BUILDING EQUITABLE COMMUNITIES:
More Funding Needed for Local Governments

Brandon Betz, Tax Policy Analyst | October 2020

Introduction

Counties, cities, villages and townships are integral units of government in Michigan. While the state handles broad issues like financing education, regulating industries and occupations and managing intrastate commerce, local units of government fund and administer essential services at a micro-scale. Counties and cities, villages, and townships (CVTs) are responsible for fire services, sewers, local roadways, parks and recreation, planning, public safety, et cetera. Because local units of government are operated on a small scale, they are more responsive to local needs and are therefore situated to address the unique demands of a community. In 2017, counties and CVT expenditures accounted for $48 billion, or 49% of direct local and state government spending combined.[1]

While $48 billion seems to be a large sum, revenue collections for counties and CVTs have lagged behind the increasing demand for services and other inflationary pressures, leaving many local units of government in states of fiscal stress. Although property values have been increasing since the Great Recession, property taxes have lagged behind inflation because of constitutional caps on the taxable value of property. Most alternative local revenue options have either been pre-empted or eliminated by the state. In exchange for these limitations and to ensure robust funding of locally provisioned services, the state has historically compensated local units of government through what is known as revenue sharing. Revenue sharing payments to localities are unencumbered, meaning that they can be spent for any general purpose. Revenue sharing has declined significantly over the last twenty years.

Increasing local revenues is a racial justice issue. To achieve the vision of racial equity, economic prosperity, and social justice, the people, organizations, and governments that support those goals need resources. With more flexible spending power, local units of government can target resources to programs and services as needed.

Local political races are easier to win in terms of funding and other typical campaign resources. Additionally, local politicians and civil servants are more responsive to neighborhood needs and are easier to hold accountable because of the relatively small size of their districts. This means that Black, Brown and indigenous communities can begin to build real power and achieve economic and social justice through programs and services administered at the local level.

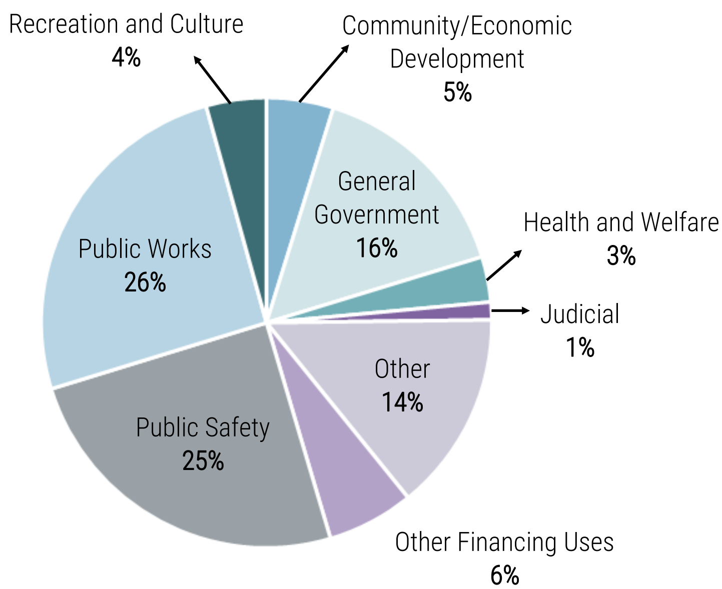
To ensure that local units of government have the funding they need in the future to fund the programs and services that build a more equitable community, the Michigan League for Public Policy recommends:

1. Significantly increasing statutory revenue sharing to counties and CVTs to at least match what is called for under the statutory formula from Public Act 532 of 1998;
2. Creating new formulas for the distribution of statutory revenue sharing to send more resources to communities with low housing wealth;
3. Expanding the Homestead Property Tax Credit;
4. Authorizing more tax options for local units of government.

Primer on Local Government Expenditures and Revenues

Cities, villages and townships spend a majority of their general fund revenues on public safety and public works. Public safety encompasses fire and other forms of public safety, while public works encompass local road funding, sanitation services and public transportation. Combined, these services account for 51% of CVT spending.

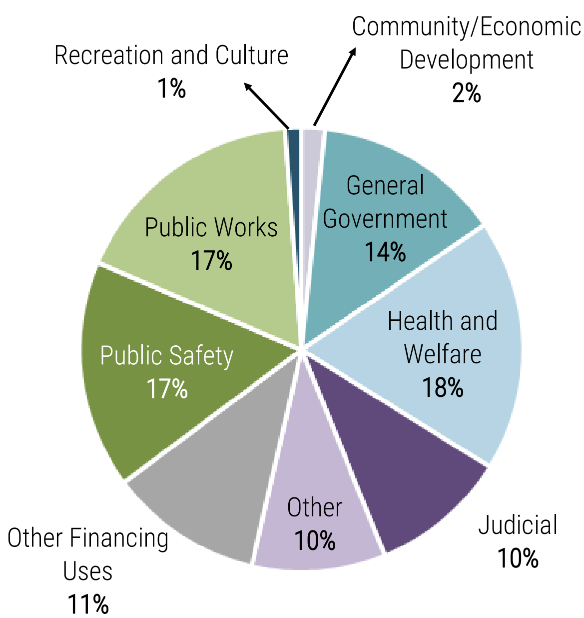
City, Village and Township Expenditures, 2019



