

STATE BUDGET UPDATE

Potential Revenue Issues



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Michigan State Budget: Potential Revenue Issues

On February 7, 2008, Governor Granholm presented to the Legislature her FY 2008-09 State budget recommendations. The revenue assumed in the Governor's budget was based on the consensus revenue estimates that were agreed to on January 11, 2008. Since this consensus revenue estimate was agreed to, the Senate Fiscal Agency (SFA) has identified several areas of concern involving the estimated levels of revenue that will be available to finance State appropriations. These revenue concerns involve the following areas:

- Tobacco Settlement Revenue
- State Education Property Tax Revenue
- Non Homestead Property Tax Revenue
- Property Tax Settlement in Midland
- Impact of Federal Stimulus Package on Michigan Revenue
- Overall Consensus Revenue Estimate

These revenue concerns have the potential to have a \$383.6 million negative impact on the State budget with a General Fund/General Purpose negative impact of \$233.2 million and a \$150.4 million negative impact on the School Aid Fund budget. These revenue impacts occur in both FY 2007-08 and FY 2008-09, but they affect the eventual decisions made regarding the FY 2008-09 State budget. Table 1 provides a summary of these negative impacts.

Table 1

Potential Revenue Shortfalls in the State Budget (millions of dollars)			
Revenue Source	FY 2007-08	FY 2008-09	Total
State General Fund/General Purpose			
Tobacco Settlement Shortfall	\$(96.7)	\$0.0	\$(96.7)
Federal Stimulus Package.....	<u>(22.3)</u>	<u>(114.2)</u>	<u>(136.5)</u>
Subtotal General Fund/General Purpose	(119.0)	(114.2)	(233.2)
School Aid Fund			
State Education Property Tax.....	\$(35.2)	\$(100.4)	\$(135.6)
Non Homestead Property Tax.....	0.0	(54.4)	(54.4)
Midland Property Tax Settlement	(33.8)	0.0	(33.8)
Federal Stimulus	<u>54.0</u>	<u>19.4</u>	<u>73.4</u>
Subtotal School Aid Fund.....	(15.0)	(135.4)	(150.4)
Total Potential Revenue Impact	<u>\$(134.0)</u>	<u>\$(249.6)</u>	<u>\$(383.6)</u>

Tobacco Settlement Revenue

Michigan receives annual payments from the United States tobacco industry under terms of a 1999 settlement. Beginning in FY 2005-06, the major tobacco companies have been withholding a portion of their annual payments to states based on a provision in the settlement agreement dealing with the enforcement of the settlement on smaller tobacco companies. The resolution of these disputed payments is currently being debated by the Attorney Generals representing the states and the major tobacco companies. Until this dispute is resolved, a portion of the annual tobacco settlement revenue received by Michigan will be withheld. The FY 2007-08 enacted budget assumed that these disputed tobacco settlement payments would be resolved in favor of Michigan. If the dispute is not resolved by the time Michigan receives its FY 2007-08 tobacco settlement payment on April 15, 2008, the level of tobacco settlement revenue appropriated in the budget will exceed the actual level of the payment by approximately \$96.7 million. This will create an FY 2007-08 General Fund/General Purpose appropriation shortfall.

Table 2
Tobacco Settlement
Appropriations and Revenue
(millions of dollars)

	FY 2007-08 Year-to-Date
<u>Appropriations:</u>	
Attorney General	\$ 0.4
Community Health	144.0
Higher Education	123.6
Treasury	<u>3.1</u>
Total Appropriations	\$271.1
<u>Tobacco Settlement Revenue:</u>	
Beginning Balance	\$ 5.1
Annual Payments	321.4
Settlement of FY 2005-06 Disputed Payments.....	33.0
Settlement of FY 2006-07 Disputed Payments.....	31.7
Interest Earnings	<u>1.0</u>
Total Settlement Revenue	\$392.2
<u>Less Revenue Transfers Out:</u>	
Payment on 21st Century Jobs Fund Bond	\$(45.7)
Deposit to 21st Century Jobs Fund	<u>(75.0)</u>
Net Revenue Deposited into Merit Award Trust Fund	\$271.5
<u>Potential FY 2007-08 Revenue Shortfall:</u>	
FY 2005-06 Disputed Payment	\$(33.0)
FY 2006-07 Disputed Payment	(31.7)
FY 2007-08 Disputed Payment	<u>(32.0)</u>
Total Potential FY 2007-08 Revenue Shortfall	\$(96.7)

