property tax credit system is a generous circuit breaker for farmers and many resident home owners. This has been used effectively by local units of government tax millage campaigns by showing the voters that for many of them the state income tax credit will offset 60 percent or more of the additional property taxes on their homes. It is usually demonstrated that additional property taxes will result in a minimum cost to the homeowner. School districts were the first to recognize this benefit. In 1982 1.5 million Michigan residents received property tax credits totaling \$650 million dollars. This was nearly 20 percent of all residential and agricultural property taxes. Some people wonder how long the state can afford these credits, because they have increased every year [3].

Also since 1978, the constitution has required the state to fund any new program or program addition it mandates upon local governments. There are several state attorney general opinions concerning the interpretation of the mandated costs. The opinions generally say the functions which local units want reimbursement for are not new, but are expanded services which are permissive or voluntary and not requirements for the state to pay. Local units have at least eight cases requesting state reimbursement in the state court of appeals. The issues include:

1. Overtime wages for fire fighters.
2. Governor's veto of an appropriation to fund fire protection.
3. Recodified solid waste landfill regulations.

4. Juror compensation for cases remanded from circuit courts to districts courts.
5. Per-pupil school aid reduction.
6. General K-12 education, special education, and driver's education programs.
7. Presidential primary election.

Some local governments feel the costs of fighting for mandated reimbursements will exceed the benefits and are not eager to take the state to court.

In recent years, the Michigan legislature has imposed additional property tax limitations which are identified as:

1. *TRUTH IN TAXATION* requires every local unit of government to roll down the tax rate so that no more tax dollars are raised from existing properties than were raised in the previous year.
2. *TRUTH IN ASSESSMENT* requires cities and townships to reduce the property tax rate in proportion to the amount the assessed value is less than the final equalized value.
3. *TRUTH IN EQUALIZATION* requires counties, villages, and authorities to reduce the property tax rate in proportion to the amount that the county equalized value is below the final state equalized value.

Units of government are required to hold special public hearings to justify the restoration of any reduction caused by the truth in taxation rollback. Sometimes a millage reduction is accepted as computed because the costs of publishing and holding hearings would be more than the restored revenue. The only way to overcome the constitutional limit, the truth in assessment, or truth in equalization roll downs is by an affirmative vote of the electorate.

The truth in assessment and truth in equalization limitations are designed to place the responsibility for increased taxes on local units and to bring assessments and equalized values closer together. If local units do not raise the assessed value to the level of state equalized value, then their tax revenues do not increase proportionally. Before, many local units would assess low, knowing that the state would increase the tax base value through equalization.

These recent legislative limitations combined with the 1978 constitutional amendments have helped reduce the average rate of taxation. In 1978, the rate was 5.389 percent (53.89 mills) and it has gone down each year to 5.277 percent (52.77 mills) in 1983.

There are complex administrative procedures for compiling the needed information to compute millage reduction fractions and base tax rate fractions.

Revenues reductions come from both the tax limitation restraints and downward fluctuations in the economy. Although property tax revenues are quite stable from year to year, the revenues from income and sales taxes react more directly to the swings of the economic cycles. Expenses do not automatically follow the cycles. A government which sustains the same level of service of prior years has higher costs today. Utility bills, payrolls, supplies, and postage as well as court settlements are more costly now. Approximately 80 percent of local government operating budgets are allocated to personnel expenditures. Most economizing results in fewer people trying to do the same work.

### **Effects of Limitations on Services**

Decisions have to be made by governments to accommodate the revenue reductions resulting from tax rollbacks, loss of tax base in some units and fewer dollars of revenue sharing. Following are examples of problems from reductions in spending [4].

1. Fewer "Free" Local Services and Increased Fees:
  - a. Garbage collected every two weeks instead of weekly.
  - b. Fee added to monthly water billing in lieu of quarterly water billing.
  - c. Cost of building permits and inspection fees increased.
  - d. Swimming pools closed.
  - e. Schools drop athletics, the arts, and cooperative education and work programs.
2. Reduced Level of Service Per Capita:
  - a. Fewer city police officers on duty to respond to emergencies.
  - b. Parks open fewer hours.
  - c. Government operations that are less visible than garbage pickup and fire and police protection are cut back the most.
  - d. School buildings closed.
  - e. Sheriff road patrols reduced or eliminated because the sheriff is mandated to operate jail but is not mandated to have a road patrol.
  - f. Assessments become out of date with changing market values.
3. Level of Maintenance and Replacement:
  - a. Park maintenance is done by volunteer groups in adopt-a-park programs.
  - b. Repairs and decorating of buildings deferred.
  - c. Street repairs are slowed down.
  - d. Old equipment is not replaced.

- e. Up-to-date technology is not acquired for doing the job more efficiently.
  - f. Landscape work stopped.
4. Bond Ratings and Borrowing:
- a. The number of bonds issued has been reduced [2].
  - b. All levels of government face higher costs of borrowing money.
  - c. The state of Michigan needed backing from Japanese banks.
  - d. Local units have to contract for bond insurance in order to sell bonds at reasonable interest rates.
5. Size of Public Workforce and Morale of Workers:
- a. The state of Michigan has offered employees early retirement to reduce the total state payroll. Only a quarter of the retirees can be replaced.
  - b. Local units combine department operations such as fire and police into a public safety department.
  - c. Layoffs of personnel.
    - (1) In 1980 the city of Flint reduced the number of employees from 2,300 to 1,600 people.
    - (2) Remaining employees are stretched thin to cover all of the responsibilities required by law.
  - d. Attrition of the workforce without recall of laid off personnel or new hires.

Despite the severity of the recent recession with unemployment that led the nation, the state of Michigan and its local governments have survived financially. They have come through so well on existing revenues with some increased taxes and frugal spending that the bond ratings have improved. Essential services have been maintained and some previously federally financed programs have been continued on local funding.

Even so, there will be a constitutional amendment proposal on the November, 1984 Michigan ballot to require a popular vote on any new state or local tax or any legislative change in the base or rate of tax which increases revenue. Any new or increased charges for fees, licenses, or permits would require a four-fifths vote of the legislative body. This proposal would also prohibit city income taxes against nonresidents that are greater than 0.5 percent. All tax increases since December 31, 1981 would be discontinued unless reinstated by a vote of the people within 90 days of the election [1].

Probably, this proposal will not pass. But it is a message to us in government that there are still large numbers of people willing to work hard carrying petitions and promoting tax limitation amendments. That was the message sent to King George the Third 200 years ago when tea ended up on several miles of shoreline around Boston.



#### REFERENCES

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- [7] Wilcox v. Board of Commissioners of Sinking Fund of City of Detroit, 262 Mich 699, 247 N.W. 923, 249 N.W. 467.