Source: Michigan Treasury Form F-65 Data

MICHIGAN LEAGUE FOR PUBLIC POLICY | WWW.MLPP.ORG

County General Fund Expenditures, 2019



Source: Michigan Treasury Form F-65 Data

MICHIGAN LEAGUE FOR PUBLIC POLICY | WWW.MLPP.ORG

General government, representing 16% of CVT spending, includes government administrators, such as mayors, councils, attorneys, clerks, election equipment and building maintenance. The "other" category represents debt services and capital outlays not otherwise represented.

CVTs also have the authority over zoning and planning, as well as some responsibility for attracting businesses and talent, housed under community and economic development. Parks and recreation, health and welfare, and payments for local judicial systems represent important but small amounts of spending from CVTs.

Michigan counties spend their revenues on similar priorities. However, Michigan counties are largely responsible for health and welfare spending, including on health departments and mental health resources. Counties are also responsible for circuit courts, family courts and probate courts.

Cities, villages and townships derive 33% of their general fund revenue from taxes. An overwhelming majority of taxes collected by CVTs are property taxes. Cities are authorized to collect a limited income tax; however, CVTs are largely unable to levy taxes outside of the property tax.

To cover the costs of administering services, CVTs are authorized to charge fees for services rendered. These include equipment and park rental fees, parking fees, trash and recycling collection fees, sewer charges and inspection fees, among others. These fees are not meant to generate extra General Fund revenue but instead are charged at a rate to offset the cost of providing these services to the public.

Charges for services represent 26% of General Fund revenues for cities, villages and townships.

The third largest revenue source for CVTs are state grants. A majority of these grants come through state revenue sharing, which are constitutional and statutory payments made to localities from state coffers. These payments represent 15% of CVT revenue, overall.

The sources of General Fund revenue for counties mirrors that of CVTs. Charges for services represent 29% of General Fund revenue collections, while tax revenues account for 28%. While revenue sharing represents approximately 15% of CVT revenue, counties rely on this revenue more, as it accounts for approximately 20% of county General Fund revenues.

Local Taxing Authority

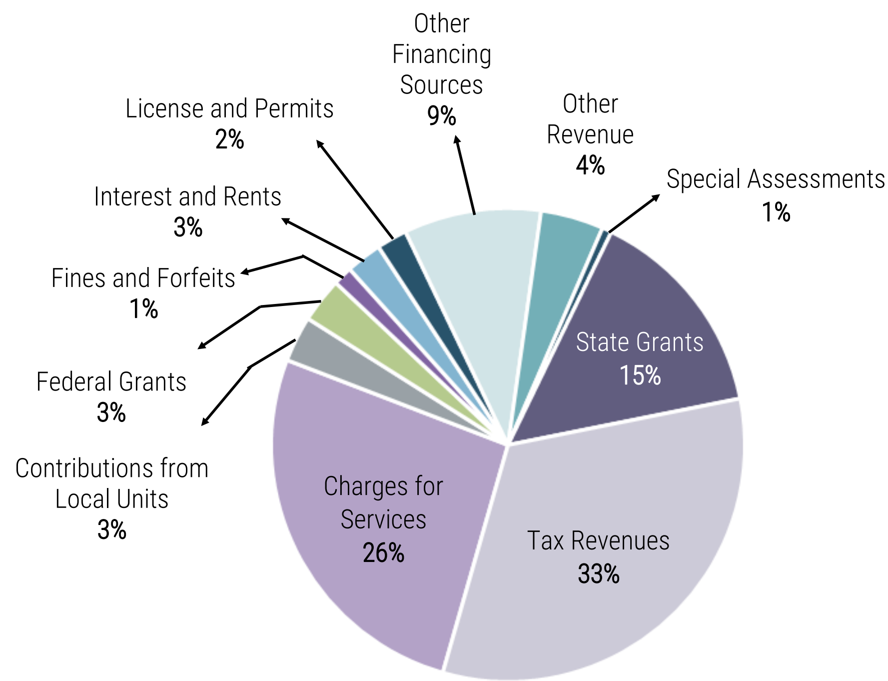
Local units of government in Michigan rely heavily on property taxes. While some local taxing options exist outside of the property tax, most local units of government are precluded from raising revenue from residents in other ways.

