State Notes

TOPICS OF LEGISLATIVE INTEREST

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Personal Property Tax Reform: A Continuing Story
By David Zin, Chief Economist

In 2012, Public Acts 397 through 403 began a phased-in property tax exemption of certain types of personal property owned by businesses. Because of the revenue impact on local units of government, a combination of a 2014 voter-approved ballot initiative and additional State legislation created a revenue source to make payments to local units in order to offset the losses. As the exemption phase-in has continued, and payments to local units have continued, interest in changing the distribution formula for payments has increased. Governor Snyder formally recommended changing the distribution formula in his fiscal year (FY) 2018-19 Budget Recommendation. This *State Notes* article provides a background on personal property tax reform and outlines a variety of proposed or potential ways to modify the distribution formula.

Background

In contrast to real property, such as land or buildings affixed to land, personal property is generally property that is not affixed to a structure, such as machinery, equipment or furniture. The 2012 legislation exempted two types of personal property: 1) commercial and industrial personal property owned by a single taxpayer and contained within a local tax collecting unit, if the true cash value of that taxpayer's total commercial and industrial property within the local unit is less than $80,000 (the small taxpayer exemption), and 2) commercial and industrial personal property that meets the definition of "eligible manufacturing property"--essentially property that is used at least 50% of the time in industrial processes or direct integrated support of such processing. Once fully phased-in, the exemptions were expected to reduce local unit revenue in FY 2027-28 by approximately $556.2 million per year and State revenue by approximately $11.8 million, and to require additional School Aid Fund expenditures of approximately $35.3 million in order to meet per pupil funding guarantees.

Because of the losses local units were projected to experience as a result of the exemptions, Ballot Proposal 14-1 was approved in August 2014, establishing a statewide authority (the Local Community Stabilization Authority, or LCSA) to levy a local use tax that funds reimbursements to local units. The local use tax is levied at a rate necessary to generate specific dollar amounts specified in statute, and reduces the General Fund portion of the use tax that the State would otherwise collect. Legislation adopted in conjunction with the ballot proposal specified how the authority's revenue would be distributed, allocating most of the revenue to local units based on their share of total statewide losses. Generally, local unit losses were calculated by comparing a local unit's taxable value for commercial and industrial personal property in the relevant year to the taxable value in 2013, and multiplying any decrease by a relevant millage rate. In statute, these losses are referred to as "qualified losses".

The LCSA distributes payments to a wide variety of local units, including local school districts, intermediate school districts (ISDs), community colleges, cities, counties, townships, villages, tax increment authorities, and other authorities that levy property taxes. Different provisions, several of which are discussed below, specify whether or not distributions are intended to 100% reimburse qualified losses and/or whether a specific type of local unit is eligible to receive different types of distributions.

Some millage rates, such as those levied for essential services (police, fire, jail, etc.), local school district and ISD debt and operating millage not reimbursed by the School Aid Fund, tax increment financing authorities, and losses attributable to the small taxpayer exemption, are reimbursed before other millage rates and local units receive 100% reimbursement for any calculated losses associated with those millage rates. Any remaining revenue then is distributed to local units, and for tax year 2016 and 2017, those distributions were based on local units' relative shares of total losses statewide. These payments reimburse debt and operating mills levied by community colleges, libraries, and authorities, as well as nonessential services mills levied by counties, cities, villages, and townships. According to statute, all of the remaining revenue received by the LCSA must be distributed, even if it exceeds qualified losses. However, for tax years 2016 and 2017, a local unit without qualified losses generally was unable to receive a payment.

The reimbursement formula's definition of qualified losses does not attempt to compensate local units for property taxes they are no longer allowed to collect because of the exemptions. For example, for a business that opened after 2013, the formula does not recognize or reimburse the local unit for any personal property tax revenue that the local unit would have received in the absence of the personal property tax exemptions. Instead, the formula was designed to compensate local units for the losses they would experience, estimated at the time the legislation was enacted and relative to their 2013 tax base. However, many factors other than the tax exemptions can cause a local unit's commercial and industrial taxable value to change over time. For example, depreciation and/or removing personal property from service can increase losses, while increases in nonexempt property can reduce overall losses. Because losses are calculated relative to the taxable values in 2013, it is possible for changes in nonexempt personal property to offset, or more than offset, losses associated with the exemptions (see Figure 1). In 2017, reimbursements exceeded qualified losses (as defined by statute) by approximately $157.1 million, essentially because of changes (primarily increases) that occurred in the value of non-exempt personal property.

