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The Michigan Tax Maze

Michigan State University Extension Service

Lynn Harvey, Al House, Beth Moore and Collette Moser, Public Policy

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## I. TAXATION : A Policy Overview

Taxation is a compulsory payment from one's income to government in exchange for direct and indirect services and benefits. It has been the subject of discussion and conflict throughout history.

This publication examines the structure of Michigan's tax system, focusing special attention on where tax money comes from and how state and local governments spend the money, including the funding of elementary and secondary education.

When discussing taxes, it is helpful to consider the following questions:

- What kind of a society do we want to live in?
- What are our responsibilities to others?
- What level of services do we expect?
- What segments of society should pay for which services?
- How can we balance our own priorities about government spending with those of others?

Our system of taxation provides:

- services that are used by the total community (i.e., roads, parks, sewers)
- services that protect citizens (i.e., police, fire, emergency medical)
- services that improve the quality of life (i.e., education, social services, mental health)

The current system of taxation has evolved over the years in response to changes in our social, economic and political environment. The growth in government spending for education, health and social services during the past 20 years has been in response to increased awareness by individuals and interest groups of problems which were not being addressed by either the private or public sectors. Our system of representative government works to balance the differing priorities of individuals and groups in determining the appropriate level of support for services.

## II. TAXES : The Basic Structure



An interconnected system of federal, state and local taxation has been developed to provide revenue for public services to citizens. The general categories of taxes include:

- individual income (federal, state and local)
- business (federal and state)
- payroll (federal—e.g., social security)

- consumption (state—e.g., sales and use, gasoline, excise)
- property (local—real and personal)
- estate and gift (federal and state)

In the maze of Michigan's 29 state and 10 local taxes, a system of credits and exemptions make the tax structure more equitable. This discussion will focus primarily on state and local taxation.

## III. YOUR TAX \$ : At The State Level



### Where The Money Comes From

The Michigan state government is currently operating on an approximately \$10 billion budget. There are seven major sources of revenue:

- |                           |                           |
|---------------------------|---------------------------|
| ● Federal Funds—24%       | ● Motor Vehicle & Fuel—6% |
| ● Income tax—22%          | ● Other Taxes—7%          |
| ● Sales Tax—20%           | ● Other Revenue—11%       |
| ● Single Business Tax—10% |                           |

### INCOME TAX (ADOPTED 1967)

Michigan's state income tax is levied on a "flat rate" basis, taxing everyone's income at the same rate. The rate is set by state law and is currently 4.6% of "taxable" personal income.

To determine the taxable base the **adjusted gross income**, as shown on the federal IRS Form 1040 is further adjusted by a \$1,500 personal exemption and other additions and subtractions. The income tax rate is then applied to the adjusted gross income base.

State law provides certain credits which reduce the amount of income tax to be paid by an individual. Credits are provided for: property and city income taxes, contributions to colleges and

libraries, and home heating costs for low-income persons. Among the 44 states levying an income tax, Michigan ranks 19th in the percent of personal income paid as income tax.

### SALES AND USE TAXES (ADOPTED 1933 AND 1937)

The Michigan sales tax is charged on most retail sales. The Constitution limits the rate to 4%. In 1974, voters approved a constitutional amendment which removed prescription drugs and most food from the sales tax. When comparing the amount of sales tax paid as a percent of personal income, Michigan ranks 34th among the 45 states which impose sales tax.

Sixty percent (60%) of **sales tax** revenues is deposited in the State School Aid Fund, fifteen percent (15%) is returned to cities, villages and townships on the basis of population; the balance is deposited in the state general fund.

The **use tax** applies to certain services and to sales that are exempt from the state sales tax. These include used auto sales, hotel and motel rooms, and intrastate telephone and telegraph communications. The rate is 4%.

### SINGLE BUSINESS TAX (ADOPTED 1975)

The single business tax—unique to Michigan—replaced seven previous taxes on business and is based on business income plus labor compensation, interest and depreciation. The rate is 2.35% of the taxable base.

This tax provides incentives (exemptions) for business investments in buildings and equipment. Other provisions give tax relief to labor-intensive, small and unincorporated businesses operating in Michigan.

### MOTOR VEHICLE TAX (ADOPTED 1965)

A portion of the revenue for road construction and selected transportation needs is derived from the motor vehicle weight tax. This tax substitutes for a general personal property tax on motor vehicles. The rate varies, depending on the weight, or in some cases, the type of motor vehicle.

### GASOLINE TAX (ADOPTED 1925)

A consumption tax, the gasoline tax is levied for the support of Michigan highways. Gasoline purchased for highway use is taxed at 11 cents per gallon. The state retains about 50% of the derived revenue to fund special marine projects, retire Mackinac Bridge bonds, and replace or construct critical bridges. The balance of the revenue is returned to counties, cities and villages for highway-related activities.