Property Taxes

Property taxes are a function of property value and millage rates. A millage rate is the tax rate used to tax property and represents the amount per $1,000 of a property's assessed value. As property values increase or millage rates are adjusted upwards, a local unit of government collects more revenue.

Property taxes are restricted constitutionally through caps on the taxable value of property and millage rates. In counties with separate, voter-fixed allocations, the total

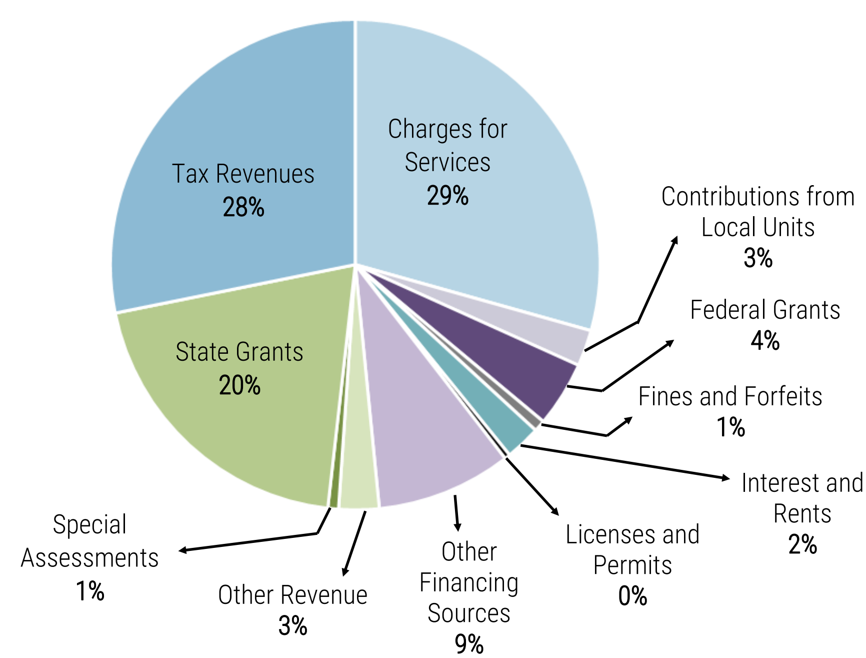
City, Village and Township General Fund Revenue Sources, 2019



Source: Michigan Treasury Form F-65 Data

MICHIGAN LEAGUE FOR PUBLIC POLICY | WWW.MLPP.ORG

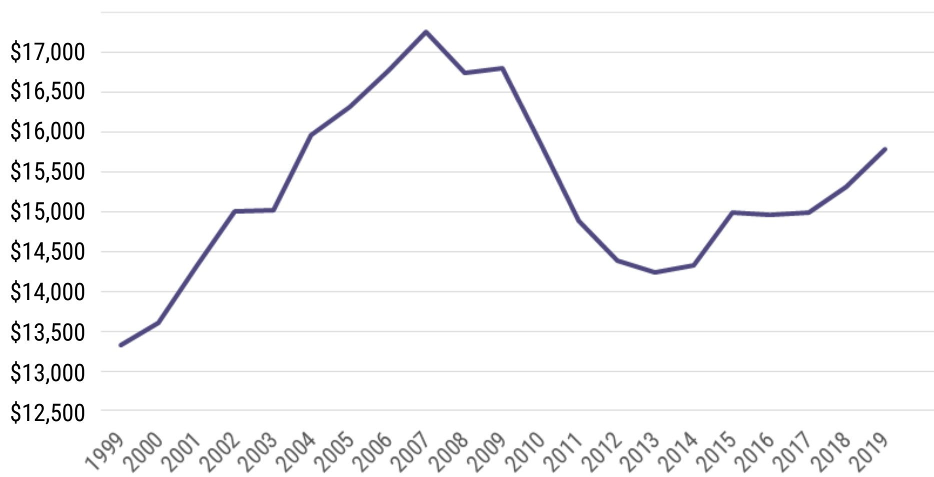
County General Fund Revenue Sources, 2019



Source: Michigan Treasury Form F-65 Data

MICHIGAN LEAGUE FOR PUBLIC POLICY | WWW.MLPP.ORG

Total Property Tax Collections, Adjusted for Inflation to 2019 Dollars (millions)



Source: 2019 Ad Valorem Property Tax Report, Michigan Treasury

MICHIGAN LEAGUE FOR PUBLIC POLICY | WWW.MLPP.ORG

amount that property can be taxed cannot exceed 15 mills or 18 mills, depending on the jurisdiction. These limitations can be lifted in some circumstances with voter approval.[2]

Excluded from millage rate limitations are cities, villages, and townships and Wayne and Macomb counties. These units of local government are exempt because they have separate tax limitations provided under charter or general law. There are also special exceptions to the millage cap for certain districts, including water authorities, port districts, metropolitan districts and downtown development authorities. Also, certain taxes imposed by municipalities for special purposes, such as garbage services, libraries, senior services, and police and pension funding are exempt.[3]

When adjusted for inflation, property tax collections in 2019 were 8.7% below collections in 2007 and only 11% above the trough in property tax collections brought on by the 2008-2009 foreclosure crisis. In 2019, real Michigan property tax collections were on par with collections in 2004.