Since 2016, the LCSA's revenue has been sufficient to not only pay all 100% guaranteed reimbursements but to offset all local units' qualified losses (calculated relative to the 2013 tax base) and still have revenue remaining. Because the statute requires the authority to distribute all of the revenue it receives, distributions are made even if the payments to a local unit will exceed the level associated with the 2013 tax base. Distributions that exceed the level associated with the 2013 tax base have often been termed "excess" or "bonus" distributions. The Governor's budget recommendations for both FY 2017-18 and FY 2018-19 froze appropriations for revenue sharing and community colleges under the argument that local units received increases as a result of these "excess" distributions; however, many local units that receive State aid through either revenue sharing or other appropriations are not eligible for the "excess" distributions, and other local units that are eligible to receive "excess" distributions do not receive constitutional and/or statutory revenue sharing payments.

The Original Distribution Formula for Calculating Payments to Local Units

The original formula for computing personal property tax reimbursements by the LCSA divided reimbursements into two categories: mills guaranteed to be reimbursed at a rate of 100% (often referred to as Tier 1 payments), and those that are not (often referred to as Tier 2 payments) (see Figure 2). Generally, reimbursements were computed relative to 2013 taxable values, so increases in nonexempt personal property could reduce the reimbursement a local unit received by masking the losses in exempt personal property. The portion of the Tier 2 payment available for reimbursement in excess of the 2013 taxable values also has been termed as a "Tier 3 payment", although the statute does not make a distinction for the portion of a Tier 2 payment in excess of the 2013 taxable value. A primary reason the statute did not formally distinguish whether or not the payment exceeded qualified loss was that, unlike Tier 1 payments, Tier 2 payments were not guaranteed to fully reimburse losses--the qualified loss only served as a measure to prorate payments across different local units in a manner related to the short-term cost of the exemptions. The original fiscal analysis indicated this point by highlighting that Tier 2 payments could fall short of, or exceed, the losses experienced by individual local units.

Under the original distribution formula, for reimbursements associated with calendar years 2016 through 2018, Tier 2 reimbursements were based on a local unit's share of total qualified losses statewide; although local school districts, intermediate school districts, and tax increment financing authorities (TIFAs) were not eligible for Tier 2 payments. (In the case of payments to schools, those reimbursements are addressed through provisions within or regarding the School Aid Fund.) Reflecting the different factors that can cause taxable values to change over time, local units where increases in nonexempt personal property exceeded the losses from the exemptions did not exhibit qualified losses and thus received no payments under Tier 2--even if there was exempt property located within the unit. For those units that exhibited taxable values lower than in 2013, the payment to the unit depended on the unit's share of total statewide losses. Thus, if a local unit exhibited 1% of total qualified losses statewide, that unit would receive 1% of the money distributed under Tier 2 payments, regardless of whether this distribution would be less than or more than the revenue that would have been received based on the 2013 taxable values. As a result of the original distribution formula, some local units with exempt property did not receive Tier 2 payments, while others received less than the actual losses, and others received more than their actual loss (especially if the loss is computed relative to the 2013 taxable values).

Beginning with reimbursements associated with calendar year 2019, the original formula for Tier 2 distributions was scheduled to change as a new formula phased-in over the next 20 years. The new formula (under the original legislation) was to be based on the acquisition cost of property subject to the essential services assessment. The essential services assessment (ESA) is basically a new, lower tax levied on personal property exempt from general property taxes. The new formula essentially represented a proxy for the revenue forgone (as opposed to qualified losses computed relative to 2013) as a result of the personal property exemptions. While the amounts calculated under the acquisition cost would not equal the actual revenue forgone, the formula was intended to adequately represent each local unit's relative share of total revenue forgone. The new acquisition cost-based formula also would mean that concepts such as "qualified loss" or "excess distribution" would become irrelevant over time, because eventually no money would be distributed based on qualified losses (i.e. losses relative to the 2013 taxable values).

The original formula, described above, applied to distributions associated with calendar years through 2017. Public Acts 247 and 248 of 2018 amended the original distribution formula, and will affect payments beginning with those associated with calendar year 2018.