State Education Property Tax

The School Aid budget includes appropriations based on revenue collected from the State Education Property Tax. The January 2008 consensus revenue estimate assumed a level of State Education Property Tax deposited into the School Aid Fund in both FY 2007-08 and FY 2008-09. Based on discussions that the Senate Fiscal Agency has been having with local government property tax assessing units and the Department of Treasury, the Senate Fiscal Agency now believes that the January 2008 consensus estimate of State Education Property Tax revenue overestimated the actual revenue collections. The consensus revenue estimate assumed 2.7% growth in State Education Property Tax revenue in FY 2007-08 and 3.0% growth in State Education Property Tax revenue in FY 2008-09. Based on the Senate Fiscal Agency analysis, we now believe that these growth rates will be revised down to 1.0% in FY 2007-08 and to zero growth in FY 2008-09 when the May 2008 consensus revenue estimates are established. Table 3 provides a recent history of collections from the State Education Property Tax. The Senate Fiscal Agency is estimating that the potential revisions will total \$35.2 million in FY 2007-08 and \$100.4 million in FY 2008-09.

Table 3

Actual Collections and Estimates (millions of dollars)		
Fiscal Year	Collections	Percentage Change
2000-01	\$1,489.6	7.8%
2001-02	1,583.7	6.3
2002-03	1,673.2	5.7
2003-04	1,824.5	9.0
2004-05	1,914.6	4.9
2005-06	2,003.5	4.6
2006-07	2,091.2	4.4
2007-08 Consensus	2,147.3	2.7
2007-08 Revised	2,112.1	1.0
2008-09 Consensus	2,212.5	3.0
2008-09 Revised	2,112.1	0.0
Addendum:		
Change in FY 2007-08 Estimate	(\$35.2)	
Change in FY 2008-09 Estimate	(100.4)	

Nonhomestead Property Taxes

The funding for the basic foundation allowance in the K-12 School Aid budget is based on a combination of funds from the State School Aid Fund and revenue collected by the local school districts from the 18-mill property tax on nonhomestead property. To the extent that the actual level of nonhomestead property tax is less than the amount assumed in the School Aid budget, the State will have to provide additional revenue from the School Aid Fund to maintain the basic foundation allowance funding level assumed in the budget. The FY 2008-09 School Aid Fund budget assumed a 3.7% growth in calendar year 2008 nonhomestead property tax collections. The Senate Fiscal Agency now believes that the actual growth will be 1.5%. This creates a \$54.4 million funding shortfall in the FY 2008-09 School Aid Fund budget. Table 4 provides a recent history of non homestead property taxes used to fund the basic foundation allowance.

Table 4
Nonhomestead Property Taxes
Appropriated in the K-12 School Aid Fund Budget
Assumed Collections and Estimates
(millions of dollars)

Fiscal Year	Appropriated Level	Percentage Change
2000-01	\$1,726.4	
2001-02	1,836.4	6.4%
2002-03	1,925.5	4.9
2003-04	2,012.4	4.5
2004-05	2,120.9	5.4
2005-06	2,218.6	4.6
2006-07	2,350.4	5.9
2007-08 Appropriated	2,478.5	5.5
2008-09 Appropriated	2,570.1	3.7
2008-09 Revised	2,515.7	1.5
Addendum:		
Change in FY 2007-08 Estimate		
Change in FY 2008-09 Estimate	(54.4)	

