Senate Fiscal Agency

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BALLOT PROPOSAL
15-1

An Overview

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On May 5, 2015, Michigan electors will have the opportunity to vote on Proposal 15-1, which would amend Article IX, Sections 8, 10, and 11 of the Michigan Constitution to increase the sales and use tax rates, exempt gasoline and diesel fuel from the sales and use taxes, dedicate additional use tax revenue to the State School Aid Fund, and revise the permissible uses of that Fund.

Proposal 15-1 is the result of House Joint Resolution UU, which was approved by more than two-thirds of the Senate and the House of Representatives in 2014. The proposal will appear on the ballot as follows:

PROPOSAL 15-1

A proposal to amend the State Constitution to increase the sales/use tax from 6% to 7% to replace and supplement reduced revenue to the School Aid Fund and local units of government caused by the elimination of the sales/use tax on gasoline and diesel fuel for vehicles operating on public roads, and to give effect to laws that provide additional money for roads and other transportation purposes by increasing the gas tax and vehicle registration fees.

The proposed constitutional amendment would:

- Eliminate sales/use taxes on gasoline/diesel fuel for vehicles on public roads.
- Increase portion of use tax dedicated to School Aid Fund (SAF).
- Expand use of SAF to community colleges and career/technical education, and prohibit use for 4-year colleges/universities.
- Give effect to laws, including those that:

  - Increase sales/use tax to 7%, as authorized by constitutional amendment.
  - Increase gasoline/diesel fuel tax and adjust annually for inflation, increase vehicle registration fees, and dedicate revenue for roads and other transportation purposes.
  - Expand competitive bidding and warranties for road projects.
  - Increase earned income tax credit.

Should this proposal be adopted?

YES [ ]
NO [ ]

If a majority of the electors vote "yes" on Proposal 15-1, the State Constitution will be amended, and a series of statutory changes will be triggered. If the electors vote "no", the Constitution will not be amended and the statutory changes will not take effect.

Summary of the Issues

Michigan's road infrastructure is primarily funded through motor fuel taxes and vehicle registration fees; in recent years, revenue from the State's General Fund also has been used for this purpose. Over time, several factors have resulted in ongoing and increasing shortfalls in transportation funding. These factors include improved vehicle fuel efficiency, which has led to lower fuel consumption and less fuel tax revenue. Another factor is inflation, which has reduced purchasing power and raised costs for road agencies. As necessary repairs are delayed, road conditions worsen and maintenance becomes more expensive.

Proposal 15-1 and related legislation would revise the way in which State taxes generate funding for roads. Currently, when gasoline or diesel fuel is purchased, the consumer pays the motor fuel tax and the sales tax. While revenue from the motor fuel tax is dedicated to transportation purposes, the sales tax supports the School Aid Fund, the General Fund, and revenue sharing with local units of government. Also, although the rate of the sales tax does not change, the amount per gallon is based on the retail price at the time of purchase; this means that the sales tax on fuel can vary from purchase to purchase.

Proposal 15-1 and related legislation would attempt to address these issues with three key changes to the State Constitution and statute. First, Proposal 15-1 would exempt motor fuel purchases from sales and use taxes. Second, to offset the revenue loss to the School Aid Fund, revenue sharing, and the General Fund due to eliminating the sales and use taxes on motor fuels, the Proposal would increase the maximum sales tax rate from 6% to 7%. This would result in an estimated net increase of $650.0 million in sales tax revenue. Third, amendments to statute would effectively increase existing motor fuel taxes and index them to inflation, resulting in an estimated $1.3 billion increase in transportation funding.

If approved, Proposal 15-1 would trigger a series of statutory changes to implement the amendments to the State Constitution and make other changes in State law, as described later in this document.[1] These statutory amendments have been passed by the Legislature and signed by the Governor, but they will not take effect unless the voters approve Proposal 15-1.

Proposed Constitutional Amendments

Article IX, Section 8 of the State Constitution prohibits the Legislature from imposing a sales tax on retailers in excess of 4% of their gross taxable sales of tangible personal property, except as provided in this section. (Under statute, retailers collect the tax from consumers and submit it to the State.) In 1994, the voters approved amendments to Section 8 to require the sales tax and use tax to be imposed on retailers at an additional 2% rate, for a total maximum rate of 6% each. The proceeds of the additional 2% sales and use taxes must be deposited in the State School Aid Fund.

Proposal 15-1 would amend Article IX, Section 8 to increase the 4% maximum sales tax rate to 5%. With the 2% that is dedicated to the School Aid Fund, the maximum sales tax rate would be 7%. (Related legislation also would increase the maximum use tax rate from 6% to 7%.)