Calculating Payments to Local Units Under Current Law
(Effective for Payments Beginning with Those Associated with Calendar Year 2018)

Public Acts 247 and 248 of 2018 enacted many changes to the original distribution formula. While the majority of Public Act 247's modifications were technical in nature, Public Act 247 made two important changes: 1) it created a formal statutory distinction separating the previous Tier 2 payment into new components that include something very similar to the "Tier 3" payment described above (i.e. any amount in excess of qualified losses), and 2) it changed both the amount distributed and the distribution formula for payments under what had previously been Tier 2. Public Act 248 changed the distribution formula in Public Act 247 by annually earmarking $13.6 million of the LCSA revenue to certain local units for Fire Protection Grants, before the new "Tier 3" payments are made (although these payments will be renamed below, to distinguish them from the previous "Tier 3" concept). These grants are made to local units in which the State has certain property which is exempt from local property taxes, especially those mills that would provide for fire protection. Public Act 248 also eliminated libraries and authorities from receiving any of the new "Tier 3" payments.

One implication of Public Act 247's changes is to largely render meaningless the description of Tier 2 (and the so-called "Tier 3") payments used prior to the adoption of the Act for individual local units. Prior to the Act's changes, Tier 2 represented all payments made to local units after the Tier 1 payments, while "Tier 3" represented a subset of Tier 2--namely the portion of the Tier 2 payment a local unit received in excess of its qualified loss. The reason these terms are no longer applicable for individual local units is because, under the Act, new types of payments are created out of the Tier 2 funds, and the total amount of one of those two payments is defined by aggregate qualified loss across all local units, even when the payments to individual local units may not be based on qualified loss.

Public Act 247 broadly divides the old Tier 2 revenue into two categories: a) the amount equal to total qualified losses statewide, and b) any revenue in excess of total qualified losses statewide. In aggregate, the second of these divisions would match the definition of "Tier 3" payments. However, because of the impact the new formula has on payments to individual local units, these categories will be referred to as Step 2 and Step 3, to distinguish them from the "Tier" terminology under the original distribution formula (see Figure 2). The Step 1 payments in Figure 2 are identical to the Tier 1 payments under the original formula and remain guaranteed at 100%.

Step 2 payments are split into two groups. The first group is distributed in the same way that Tier 2 payments were distributed in 2016 and 2017--based on a local unit's share of total qualified losses. However, beginning in 2021, 15% of the Step 2 payments are to be distributed based on the acquisition cost of property subject to the essential services assessment, and that percentage will increase by 5% each year until all Step 2 payments are distributed according to acquisition cost. As a result, the Step 2 payments will follow roughly the same distribution progression that the prior law would have applied to all revenue after the Tier 1 payments (i.e. Tier 2 payments), except that now the total amount distributed will be limited to the aggregate value of all qualified losses rather than all revenue remaining after Step 1 (a.k.a. Tier 1) payments.

Step 3 payments will be made using any revenue that remains after Step 1 payments, Step 2 payments, any payments necessary to correct payments made in a prior year, and the earmark of revenue to the Fire Protection Grants. Step 3 payments will be distributed to individual local units based on their share of the Step 2 payments, inclusive of any adjustments for certain overpayments and/or underpayments. Furthermore, Step 3 payments will be distributed only to cities, community colleges, counties, townships and villages. Compared to the original statute, Public Act 248 eliminates any payments to authorities (i.e., a transportation authority or library authority that is authorized to levy property taxes) in excess of qualified losses, although as described below, the new formula will not ensure that 100% of the qualified losses are reimbursed. To illustrate, under the original formula both a city library and a library authority could receive Tier 2 (and "Tier 3") revenue, while under Public Act 248, only the city library would receive a Step 3 payment, while the library authority (such as a district library or regional library system) would receive only a portion of its qualified losses.

For local units such as cities, community colleges, counties, townships, and villages, Public Act 247 does not alter the distribution of payments relative to the original formula. While Public Act 248 reduces the revenue available for distribution by earmarking revenue to Fire Protection Grants, eliminating Step 3 payments to authorities largely offsets the impact on other local units. Like the original formula, the portion distributed according to qualified losses will go only to those local units with qualified losses, while the portion distributed according to the acquisition cost of property subject to the ESA will be distributed to almost all local units. Similarly, over time the new distribution formula will (like the original formula) increase the chance that a local unit is not fully reimbursed relative to the unit's 2013 level.

However, unlike the original formula, the new distribution formula under Public Acts 247 and 248 eventually will become unviable. As the value of non-exempt property continues to rise over time, eventually no local unit will exhibit a qualified loss. Once that point is reached, no revenue will be distributed under Step 2. However, because the revenue to be distributed in Step 3 is distributed based on the payments made under Step 2, the formula will have no payments upon which to base the distribution. While at least some qualified losses are likely to exist for years, if not decades, at some point in the future qualified losses eventually will equal zero.