These trends in property tax collections are the product of two intertwined constitutional limitations.

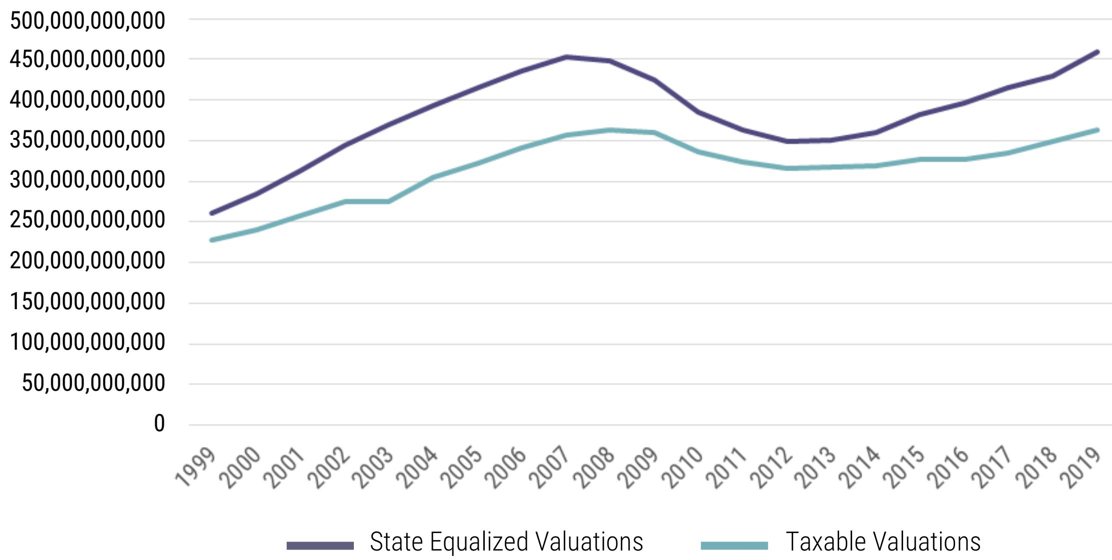
The Headlee Amendment

The Headlee amendment, passed in 1978, requires local units of government to reduce their millage rate when the annual growth on existing property is greater than the rate of inflation. This means that a local unit of government's millage rate gets "rolled back" so that the resulting increase in property tax revenue in the entire taxing district is no more than the rate of inflation.

Proposal A

Proposal A was passed in 1994 and included major property tax reform, essentially shifting the cost of K-12 education from local property taxes onto the state. The amendment dramatically lowered property taxes in exchange for a 2-cent increase in the sales tax. Proposal A changed the property tax to be levied on a property's taxable value instead of state equalized value. Under Proposal A, taxable value increases are capped at the least of 5% or the rate of inflation. When property is sold, taxable value is reset to the state equalized value and then annual increases in taxable value are capped again.

State Equalized Value vs. Taxable Value



Source: 2019 Ad Valorem Property Tax Report, Michigan Treasury

MICHIGAN LEAGUE FOR PUBLIC POLICY | WWW.MLPP.ORG

Because of this amendment to the constitution, taxable value lags behind state equalized value, meaning that property tax growth has lagged significantly behind increasing property values.