In addition, the proposed amendments to Section 8 would prohibit the sales tax or use tax from being charged or collected after October 1, 2015, on the sale or use of gasoline or diesel fuel used to operate motor vehicles on public roads or highways.

Proposal 15-1 would amend Article IX, Section 10 to require 15% of all sales taxes imposed at the proposed 5% rate, rather than the current 4% rate, to be used for assistance to townships, cities, and villages (Constitutional revenue sharing).

Article IX, Section 11 establishes the School Aid Fund and specifies that the Fund must be used exclusively for aid to school districts, higher education, and school employees' retirement systems. Section 11 also dedicates to the School Aid Fund 60% of the sales tax imposed at the 4% rate, 100% of the additional 2% sales and use taxes, and other tax revenue provided by law.

Under Proposal 15-1, the School Aid Fund would have to be used only for school districts, community colleges, public career and technical education programs, scholarships for students attending public community colleges or public career and technical education programs, and

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[1] For a detailed explanation of transportation funding in Michigan, Proposal 15-1, and the related legislation, please see the Senate Fiscal Agency article, "The Long and Winding Road: Proposal 1 and Road Funding Reform", *State Notes* Winter 2015: http://www.senate.michigan.gov/sfa/Publications/Notes/2015Notes/NotesWin15gs.pdf

school employees' retirement systems. Sixty percent of the sales tax imposed at a maximum rate of 5% (as well as 100% of the additional 2% sales and use taxes, and other tax revenue provided by law) would be dedicated to the Fund.

In addition, Proposal 15-1 would dedicate to the School Aid Fund an amount equal to 12.3% of the use tax imposed at a maximum rate of 5%.

Related Legislation

In addition to amending the State Constitution, Proposal 15-1 would give effect to a number of public acts passed in 2014.[2] A brief description of these statutory changes follows.

Public Act 467 would amend the General Sales Tax Act to increase the maximum sales tax rate from 6% to 7%, and to exempt the sale of gasoline or diesel fuel from the sales tax beginning October 1, 2015. These changes would implement a portion of the proposed changes to Article IX of the Constitution.

Public Act 468 would amend the Motor Fuel Tax Act to revise the taxation of gasoline and diesel fuel. The current fuel tax rates of 19 cents per gallon of gasoline and 15 cents per gallon of diesel fuel would apply until September 30, 2015. Beginning October 1, 2015, and on each subsequent October 1, the Michigan Department of Treasury would have to calculate the gasoline and diesel fuel tax rates by multiplying the average wholesale price of the respective fuel by 14.9%, and rounding up to the nearest 1/10 of one cent. These rates would be subject to a rate floor of 41.7 cents per gallon beginning on October 1, 2015. Each subsequent October, the rate floor would be the previous year's rate floor multiplied by 1 plus the lesser of .05 or the rate of inflation.

Also, for two fiscal years, Public Act 468 would allocate a portion of the Michigan Transportation Fund (MTF) toward debt service for past projects.[3] In fiscal year (FY) 2015-16, the first $400.0 million of the additional revenue generated from the rate increase would be appropriated to the MTF, with the remainder allocated to Michigan Department of Transportation (MDOT) debt service. In FY 2016-17, the first $800.0 million would be appropriated to the MTF, with the remainder allocated to MDOT debt service. (The Department currently has roughly $1.9 billion in debt liability.)

Public Act 469 would amend the Income Tax Act, for tax years beginning after December 31, 2015, to increase the earned income tax credit (EITC) from 6% to 20% of the amount of the Federal EITC that a taxpayer may claim. Public Act 469 also would increase the homestead property tax credit for senior citizens and disabled taxpayers whose total household resources are between $3,001 and $6,000.

Public Act 470 would amend the Michigan Vehicle Code to modify the registration tax schedule for trucks that weigh less than 8,000 pounds towing a trailer or other combination of vehicles and for trucks weighing 8,001 pounds or more, road tractors, and truck tractors. Public Act 470 also would discontinue the discount of registration fees for vehicles of the model year 1984 or later. In addition, it would increase the registration fees for vehicles powered by electricity.

Public Act 471 would amend Public Act 51 of 1951, the Michigan Transportation Fund law, to make local road agencies subject to competitive bidding requirements similar to those that apply

[2] A Senate Fiscal Agency summary and fiscal analysis of House Joint Resolution UU and the enacted legislation, dated 1-16-15, can be found on the Michigan Legislature website: http://www.legislature.mi.gov/documents/2013-2014/billanalysis/Senate/pdf/2013-SFA-HJRUU-N.pdf

[3] Public Act 468 actually refers to the first $400.0 million and the first $800.0 million "received and collected" under the Motor Fuel Tax Act, despite the reported intent to allocate the first $400.0 million and $800.0 million of the additional revenue resulting from the tax rate increase. The Senate Fiscal Agency's analysis assumes that subsequent legislation will revise the language to reflect that intent.

to the Michigan Department of Transportation. Public Act 471 also would require MDOT, and any local road agency that received at least $20.0 million from the MTF in 2013, to develop and implement a performance-based maintenance system and a performance rating system for maintenance services.