Under the original distribution formula, as the distribution of taxable values shifts each year, any given local unit could experience substantial increases or decreases in its Tier 2 payment. The formula under Public Acts 247 and 248 does not change the volatility of payments because taxable values, qualified losses, and acquisition costs of exempted property will continue to change from year to year at different rates in different communities, thus changing each local unit's share relative to the total. As a result, forecasting any local unit's future reimbursement requires forecasting the acquisition cost of exempt property, and the change in taxable values for every local unit in the State--an impossible task. Illustrations of alternative formulas can be generated by calculating how a prior year might have been distributed, but accurate prospective payment forecasts to individual local units are simply not possible.

Issues Relevant for Distribution Formulas

While the original distribution formulas were enacted as a result of Proposal 14-1 of 2014, the ballot language did not indicate the purpose of the LCSA beyond indicating that the Authority was to "provide revenue to local governments dedicated for local purposes, including police safety, fire protection, and ambulance emergency services". Proposal 14-1 did not identify the purposes of any distributions, nor compare them to expected revenue losses under any measure. Similarly, neither the legislation enacted with the exemptions in 2012 nor related to Proposal 14-1 states the purposes or goals of any distribution formula for revenue received by the LCSA beyond language in Public Act 86 of 2014, which states that the Act establishing the LCSA should be "broadly interpreted to effectuate" legislative intent--although the legislative findings in the Act do not mention anything regarding the distribution of revenue beyond indicating that one of the purposes of the Act is to "[d]edicate revenue for local purposes, including, but not limited to, police safety, fire protection, and ambulance emergency services".

However, much of the analysis and media coverage regarding Proposal 14-1 claimed an intent for the legislation. An April 1, 2014 press release from the Governor's Office indicated the legislation "will provide an estimated 100 percent reimbursement to municipalities for lost personal property tax revenue". An analysis of Proposal 14-1 by the Citizen's Research Council indicated that "[o]riginal PPT reforms enacted in 2012 included only partial reimbursement for lost local government revenues. A second legislative package that was enacted in 2014 contained a revised reimbursement plan which is expected to provide full replacement revenues for local units of government."

The Mackinac Center echoed that conclusion in its *Policy Brief*, which stated:

> The package of bills…includes a mechanism for reimbursing local government units for the revenue lost from these new exemptions. The state would set aside a portion of the statewide Use tax revenue, and use this revenue to reimburse local governments. It is estimated that local governments will be reimbursed for the entirety of the revenue lost due to the personal property tax cuts.

Media and special interest groups also made similar statements, with the Detroit Chamber of Commerce indicating, "Proposal 1 guarantees that 100 percent of the revenue lost due to the elimination of the personal property tax will be replaced from funding through the State Use Tax", and the Detroit News stating "[u]nder a deal with local officials Lt. Gov. Brian Calley helped to broker, the state will make up 100 percent of revenue lost as the personal property tax is phased out."

Few of these announcements and analyses specified the standard by which the legislation measured "lost revenue". However, as Crain's Detroit Business indicated:

> It looks like local communities will be made whole on personal property tax after all.…

> The plan, as originally proposed, would have guaranteed only 80 percent reimbursement, but it would have allowed communities to seek a special assessment to make up the difference.
>
> The Michigan Legislature repealed the personal property tax during the lame-duck session in December 2012, if approved by voters this August. That gave supporters of the repeal time to build their case, and opponents time to work with the administration to ensure that the loss of revenue the tax produces does not cause shortfalls in municipal budgets around the state.
>
> Full reimbursement is defined as the amount of money local governments were receiving in December 2012.

In actuality, the statute does not define "full reimbursement", but does define qualified losses relative to the revenue received based on tax values used for the 2013 tax year, even if it does not indicate that payments will fully compensate all qualified losses.

Neither the legislation, nor statements associated with Proposal 14-1, indicate the goal or purposes of any distributions once all local units had received enough payments to allow them to reach the 2013 level. Furthermore, the issue of how changes in revenue not associated with the exemptions should affect payments is not addressed--although the statute implicitly conflates such changes with any changes resulting from the exemptions.

Important Issues for a Distribution Formula

Any distribution formula for LCSA revenue will, either implicitly or explicitly, answer the following questions:

1) Should distributions be based on factors related to revenue lost from exempting personal property from taxation?

2) If distributions should be based on lost revenue from the exemptions, what is the appropriate way to measure the loss? Should it be based on the revenue received in a specific year, or on what would have been received absent the exemptions? Should losses be adjusted for inflation and/or economic growth, adjusted for population changes, the economic structure of the local unit and/or its reliance on personal property taxes, or some combination of these factors and perhaps others?