### How State Tax \$ Are Spent

Michigan's Constitution specifies that the state budget must be balanced annually. If state revenues in a particular year do not meet the amount budgeted, the governor must order reductions in expenditures. Constitutional mandates and federal restrictions account for the yearly allocation of nearly 70% of the state budget. Michigan voters amended the Constitution in 1978,

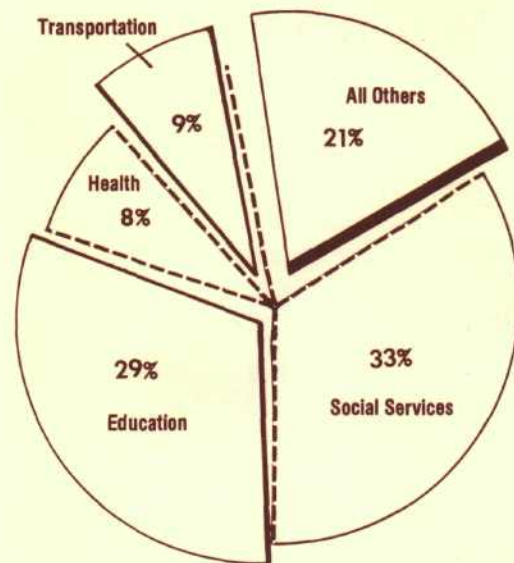


Figure 1 — Major expenditures from 1982 state budget.

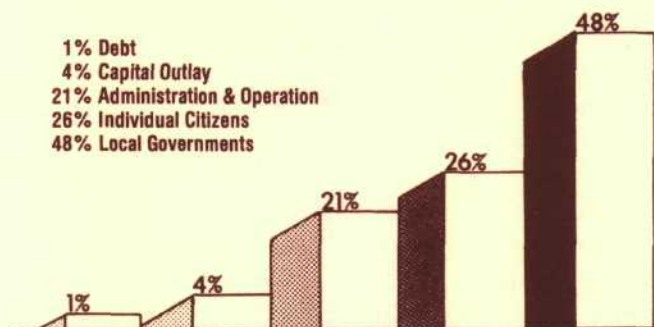


Figure 2 — Distribution of state funds (1981).

requiring the state to return 41.6% of the total adjusted state budget to local governments. The money is returned in the form of state revenue sharing, school aid, courts, mental health, roads, etc.

The major expenditures from the 1982 total state budget are shown in Figure 1. Another method of classifying the distribution of state funds (1981 figures) is shown in Figure 2.

## IV. YOUR TAX \$ : At The Local Level



Funding for local government—counties, schools, townships, villages, cities, intermediate school districts, community colleges—comes from three main sources: approximately one-third of the revenue for local governments is provided by the property tax, one-third from the state, and 11% from the federal government. Local fees, user charges and minor local taxes provide the balance of funding for local governments.

### Where The Money Comes From

State law permits local governments to supplement state and federal funds by raising their own money through ten possible local taxes. The largest revenue producer for local governments is the property tax, generating 90% of local taxes.

### THE PROPERTY TAX

The property tax is a local tax. All property tax revenues are collected, administered and spent at the local level. The property tax, the state's oldest tax, was adopted in 1793 when Michigan was part of the Northwest Territory. The general property tax is considered a tax on wealth as measured by the value of one's property. Every property owner in Michigan is subject to the property tax by at least four units of government—the county, the school district, intermediate school districts and the city or township in which the property is located. Villages, special authorities (airports, public transportation, etc.) and community colleges may also levy taxes on that property.

Nearly 50% of Michigan property owners pay their property taxes through escrow accounts. An escrow agreement is part of many mortgage contracts. The property tax is paid in monthly installments along with principal and interest in the mortgage payment. When property taxes are due, the lending institution pays them from the escrow account to the appropriate local government units.

### ASSESSMENT LIMIT

Michigan's Constitution provides for the uniform general "ad valorem" (according to value) taxation of real and tangible personal prop-

erty. The Constitution provides that property can be assessed at no more than 50% of true cash value (market value). The Constitution also specifies that counties, townships and school districts, including intermediate school districts, together may not levy more than 15 mills (18 mills with a set voted allocation) without a vote of the people, and then up to a maximum of 50 mills. Limits for cities, villages, charter counties and charter townships are set by law or by charter.

The property tax is determined by two factors: the tax rate and the assessment on property as finally equalized by the state.

The unit of measurement for the property tax, the mill, is defined as \$1 per \$1,000 of SEV (State Equalized Value).

Property is assessed by the city or township. The assessed value is determined through appraisals and sales studies which take into account factors such as the usual selling price of comparable property, size and location of property, type of construction, etc. State law requires that property values be equalized separately within each of the seven classes of property by the county and state to insure that all properties are assessed uniformly statewide.

### EQUALIZATION FACTOR

The tax equalization office in each county appraises property and conducts sales studies of the properties in every township and city in the county. A factor is applied which should result in each class of property having an assessed value of 50% of "true cash value." The State Tax Commission then uses the same process to assure that each class of property in the county is assessed at 50% of true cash value. Property owners may appeal to a township or city board of review. Townships, cities and counties may appeal equalizations to the State Tax Tribunal and the State Court of Appeals.