Consequences of the Confluence of Proposal A and the Headlee Amendment

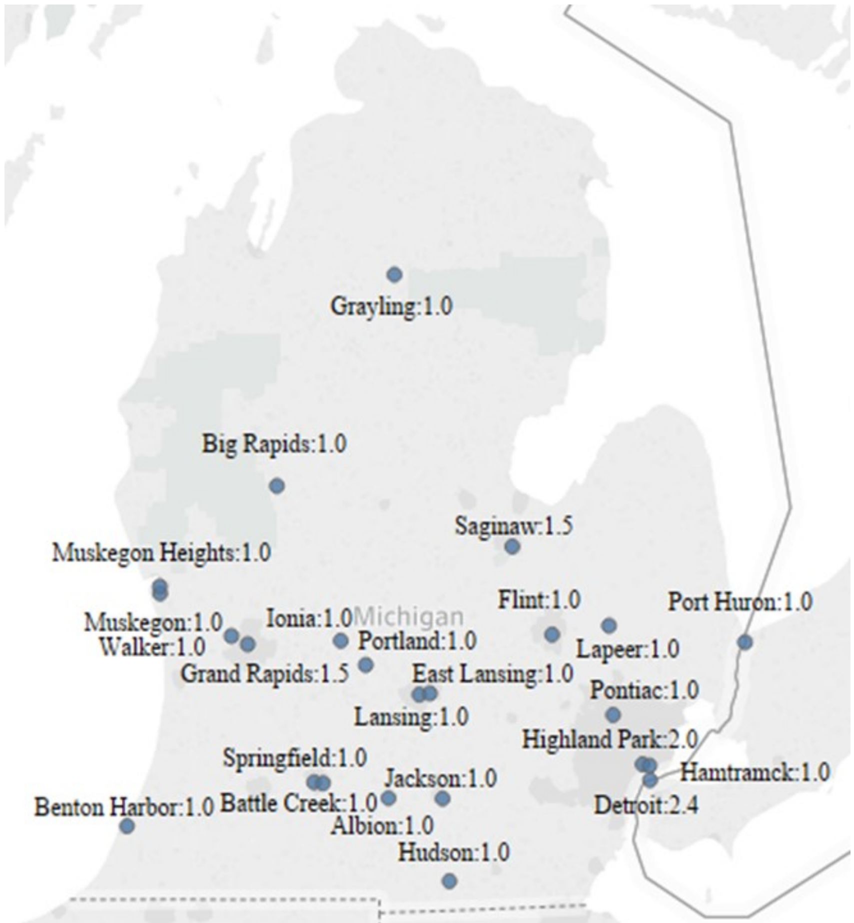
The passage of Proposal A had some unintended consequences when combined with the Headlee Amendment. Proposal A's property tax changes did not specifically exclude from Headlee rollback calculations increases in property taxes resulting from property transfers. Under Proposal A, if property is sold, the taxable value of that property increases to the state equalized value of the property. This leads to an increase in property tax collections from the property, which triggers a Headlee rollback, thus rolling back the maximum authorized millage rate. This results in a reduction in new revenues that would have been realized by the bump in taxable value of the sold property.

Even though taxable values for particular properties increase at the rate of inflation under Proposal A, the triggered Headlee rollbacks cause a less-than-inflationary increase in the actual revenue from property taxes. This has limited property tax growth over time.[4]

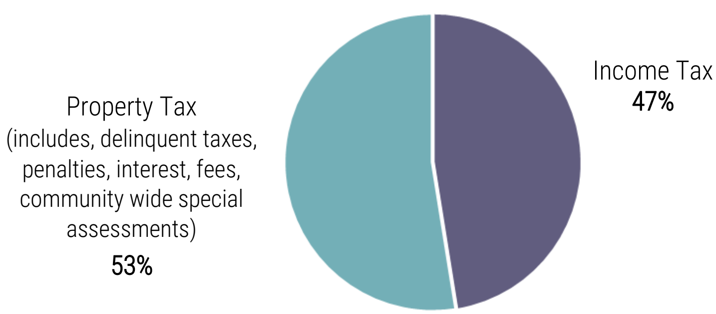
City Income Taxes

The Uniform City Income Tax Act of 1964 authorizes cities to enact a broad-based income tax on residents and non-residents whose work or business activities are conducted within the city. Also, the act allows for a direct tax on federal taxable income for corporations. The income tax can be levied at a maximum rate of 1% on residents and corporations and 0.5% on the income of non-residents who work in the city. Detroit is authorized to tax income at 2.2% for residents, 2% for corporations, and 1.1% on non-residents. The act also requires an exemption for not less than $600 of income, meaning that the first $600 of income is not included in income tax calculations. In 2019, there were 24 cities that levied an income tax.[5]

Cities That Levy an Income Tax



City Tax Breakdown for Cities with Income Tax, 2019



Source: Michigan Treasury Form F-65 Data

MICHIGAN LEAGUE FOR PUBLIC POLICY | WWW.MLPP.ORG

Even though city income taxes are limited, cities with an income tax rely heavily on it as a revenue source. In 2019, city income taxes represented 47% of tax collections for cities with an income tax. Income tax revenues have been rising since the Great Recession, as more workers have entered the labor force and found jobs. Unlike property taxes, income tax collections are uncapped and have tracked with personal income, rising more than inflation year-over-year since at least 2010.