3) If revenue loss is to be measured, how should changes not associated with the exemptions be addressed?

4) If revenue loss is to be measured, how should funds in excess of those losses be distributed?

5) If distributions are not based on revenue lost from the exemptions, what are the appropriate factors upon which to base distributions? Should distributions follow some current or prior version of either constitutional and/or nonconstitutional revenue sharing distributions? Should the type of local unit, or how a local unit is organized, result in different payments?

The original distribution formula explicitly based distributions on the loss relative to 2013, and allowed changes in taxable values not associated with the exemptions to increase or decrease calculated losses. The original distribution formula distributed any revenue in excess of losses in the same proportion as losses. Beginning in 2019, the original formula was to begin phasing in a distribution based on the acquisition cost of exempt property; meaning that as calculated losses relative to 2013 declined as a result of inflation and/or the growth in the value of nonexempt personal property, revenue would be distributed based less on calculated losses and more on the value of exempt property. Under the original formula, the concept of a "Tier 3" or "excess" payment eventually would vanish as the new formula phased in.

The current distribution formula, after Public Acts 247 and 248, would still be based on calculated losses and, eventually, the value of exempt property. While the new formula distributes revenue in the same proportion as the original formula, it explicitly recognizes a split between the aggregate revenue needed to reimburse total qualified losses and any additional revenue available. The new formula recognizes this split even though after 2021 the revenue to be distributed under that part of the formula will be distributed to local units that do not exhibit qualified losses. Furthermore, unlike the original formula, the split that recognizes "excess payments" will not vanish as the formula adjusts over time.

The current distribution formula answers the questions above as follows:

1) Distributions should be based on factors relating to the revenue lost from exempting personal property.

2) Revenue loss should be initially measured by calculated losses relative to 2013 but should eventually be measured by the acquisition cost of exempt property. No adjustments should be made for inflation, economic growth, population, or any other factors.

3) As long as qualified loss is included in the calculation, changes <u>not</u> associated with the exemptions are to be combined with changes associated with the exemptions.

4) Funds in excess of qualified losses should not be distributed to authorities, and other eligible units should receive payments based on their share of payments already distributed under other components of the formula.

5) These questions do not apply because all of the distributions under the current formula are based on factors related to the exemptions.

Alternatives to the Current Distribution Formula

As mentioned above, the Governor's FY 2018-19 Budget Recommendation proposed modifications to the LCSA's distribution formula. The Michigan House also passed legislation to amend the formula. This section summarizes those proposals, as well as describes other approaches that could be harnessed to address issues that have arisen under the current distribution formula.

The Governor's Proposal: The Governor's FY 2018-19 Budget Recommendation proposed modifying the distribution formula for Tier 2 payments. The proposal would make Tier 2 payments identical to the original formula until the qualified losses (computed relative to 2013 values) were paid. After paying qualified losses, the proposal directed $15 million to fund Fire Protection Grants and then divided the remaining revenue in set shares to community colleges, counties, cities, villages, and townships. The proposed formula eliminated "excess" distributions to libraries and authorities. The proposed amount to be distributed to community colleges would be allocated based on the same proportions as State appropriations, while the remaining distributions would be paid on a per person basis based on a unit's revenue sharing population. While the proposed formula would ensure that all community colleges, counties, cities, villages and townships received a Tier 2 payment, the distributions after qualified losses were paid would have no relationship to the value of exempt personal property within the local unit and, in a number of cases, would transfer payments from local units with substantial exempt personal property relative to population to local units with little exempt personal property relative to population--in other words, from heavily industrialized areas to nonindustrial areas.

The House Proposal in House Bill 5908 (H-1): The House passed a new redistribution formula which combined aspects of the current distribution formula and the Governor's proposal. The House formula would have ensured that local units with qualified losses were reimbursed for those losses, at least as long as the revenue directed to the LCSA exceeded the value of qualified losses, despite including provisions that would phase-in distributions based on the acquisition cost of property subject to the essential services assessment. Similar to current law, the House formula earmarked $12.0 million in revenue for fire protection grants, and eliminated distributions to units other than cities, community colleges, counties, townships, and villages that exceeded a unit's qualified loss. For those local units that could receive them, the House proposed that distributions beyond a unit's qualified loss would be split across the types of local units (like the Governor's proposal) and would begin a phase-in to the Governor's per capita distribution, except that the per capita distribution would never comprise more than 50% of the distribution, the remaining portion of the distribution would be based on qualified loss, and community college payments would be based on fiscal year equated students rather than the share of State appropriations. Compared to the Governor's proposal, the House proposal would have distributed more revenue to units with qualified losses, but still would distribute an increasing share of revenue in a manner not related to the value of exempt property within a local unit.