Public Act 472 would amend a statute that pertains to county roads and county road commissions, to allow one or more township boards to require a county road commission to use competitive bidding to contract for the work on a road project, if the township or townships contributed 50% or more to the cost of the project and met other conditions.

Public Act 473 would amend Public Act 51 of 1951 to authorize the State Treasurer to receive money or other assets from any source for deposit into the Michigan Transportation Fund. Public Act 473 also would require MDOT, county road commissions, cities, and villages to secure warranties for full replacement or appropriate repair for projects exceeding $1.0 million and construction projects undertaken after the Act took effect.

Public Act 473 also would establish the Grade Crossing Surface Account within the State Trunkline Fund and specify criteria for use of funds deposited into the Account.

In addition, Public Act 473 would require MDOT to establish technical assistance programs, assist in creating incentives and sources of capital, and increase information programs for small business and disadvantaged business enterprises regarding contracts to construct, repair, or maintain roads or bridges. The Act also would allow a city to use for public transit purposes up to 20% of the money it receives from the MTF, if more than 10.0 million passengers used public transit in the city in the previous fiscal year.

Public Act 474 would amend the Use Tax Act to increase the maximum rate of the use tax from 6% to 7%; exempt from the use tax the purchase of gasoline or diesel fuel used to operate a motor vehicle; and require an amount equal to 12.3% of use tax collections (excluding the 2% dedicated to the School Aid Fund) to be deposited in the School Aid Fund from the State share of the use tax, after other distributions. These amendments would implement a portion of the proposed changes to Article IX of the State Constitution.

Public Act 475 would amend the Motor Carrier Fuel Tax Act to make the fuel tax rate under that Act consistent with provisions contained in Public Act 468.

Public Act 476 would appropriate $40.0 million from the School Aid Fund for the At-Risk program if Proposal 15-1 were approved. (Public Act 476 amends the State School Aid Act and makes other changes that do not depend on approval of the Proposal.)

In addition, Public Acts 553 and 554 of 2014 amend the General Sales Tax Act and the Use Tax Act, respectively, to create a presumption that a seller is engaged in making retail sales in Michigan, or has nexus with Michigan, if the seller or an affiliated person enters into certain agreements or performs certain activities. This "affiliate nexus" legislation, often called "main street fairness", applies to online retailers and others. Public Acts 553 and 554 will take effect on October 1, 2015, and are not contingent on the approval of Proposal 15-1, but they are considered related to the transportation funding package.[4]

Fiscal Impact

Proposal 15-1 would result in substantial revenue increases at the State and local levels. The overall effect would increase State revenue by roughly $1.8 billion in FY 2015-16.

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[4] The fiscal impact of Public Acts 553 and 554 is included in the Senate Fiscal Agency's analysis of the transportation package, cited in Note 2.

Eliminating the sales and use taxes on motor fuels, increasing the sales and use tax rates from 6% to 7%, earmarking an additional portion of the use tax for the School Aid Fund, and increasing the earned income tax credit would result in the following estimated net increases in FY 2015-16: $292.0 million for the School Aid Fund, $100.0 million for Constitutional revenue sharing, and $15.0 million for the General Fund.

In FY 2015-16 and FY 2016-17, respectively, approximately $815.0 million and $460.0 million of any new revenue from the motor fuel tax increase would be directed to MDOT debt service. In subsequent years, all new revenue from the increase would be directed to road agencies and comprehensive transportation purposes, resulting in a steady increase to road agencies and the Comprehensive Transportation Fund from FY 2015-16 to FY 2017-18.

Increasing motor fuel taxes, increasing registration fees for commercial trucks, and eliminating a discount on registrations for passenger vehicles, would result in the estimated net funding increases shown in the following table.

Fiscal Year	State-Level Roads	Local Roads
FY 2015-16	$180.0 million	$280.0 million
FY 2016-17	$350.0 million	$540.0 million
FY 2017-18	$575.0 million	$900.0 million

Beginning in FY 2015-16, these changes also would generate a $25.0 million increase for the Recreation Improvement Account of the Michigan Conservation and Recreation Legacy Fund.

The proposed amendments to the sales tax and the motor fuel tax would result in the following net gains in the Comprehensive Transportation Fund: $27.0 million in FY 2015-16; $71.0 million in FY 2016-17; and $128.0 million in FY 2017-18.