Midland Property Tax Settlement

On February 21, 2008, the City of Midland announced an agreement with the Midland Cogeneration Venture to settle a property tax dispute covering property tax assessments for tax years 2001 through 2007. The proposed settlement is currently pending in front of the Michigan Tax Tribunal. The Department of Treasury has filed a motion to intervene in the proposed settlement. If the Michigan Tax Tribunal accepts the settlement as proposed by the City of Midland and the Midland Cogeneration Venture, the settlement will have a \$33.8 million negative impact on the FY 2007-08 School Aid Fund budget. This is a combination of the property tax loss from the State Education Property Tax and reimbursements to the Midland Public Schools to hold the basic foundation allowance funding constant given the loss of revenue from nonhomestead property resulting from the proposed settlement.

Impact of Federal Stimulus Package on Michigan Revenue

The Federal Economic Stimulus Act of 2008 was passed by Congress on February 7, 2008, and signed into law by President Bush on February 13, 2008. The purpose of this Act is to provide a fiscal stimulus to the slumping United States economy. Under this Act, the Federal government will inject \$151.7 billion into the economy in FY 2007-08 and another \$16.3 billion in FY 2008-09. The major features of this stimulus package are income tax rebates to individuals and a tax reduction for businesses by accelerating the depreciation of equipment purchases.

The Federal Stimulus Act of 2008 will have a direct impact on Michigan tax revenue in two ways: 1) The Federal rebates spent by individuals in Michigan will help boost sales tax, casino tax, and lottery revenue, and 2) the acceleration in depreciation that businesses will be able to claim will reduce Michigan business tax revenue and individual income tax revenue. Table 5 provides a summary of the Senate Fiscal Agency estimates of the impact of the Federal stimulus on Michigan State government revenue in FY 2007-08 and FY 2008-09. The net impact is a \$32.5 million revenue gain in FY 2007-08 and a \$94.4 million net revenue loss in FY 2008-09. The impacts of the Federal Stimulus Act of 2008 on Michigan revenue were not factored into the consensus revenue estimates agreed to in January 2008.

Table 5

Estimated Fiscal Impact of Economic Stimulus Act of 2008 on Michigan Revenue (millions of dollars)		
Provision	FY 2007-08	FY 2008-09
<u>Federal Tax Rebate to Individuals</u>		
Sales Tax.....	\$53.8	\$24.6
Lottery.....	10.6	1.0
Casino Tax.....	<u>4.5</u>	<u>0.4</u>
Subtotal Revenue Impact from Rebates	\$68.9	\$26.0
<u>Acceleration of Business Depreciation</u>		
Michigan Business Tax.....	\$(33.2)	\$(116.4)
Individual Income Tax.....	<u>(3.2)</u>	<u>(4.0)</u>
Subtotal Revenue Impact from Business Changes.....	\$(36.4)	\$(120.4)
Estimated Net Impact on Michigan Revenue.....	\$32.5	\$(94.4)
<u>Impact by Fund:</u>		
General Fund/General Purpose.....	\$(22.3)	\$(114.2)
School Aid Fund	54.0	19.4
Other.....	0.8	0.4

Potential Adjustments to Consensus Revenue Estimates

On January 11, 2008, the Consensus Revenue Estimating Conference agreed to consensus estimates of FY 2007-08 and FY 2008-09 General Fund/General Purpose (GF/GP) and School Aid Fund (SAF) revenue. Since these consensus revenue estimates have been agreed to, the State of Michigan has collected two additional months of revenue. During January 2008, actual collections from the State's major taxes were approximately \$40.0 million below the amount the Senate Fiscal Agency expected consistent with the consensus revenue estimate. The actual level of revenue collections for February 2008 is still being finalized, but based on preliminary data, the SFA believes that actual collections for February 2008 will be at expectations.

Outside of the previously mentioned changes in the estimates of the State Education Property tax, it is still too early to draw any definite conclusions as to potential changes in the January 2008 consensus revenue estimates.