Accelerate the Acquisition Cost Approach. An issue with the original (and current) distribution formula, especially during 2016 and 2017, is that because it is based on qualified losses and combines changes in taxable values associated with the exemptions with those that are not, many local units do not receive a Tier 2 payment. (As indicated above, this combining means that growth in non-exempt property could mask, or exceed, losses from the personal property tax exemptions.) Furthermore, because the LCSA must distribute all revenue it receives, many local units that do receive Tier 2 payments receive more than their qualified losses (i.e. the "excess" payments mentioned earlier). In some cases, these local units' Tier 2 payment may exceed the amount they would have lost even if the nonexemption-related changes were not included in the calculation for qualified losses.

Because the new acquisition cost based formula that will phase in does not include the concept of qualified losses, it eliminates the idea of "excess" payments. If an objection to the current distribution formula is that local units are receiving "excess" payments, the acquisition cost formula looks more at a relationship with exempt property without respect to how taxable values have changed due to factors not related to the exemption. As a result, one way to address the issue of "excess" payments would be to distribute all payments in excess of the qualified loss according to the acquisition cost based formula. Such an approach could either maintain the approximately 20-year phase-in, so that within 20 years all revenue would be distributed on the basis of acquisition cost regardless of whether qualified losses still existed, or the formula could be structured to always reimburse qualified losses first, and then use acquisition cost for any remaining revenue. The second option is perhaps more compelling because only the acquisition cost portion is not affected by changes in taxable value not due to the exemptions. Relative to the acquisition cost formula, the qualified losses formula--even if limited only to reimbursing up to the total of qualified losses--will distribute less revenue to local units that experience growth in non-exempt personal property and additional revenue to local units where economic decline and/or changing demographics result in the retirement or migration of taxable personal property.

Taxable Value Options. As mentioned earlier, how to measure a local unit's "loss" due to the property tax exemptions is a fundamental question. The current calculation of qualified loss is distorted by changes in taxable value not related to the exemption. One option would be to redefine the definition of calculated loss to reflect the taxable value of exempt property. Taxpayers largely track a variant of this information already, as the taxable values for most personal property closely track the values that firms must use when claiming depreciation for Federal or State income tax purposes. As a result, there are several variants that could produce either approximate or exact taxable values for exempt property. One option could calculate qualified loss based on depreciated values used for income tax purposes. An alternative approach could simply require taxpayers to report the taxable value of exempt property, although without levying an actual tax, there is little reason for either taxpayers or taxing authorities to invest meaningful effort in ensuring the values are accurate. A variant of this second option could subject the exempt property to the State Education Tax, and perhaps eliminate the Essential Services Assessment to offset the impact of the change on both the State and taxpayers. Any option that resulted in local units being able to determine the taxable value of exempt property would allow the LCSA to calculate local unit losses exactly.

Distributions not related to the value of exempt property. An infinite number of distribution formulas could be devised, whether for all Tier 2 revenue, Step 3 revenue, or just "excess distributions". Although both the original and the current statutes suggest distribution formulas that remain linked to the value of exempt property (and through which all local units could receive a share of the money), the proposals from the Governor and the House suggest that distributions could be based in whole, or in part, on factors such as selected State appropriations or population. Similarly, given that at various points in time nonconstitutional revenue sharing has been used to reimburse local units for State-imposed property tax changes, a distribution formula also could include aspects of any current or previous revenue sharing formula.

