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BILL ANALYSIS

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House Bill 5908 (Substitute H-1 as passed by the House)
Sponsor: Representative Rob VerHeulen
House Committee: Appropriations
Senate Committee: Appropriations

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**CONTENT**

The bill would amend the Local Community Stabilization Authority Act to change the distribution of disbursements made by the Local Community Stabilization Authority (LCSA). The LCSA was created in 2014 in order to reimburse local units of government for revenue lost due to reductions in the taxes levied on industrial and commercial personal property, under statutory amendments enacted in 2014. The Act authorizes the LCSA to levy a share of the State's 6% use tax and to distribute that revenue to municipalities according to the Act. The Act defines municipalities to include, but not be limited to, counties, cities, villages, townships, authorities other than an authority created under the Act, local and intermediate school districts, community college districts, libraries, and other local and governmental taxing units. The total amount of use tax the LCSA is authorized to levy for each year is determined by the Act.

Current Law

Reimbursements made to an individual local unit by the LCSA are determined by a multi-part formula that is scheduled to change over time (as described below). Most of the current revenue distribution made to municipalities is based on the unit's qualified loss. The qualified loss is basically the taxable value of commercial and industrial personal property in the current year minus the taxable value of commercial and industrial personal property in 2013, multiplied by the appropriate millage rate. Additional provisions, related to the exemption of personal property owned by certain small taxpayers, do not use current-year taxable values but are also computed relative to the taxable value in 2013.

Because the 2014 tax changes exempted only some industrial and commercial personal property from taxation, over time fewer municipalities will experience a qualified loss as the taxable value of nonexempt personal property surpasses the taxable value of all personal property in 2013. As a result, beginning in 2019, the Act begins to phase in an alternative distribution that does not rely on qualified loss. Instead, the new formula relies on the distribution throughout the State of the acquisition cost of exempt property that is subject to the Essential Services Assessment (sometimes referred to as the "dynamic formula"). As a result, the taxable loss portion of the formula effectively ensures that a local unit does not receive less revenue than received from personal property taxes in 2013, while the dynamic formula distributes revenue based on a proxy for the value of exempt property.

Certain qualified losses are reimbursed at 100% before the rest of the LCSA revenue is distributed. These are commonly referred to as "Tier 1" reimbursements. These include losses for various school district and ISD debt and operating mills, tax increment financing

authorities, essential services (including ambulance, fire, police, jail, and pensions for those who provide essential services), and the small taxpayer exemption.

In 2018, after the Tier 1 reimbursements are made, the remaining balance is distributed to all municipalities in proportion to the municipality's share of total qualified losses. The amount of the distribution that reimburses for actual remaining qualified losses is commonly referred to as a "Tier 2" payment, and any excess received by a local unit that exceeds the loss relative to the taxable value in 2013 is commonly referred to as a "Tier 3" or "bonus" payment.

Beginning in calendar year 2019, 5% of the remaining balance after Tier 1 reimbursements are made must be distributed to municipalities according to their share of eligible personal property as determined using the dynamic formula. The percentage of the remaining balance distributed according to the dynamic formula will increase by five percentage points each year until the entire remaining balance is distributed according to the cost at acquisition measure that defines the dynamic formula.

As mentioned above, both the total amount of qualified losses statewide and the number of municipalities that experience any qualified losses will shrink over time as growth occurs in the value of nonexempt personal property. Similarly, as the dynamic formula phases-in, it will reduce the revenue available for distribution according to qualified loss and thus reduce any "bonus" payments.

Proposed Changes

The bill would not change Tier 1 payments.

Under the bill, the dynamic formula would be phased in over the same time period, but instead of reducing the amount of use tax revenue that will be distributed according to qualified losses, it would be used to distribute the revenue for qualified losses. As a result, the total revenue to be distributed under Tier 2 would be determined by qualified losses, but would be distributed according to acquisition costs. Furthermore, the dynamic formula would no longer be used to distribute the remaining balance of the use tax revenue after Tier 1 payments.

Beginning in calendar year 2018, $12.0 million would be distributed to municipalities for fire protection grants (after Tier 1 reimbursements), and the remaining balance would be distributed as follows:

-- 48% to cities
-- 30% to counties
-- 15% to community colleges
-- 5% to townships
-- 2% to villages

Within each municipality type, the bill would distribute funds to each unit based on population and qualified loss as shown in Table 1. The calculation for each unit would be based on its share of population and qualified loss relative to all units of that type. Community colleges would use "fiscal year equated students" instead of population. Population for counties, cities, villages, and townships would be determined in the same manner as in the Glenn Steil State Revenue Sharing Act (MCL 141.903). Fiscal year equated students would be determined by the Department of Education as reported in the State community college database pursuant to Section 217 of the State School Aid Act (MCL 388.1817).