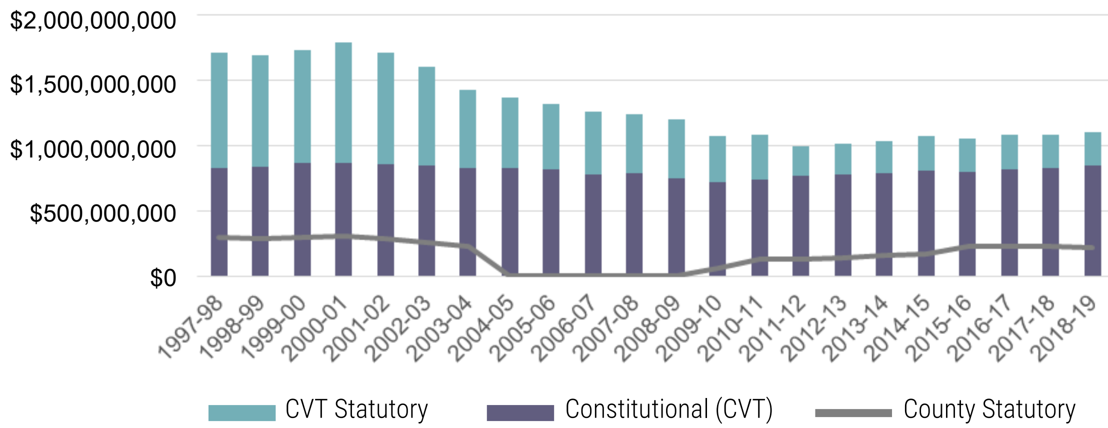
Revenue Sharing

The state has created two primary mechanisms for providing funding to local units of government. The first is through Public Act 51 of 1951, which allocates a portion of gas tax revenue to local units of government earmarked specifically for local road maintenance and construction. The formula is based on the number of miles of road within a local taxing jurisdiction. The second mechanism, revenue sharing, is an unrestricted source of revenue for counties and CVTs.

There are two types of revenue sharing, known as constitutional revenue sharing and statutory revenue sharing. Constitutional revenue sharing is distributed to cities, villages and townships on a per capita basis. The source of constitutional revenue sharing has changed over time but has largely been maintained since 1946. Since 1974, the constitutional earmark for revenue sharing is equal to 15% of 4% of the sales tax.

Statutory revenue sharing, on the other hand, has not been maintained over time. The original purpose for statutory revenue sharing was to reimburse counties and CVTs for the erosion of local taxing authority by the state. There have been various earmarks for statutory revenue sharing over the years, including the distribution of liquor license fees, sales

Revenue Sharing Payments, Adjusted for Inflation to 2019 Dollars



Source: Michigan House Fiscal Agency

MICHIGAN LEAGUE FOR PUBLIC POLICY | WWW.MLPP.ORG

taxes, income taxes and single business taxes. In 1998, the Revenue Sharing Act was amended to specify that the above funding sources would be replaced by 21.3% of sales tax revenue collected at the 4% rate.

Since statute cannot mandate an appropriation, statutory revenue sharing has not been fully funded since 2001.[6]

Statutory revenue sharing has gone under different names with various requirements to be met by counties and CVTs. The Economic Vitality and Incentive Program (EVIP) replaced statutory revenue sharing in 2010 for CVTs. This program made statutory payments contingent on fulfilling requirements related to accountability and transparency, consolidation and collaboration, employee compensation issues, and reducing unfunded liabilities. CVT Revenue Sharing replaced EVIP in 2014, leaving only requirements related to accountability and transparency. Starting in 2013, 20% of county revenue sharing payments became subject to the County Incentive Program, which imposed the same accountability and transparency requirements as the Economic Vitality and Incentive Program.

Fines and Fees

In the face of declining revenues and increasing service delivery costs, local units of government in Michigan are forced to confront this structural imbalance in increasingly inequitable and unpopular ways. One of these solutions that has been recorded in many states is the increasing reliance on fine and fee collection to pay for city services.

The white supremacist system on which modern policing is built and longstanding racially biased policing in Michigan have created a system where Black and Brown people in Michigan are systematically targeted by police. For example, national data from traffic stops suggests that Black drivers are likely targeted for pull-overs by police officers and are held to a lower standard for search decisions.[7] Systemic racism in policing extends beyond traffic stops, however. These same tendencies are likely seen in other interactions between police and Black, Brown, and indigenous individuals, meaning that they are likely fined at greater rates than white people. Additionally, because of longstanding racism and discrimination in the workforce, Black and Brown families have been excluded from higher-paying jobs, leading to these families having less discretionary income. Without discretionary income, unexpected fines and fees can be a heavy burden for a family to bear.[8] As such, a heavy reliance on fines and fees will disproportionately affect Black and Brown communities.

The State of Local Revenues Today

Michigan local governments have seen their local revenue options diminish over the last few decades at the hands of the state, while the state has promised to make local units of government whole though revenue sharing. According to data provided by the Michigan Treasury, revenue sharing payments to CVTs declined 35.4% and payments to counties fell 25.4% between 1997 and 2019. The Michigan Legislature has not been pulling its weight in providing statutory funding to local units of government; in 2019, 64% of revenue sharing payments were constitutional, as compared to 41% in 1997.

The budget for 2020-21 held harmless statutory revenue sharing for counties and CVTs. However, constitutional revenue sharing is estimated to fall by $14 million next year. This is going to put cities, villages and townships in worse financial shape as they recover from the budgetary effects of the COVID-19 pandemic.