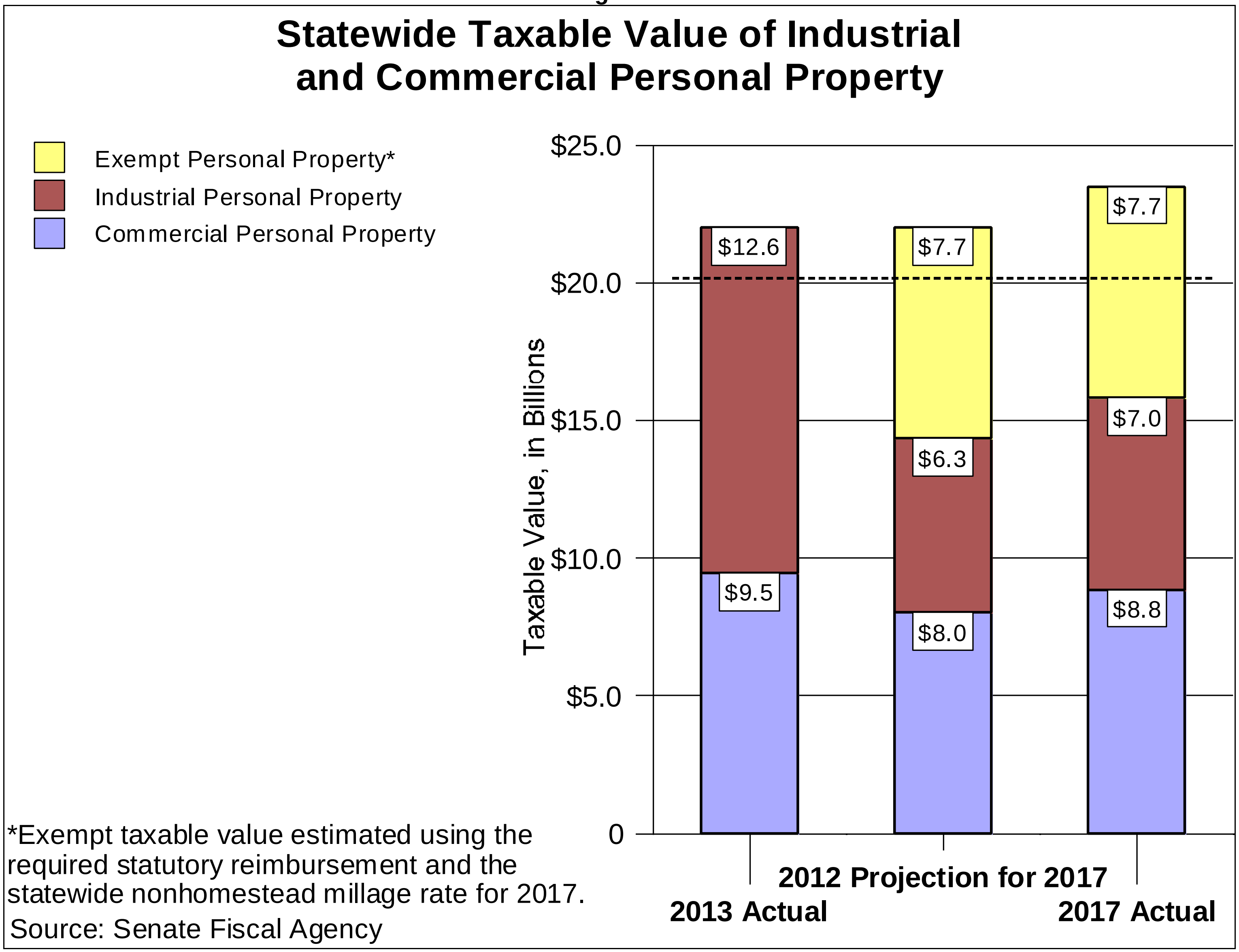
Conclusion

By their nature, distribution formulas are zero-sum: one recipient cannot receive a larger distribution without at least one other recipient receiving less. As a result, it is important for any distribution formula, or a change in a distribution formula, to define what it seeks to accomplish. By articulating goals, a formula can be evaluated by how well it meets those goals, and any differences (or changes) between the distributions that communities receive can be justified rather than appearing arbitrary.

Currently, distributions to local units are based on qualified loss: a measure of revenue loss that includes factors unrelated to the personal property tax exemption. In the future, a new formula will be phased in that instead will use acquisition cost as a proxy for the distribution of lost revenue. The original distribution formula did not distinguish between payments up to, or beyond, qualified loss. The current formula makes that distinction, although functionally, the current formula also will largely render that distinction irrelevant. Regardless, to date, all distributions have had some relationship with the value of exempt property. The Governor and the House made proposals that would move distributions to be based on factors not related to the value of exempt property.

This paper has discussed factors that any distribution formula will either implicitly or explicitly address, and broadly described several modifications to the current distribution formula that could be made to more specifically address those factors. Generally, the future distributions to individual local units will be impossible to predict under formulas tied to the value of exempt property, even if those distributions will more accurately reimburse local units for their losses. Distributions based on other factors may be more predictable, but will be more likely to redistribute revenue away from local units with the most substantial losses. How the Legislature and the Governor have addressed these concerns has been a topic for debate and, regardless of whether any changes are made to the distribution formula in the near future, that debate is likely to continue for years.