**Table 1**

| Calendar Year | Percent Distributed by Population | Percent Distributed by Qualified Loss* |
|---|---|---|
| 2018 | 10% | 90% |
| 2019 | 20% | 80% |
| 2020 | 30% | 70% |
| 2021 | 40% | 60% |
| 2022 and each calendar year thereafter | 50% | 50% |

* Distributions would continue as long as there is a qualified loss for any units in the municipality type, but over time, qualified loss will decline to zero. The bill does not indicate how funds would be distributed after that (as discussed in the text below).

Because both the total amount of qualified losses statewide, and the number of municipalities that experience any qualified losses, will shrink over time (described above), and because the proposed distribution formula would be based only on qualified losses and population, at some point in the future no LCSA reimbursements would be distributed by qualified loss (or according to the dynamic formula).

The bill does not indicate how funds would be distributed after there are no qualified losses for any units in a municipality type. It also does not indicate whether at that point 100% of funds would be distributed by population, or if only 50% of funds would be distributed. If only 50% of funds were distributed, the bill does not indicate what would be done with the remaining balance.

The bill specifies that payments would have to be made by May 20 of the year following the year the millage was levied, except for fire protection grants, which would have to be made by November 30 of each year. The bill also would change the LCSA payment date to counties for county allocated millage from September 20 of the year the millage was levied to October 20 of the year the millage was levied.

MCL 123.1345 et al.

## FISCAL IMPACT

The bill would have no impact on State revenue as it would not revise the dollar amounts to be levied by the LCSA. However, because the bill would alter the distribution of the LCSA reimbursements, it would have a positive fiscal impact on some municipalities and a negative impact on others. The bill also would eventually eliminate any link between reimbursements and the value of exempt property or any associated losses.

Because each local unit's LCSA distribution depends not only on that unit's millage rates and taxable values, but also on the taxable value and millage rates in all other local units statewide, it is not possible to forecast future year distributions under either the bill or current law. While it is possible to provide information on how past distributions would have been distributed were the bill in effect, the limited history of distributions indicates that for specific units, payments can change significantly from year to year and that retrospective distributions are of limited predictive value. At this time, despite the limited predictive value, the Senate

Fiscal Agency is still working on providing individual local unit data on the effect of the bill had it been in effect during 2016 and 2017.

Current law attempts to reimburse all municipalities for their qualified losses first (reimbursing for personal property tax losses since 2013) and then distributes the remaining balance according to each unit's share of total qualified losses. Beginning in calendar year 2019, current law phases in reimbursement according to the dynamic formula, which essentially distributes LCSA funds according to each unit's share of exempt personal property, regardless of whether that results in a loss compared to 2013. The bill would apply the dynamic formula only to a declining portion of the total revenue to be redistributed, and would focus more on population and qualified losses (which will eventually decline to zero) to distribute the majority of revenue. Compared to current law, the bill would increase the proportion of revenue distributed according to qualified losses (i.e. based on changes in taxable value since 2013), while qualified losses continued to exist, and reduce the proportion of revenue distributed according to the value of exempt property. Similarly, while current law will eventually distribute all LCSA revenue, after Tier 1 payments are made, according to a proxy for the value of exempt property, the bill would eventually make distributions based only on population.

The bill also would create significant disparities between local unit distributions over time, and additional causes for significant year-to-year swings in reimbursement payments. For example, at some point only a few counties (and eventually a single county) will exhibit qualified losses. Under the bill, as long as that remaining county exhibited qualified losses, it would receive 50% of the 30% of LCSA revenue to be distributed, plus its per capita share of the other 50%. The remaining 82 counties would split the remaining 50% on a per capita basis. Once that remaining county no longer exhibited qualified losses, reimbursements would decline significantly, as the county switched to receiving payments only according to population. Similar distortions would occur for other types of local units because of the way the bill categorizes unit types and payment distributions.

Because of the bill's switch to population as a basis for distributions rather than the value of exempt property, the bill would effectively increase revenue to local units with low personal property per capita at the expense of local units with high values of personal property per capita. Generally, this implies that distributions would be transferred from more industrialized areas to higher-population unindustrialized areas.

In addition, the bill would amend many of the same sections that House Bill 5086 would amend. The S-1 version of that bill proposes alternative distribution formulas different from those in current law or in House Bill 5908 (H-1). While the two bills are not tie-barred, if both bills were enacted, the changes in House Bill 5908 would be effective only if it were signed into law after House Bill 5086.

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