The local response to declining revenues has been varied, including increased intergovernmental collaboration, service and budget cuts, and increases in property taxes and fines and fees where possible.[9] As of 2018, local revenue per capita in Michigan is far below the national average and lower than Michigan's neighboring Great Lakes states.[10]

Since the onset of the COVID-19 pandemic in Michigan, local units of government have had to tackle unprecedented declines in local revenue. In response to these revenue reductions and the structural inflexibility of local units of governments to raise revenue, governments have been forced to cut their budgets significantly. The CARES Act allocated $793.8 million in limited-purpose funds to local units of government with populations greater than 500,000; however, this allocation only went to five units of local government. These funds were limited in purpose in that they could not be used to cover budget deficits and were to be used for expenses incurred due to the COVID-19 pandemic. Without additional aid to all local units of government, residents in these counties and CVTs will face more problems.

Health data from the Department of Health and Human Services shows that there has been a significant disparate impact of COVID-19 on the health of people of color in Michigan. These effects reverberate throughout the economy as residents are pulled out of the workforce to attend to their families with COVID-19. This means that the fiscal impact of COVID-19 will be felt more heavily in communities of color.

Building a Better Future

In Michigan and in states nationwide, people have been calling for governments at all levels to take a more active stance on addressing racial justice. According to recent polling, 69% of voters in Michigan think that government should be engaged in acknowledging and addressing systemic racism.[11] While every level of government needs to play a role, local units of government are uniquely situated in that they have power over systems that directly impact the lives of residents. For example, local units of government are charged with ensuring the distribution of clean water and the maintenance of robust sewer systems. They also oversee neighborhood development, making sure that neighborhoods are safe, clean and vibrant. Counties, cities, villages and townships also administer many human and community services to residents who need extra support due to circumstances beyond their control.

Revenue Sharing as a Tool for Racial Equity

To create and maintain an equitable society, governments, organizations and people need money. Though not all racial equity issues are economic, economic conditions play an integral part in defining racial inequities. Creating equitable systems means putting resources into communities. An example of this is the racial justice movement aimed at defunding and abolishing the racist system of policing.

The defund movement is pushing for the reinvestment of revenues from policing into racially equitable systems that target and preempt the root causes of crime. To do this, local units of government are going to need funding to reinvigorate opportunities in communities of color to reduce income and wealth inequality. Funding a completely new vision of public safety will require injections of money from the state to help fund the mental health services, youth programs and social safety net that will achieve that vision.

Without increased revenue sharing, local units of government will have to meet the increasing demand for services in other ways, be it raising property taxes or increasing fines and fees where they are able. Revenue sharing is a much more equitable option for local funding because local property taxes are more regressive than state taxes as a whole, meaning that people with lower incomes contribute a higher proportion of their income in property taxes than do higher income individuals. With a higher proportion of income spent on taxes related to housing, low-income individuals have to forego other necessary purchases.

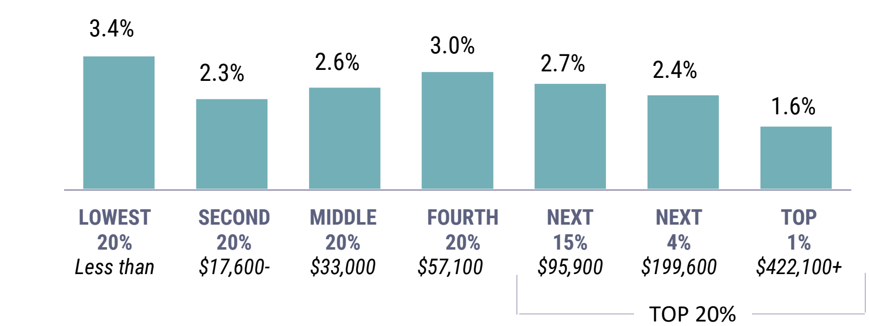
Revenue sharing is a useful tool because it gives some diversity in revenue sources for local governments. While local property tax revenues are directly related to the housing market, revenue sharing dollars are drawn from many revenue sources at the state level that better track the economy. As such, counties and CVTs that receive revenue sharing dollars can benefit from wider economic growth that is not captured in property values. This means that local taxes are not needed to capture new economic activity within a city because those are captured in part through local revenue sharing.[12]

Today, statutory revenue sharing payment calculations to local units of government are based on either how much the local unit received in previous years or are calculated per capita. Per capita payments and payments based on previous years do not reflect the needs of communities and ignore structural financial difficulties that communities of color face. These racially disparate difficulties with local finances are not an accident. Black, Brown and indigenous people have historically been held back from purchasing homes and building wealth. This combined with white flight to the suburbs have left cities and other local units of government with property values that do not match the demands for service by those units of government. Because local revenues are tied directly to property values, communities with relatively low housing values collect less revenue than those with high housing values. To compound this issue, racist policies have historically pushed people of color into neighborhoods with low housing wealth. To better allocate funds to local units of government in need, a different metric should be used. An equitable way to do this would be to change the revenue sharing formula to take into account for communities with relatively low housing wealth.