Michigan citizens paid an estimated \$4.9 billion in property taxes during 1981 on property valued at \$92 billion. The share of property taxes paid in 1980 on different classes of property was: 35% on industrial and commercial property, 58% on homes, 7% on farms. In 1980, the monies collected in property tax represented 4.4% of personal income in the state, ranking the state 16th among the 50 states.

A system of property tax exemptions and credits has evolved over the years. Exemptions include religious, educational and governmental properties. Tax credits are amounts subtracted from the taxes owed. In Michigan, credits are provided through the following programs:

- 1. Homestead Property Tax or "Circuit Breaker"** — a program enacted by the Legislature in 1973 to provide a property tax credit against an individual's state income tax liability or a direct refund to eligible recipients. This credit takes effect when property taxes exceed 3.5% of household income. Additional relief is provided for seniors and disabled citizens. In 1980, 1.4 million taxpayers received tax refunds through the circuit-breaker program. The average credits were \$275 for general taxpayers and \$459 for senior citizens. Although property tax is solely a local tax, the homestead property tax credit is paid entirely from state funds.
- 2. The Farmland and Open Space Preservation Program**—P.A. 116 of 1974—a program to provide a refundable tax credit for farmers who contract to maintain the land as farmland or

qualified open space for at least 10 years. In 1980, 9,100 farmland owners received an average credit of \$2,700. Participants in this program are also eligible for credits under the Homestead Credit Program. The cost of this credit is also paid by the state.

- 3. Industrial and Commercial Facilities Abatement Programs**—P.A. 225 of 1978 and P.A. 198 of 1974—plans to provide tax incentives to renovate and expand or to build new commercial or industrial facilities.

#### CITY INCOME TAX

Sixteen cities in Michigan levy an income tax. This tax is provided by state law and is subject to referendum with the approval of a city's electorate. These cities, except Detroit, levy a 1% tax on the incomes of residents and 0.5% on non-residents who work within the city. Detroit residents pay 3%, and nonresidents working in Detroit pay 1.5%.

#### How Local Tax \$ Are Spent

The various units of local government use property tax and other local revenue to provide public services. Townships, cities and villages contribute to the maintenance of roads and bridges, provide fire and police protection and other services as determined by citizens and local officials. Counties provide jails, a police force, roads, parks and recreation, a local court system, and general governance. Schools provide primary, secondary, special, vocational and adult education.

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## V. YOUR TAX \$ : Funding K - 12 Education



The funding of kindergarten through 12th grade education (K-12) is one of the largest expenditures of state and local governments and the subject of considerable public concern and discussion.

### WHERE DOES THE MONEY COME FROM

Local, state and federal sources provide the dollars to operate the 529 K-12 school districts in Michigan. The "share" of each source in 1980 was as follows:

- 59% local (property tax)
- 35% state
- 6% federal

The heavy reliance on the property tax to fund education causes much public dissatisfaction with the property tax and with education. As property values have escalated in recent years, operating costs such as teacher salaries, supplies, and services have also increased. The vote on the question of millage for the operating budgets for local schools represents one direct vote by citizens on taxation. During fiscal 1980-81, 870 school millage questions were submitted for voter approval and 49% were approved.

The **state school aid fund** is composed of money from the state's general fund, specified state taxes

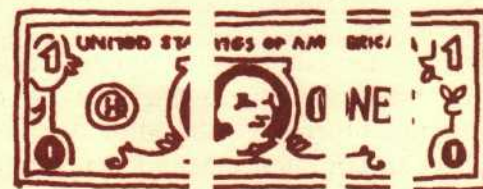
and the lottery. Local school districts receive money from the state through two major sources: 1) the general membership formula based on enrollment and 2) categorical aid for special programs.

In an effort to equalize the differences among districts in the amount spent per pupil on education, the **state school aid formula** was established in 1974. The annually adjusted formula was designed to guarantee that any two districts levying the same number of mills will raise the same amount of money per pupil, regardless of local property value, through the combination of state aid and local taxing effort. In 1981, 74% of the school districts received state aid. The remainder of the school districts had local property tax revenue which exceeded the guaranteed amount and thus did not qualify for state aid.

**Categorical aid** from the state provides funds for specific programs such as special and vocational education and transportation. Federal funds compose only a small portion of the budget for local schools, with the money designated for programs such as special education and aid to the disadvantaged.

## VI. Knowing What Happens To Your Tax \$

- Do you know how much you pay in property taxes? In state taxes? In federal taxes? What percent do these taxes compose of your personal income?
- Are you eligible or do you receive the Homestead Property Tax credit or the Farmland Open Space Preservation Act (PA 116 of 1974)?
- Do you know the steps to take if you feel the assessment on your property is incorrect?
- Have you attended any budget hearings held by your local units of government? Do you seek reliable information about how these units spend your tax dollars?
- How often do you communicate your opinions about government spending priorities to your elected officials?



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