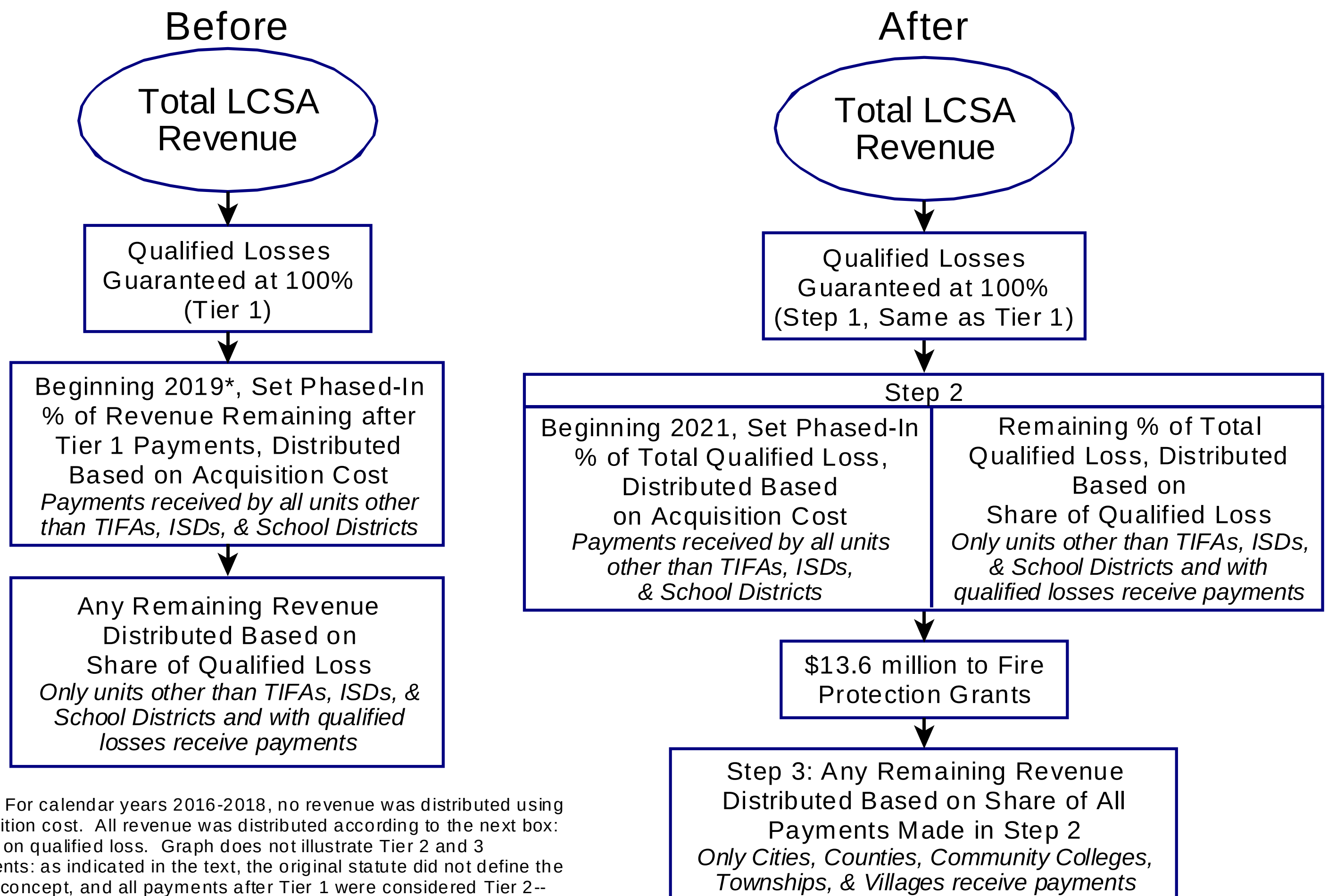
Figure 1



Ellen Jeffries, Director – Lansing, Michigan – (517) 373-2768
www.senate.michigan.gov/sfa

Figure 2

LCSA Payment Distributions
Before and After Public Acts 247 and 248 of 2018



*Note: For calendar years 2016-2018, no revenue was distributed using acquisition cost. All revenue was distributed according to the next box: based on qualified loss. Graph does not illustrate Tier 2 and 3 payments: as indicated in the text, the original statute did not define the Tier 3 concept, and all payments after Tier 1 were considered Tier 2--regardless of the how the payent was distributed.

Ellen Jeffries, Director – Lansing, Michigan – (517) 373-2768
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