Property Tax Reform

Property taxes are inequitable. For the average family, a house represents most of their wealth. Meanwhile, housing for people with higher incomes typically represent a smaller proportion of their wealth because they also tend to have wealth in other vehicles, such as stocks, bonds, business interests and other assets that are exempt from property taxes. For homeowners, home values as a share of income decline at higher incomes. Also, property taxes are passed on in part to renters, who have, on average, less income than homeowners.[13]

Property Tax in Michigan



Source: *Michigan: Who Pays? 6th Edition.* ITEP, itep.org/whopays/michigan/

MICHIGAN LEAGUE FOR PUBLIC POLICY | WWW.MLPP.ORG

Data from the Institute on Taxation and Economic Policy shows that property taxes in Michigan are indeed regressive. While the lowest 20% of earners pay an average of 3.4% of their incomes on property taxes, the top 20% pay less than 2.7% of their incomes on property taxes. Because local units of government are reliant mainly on property taxes for revenue, this indicates that the cost of administering services through local units of government are borne primarily by people with lower incomes. This analysis includes residential and business property taxes passed on to renters and commercial and industrial property taxes passed onto consumers. Because of intergenerational trauma and systemically racist policies and discrimination, Black, Brown and indigenous people are more likely to have lower incomes.

Expanding the Homestead Property Tax Credit

To counter the regressive nature of the property tax, Michigan instituted the Homestead Property Tax Credit. This credit is among a class of credits known as “circuit-breaker.” Michigan’s circuit-breaker is relatively effective as compared to other states’ methods of relieving property taxes because it is broadly given to low-income homeowners and renters regardless of age.

The Homestead Property Tax Credit is authorized for individuals with household resources[14] less than $60,000 in their first homes with taxable values less than $135,000. The amount of the credit is equal to 60% of the property taxes, or 23% of rent, which exceed 3.2% of total household resources. $1,500 is the maximum allowed amount of the credit, which is reduced by 10% for every $1,000 of household resources exceeding $51,000. The credit is refundable, meaning that if the credit exceeds a taxpayer’s tax liability, then the balance of the credit is refunded to the taxpayer in cash.

To create more equity in the property tax system, the Homestead Property Tax Credit should be amended in two ways. First, decreasing the threshold on household resources will mean that taxpayers will be able to claim a higher credit, thus offsetting the cost of property taxes. Second, the income and taxable value thresholds should be amended to tie in with inflation to ensure that the value of the credit is not reduced over time.

Expanding Local Tax Options

While expanding local tax options for local units of government is not a silver bullet for the problems associated with local revenue, it can be a supplemental policy that helps cover the gap. To enact any of the below policies, the Legislature would need to authorize these tax options and the options would need to be placed on the ballot in local communities. This means that these expanded tax options would take some time to implement fully and will be dependent on the will of the voters in each locality. The options include:

- Motor vehicle taxes
- Motor vehicle registration fees
- Alcohol taxes
- Tobacco taxes
- Cannabis taxes
- Entertainment, amusement and admissions taxes.

Endnotes:

1. U.S. Census Bureau Survey of State and Local Finances, 2017.
2. Outline of the Michigan Tax System: 2020 Edition," Citizens Research Council of Michigan. July 2020.
3. Ibid.
4. "Headlee Rollback and Headlee Override." Michigan Municipal League. October 2016.
5. "Outline of the Michigan Tax System: 2020 Edition," Citizens Research Council of Michigan. July 2020.
6. "State Revenue Sharing," Jim Stansell. October 2017.
7. "A large-scale analysis of racial disparities in police stops across the United States." Pierson, E., Simoiu, C., Overgoor, *J. et al. Nat Hum Behav* 4, 736–745 (2020). Accessed 9/30/2020 from: https://doi.org/10.1038/s41562-020-0858-1
8. "Preventing the Criminalization of Poverty through Driver's License Suspension Reform." Simon Marshall-Shaw. 2020.
9. "Diversifying Local-source Revenue Options in Michigan." Citizens Research Council of Michigan. February 2018.
10. Ibid.
11. "Michiganders Want State Lawmakers to Act on Threats of COVID Crisis." State Innovation Exchange. July 2020.
12. "Diversifying Local-source Revenue Options in Michigan." Citizens Research Council of Michigan. February 2018.
13. "Who Pays? 6th Edition." Institute on Taxation and Economic Policy. October 2018.
14. Household Resources are defined as all income without adjustments for business and other related losses.