Ballot Proposal 1 of 2015

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TRANSPORTATION FUNDING PACKAGE

Ballot Proposal 15-1
May 5, 2015 Special Election
Placed on the ballot by the Legislature
Complete to 4-6-15

BRIEF SUMMARY OF THE BALLOT PROPOSAL:

The ballot proposal has been put before the voters by the Legislature's adoption of House Joint Resolution UU, which would amend the State Constitution. One component of the resolution is an increase in both the state's sales tax and use tax rate from 6% to 7%. Increasing these tax rates requires a constitutional amendment, and a constitutional amendment requires approval of the voters. Ten other bills would become law if the constitutional amendment is approved.

The primary focus of the ballot proposal is raising additional revenue for roads, but other features include an expanded earned income tax credit for low-income workers, additional funding for the K-12 school system and local units of government, and revisions to various contracting and warranty requirements for road construction and maintenance.

Passage of the ballot proposal would increase revenue from motor fuel taxes and vehicle registration taxes. This revenue is constitutionally dedicated for transportation and would be distributed to the Michigan Department of Transportation and to local road agencies for the preservation of the state trunkline highway system, county roads, and city and village streets. A portion of this transportation revenue would be used for improvements to public transportation programs.

Passage of the ballot proposal also would exempt motor fuel sales from the state general sales and use tax, while increasing the overall state sales and use tax rates from 6% to 7%. The net effect of these sales and use tax changes would be to provide additional money for the K-12 school system, as well as revenue sharing to local units of government.

Based on House Fiscal Agency estimates of the fully phased-in impacts of the package, there would be an estimated increase in state revenue of $1.9 billion as of Fiscal Year (FY) 2017-18.

Of this total, in FY 2017-18, $1.3 billion would be distributed to state and local road agencies. Revenue for public transportation would increase by $116.1 million. The School Aid Fund would receive an additional $200.0 million. Constitutional revenue sharing for local units of government would increase by $111.1 million. The state's General Fund, as of FY 2017-18, would increase by $173.0 million, (which takes into account a cost to the General Fund in that year of $269.1 million from the expanded earned income tax credit).

A detailed account of the funding impacts over the first three fiscal years after the proposal takes effect, from 2015-16 through 2017-18, if approved by voters, can be found later in this document and in an accompanying table.

This summary will describe the key features and fiscal impact on the package as a whole. For a bill-by-bill description of the proposed legislation, see the House Fiscal Agency analysis dated 2-16-15 on the House Fiscal Agency website at:

http://www.house.mi.gov/hfa/PDF/Transportation/Legislative_Analysis_Transportation_Funding_Package.pdf

or on the Michigan Legislature website at:
http://www.legislature.mi.gov/(S(wpntpexpwhqyvrnwv0srpcco))/mileg.aspx?page=getObject&objectName=2014-HJR-UU

The following is the official language as it will appear on the ballot.

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 [ ]

MAIN ELEMENTS OF THE PROPOSAL:

The package as a whole contains a constitutional amendment and ten associated bills. The following are the key features.

Tax-Related Provisions

- Sales of gasoline and diesel motor fuel would be exempt from the state's general sales tax after October 1, 2015. This would result in an estimated reduction in sales tax revenue of $653.6 million in Fiscal Year (FY) 2015-16, including a $479.3 million reduction in the School Aid Fund.

- The maximum sales and use tax rates would increase by one percentage point, from 6% to 7%. This would increase sales and use tax revenue by about $1.5 billion per year, including about $800 million for the School Aid Fund.

- The current fixed tax rates of 19 cents per gallon for gasoline and 15 cents per gallon for diesel motor fuel would be replaced by per-gallon tax rates that would be computed by multiplying the average wholesale gasoline price and the average wholesale diesel fuel price, respectively, by 14.9%, subject to certain limitations. This would increase motor fuel tax revenue by about $1.3 billion per year, all of which would be dedicated to transportation-related purposes.

  The rates would change annually through a process defined in the legislation. The initial tax rates would be 41.7 cents per gallon for gasoline and 46.4 cents for diesel motor fuel based on the legislation's definition of the initial average wholesale prices as the 12-month rolling averages for gasoline and diesel from July 2013 through June 2014. The tax rates would be adjusted in future years, limited by a rate floor and rate ceiling, both of which would be adjusted annually based on inflation (or 5% whichever is less). As a result, the tax rate for gasoline would increase by at least the rate of inflation over time (assuming inflation remains below 5% per year) but could not increase by more than 5 cents per gallon above the rate of inflation. Tax rates for alternative fuels would also be established.

- The Michigan Vehicle Code would be amended to (1) phase in increases in registration taxes for trucks weighing over 26,000 pounds gross vehicle weight (GVW) over a three-year period, beginning March 1, 2016; (2) eliminate the "depreciation" of ad valorem tax rates for passenger cars, vans, and light trucks; and (3) create a new registration tax surcharge for electric-powered motor vehicles. The latter two changes would be implemented beginning January 1, 2016. The revenue increases from these changes would phase in over a long time period, but would raise approximately $100 million in revenue by FY 2017-18.

- The Income Tax Act would be amended to increase the Earned Income Tax Credit (EITC) from 6% to 20% of the credit allowed under Section 32 of the federal Internal Revenue Code, beginning with the 2016 tax year. This would reduce

GF/GP revenue by $260.0 million in the first year the expanded credit could be claimed. The legislation would also increase the amount of the homestead property tax credit for senior citizens and disabled taxpayers whose total household resources are between $3,001 and $6,000, by reducing the household income qualifiers.

Changes in the Distribution of Revenue

- Sixty percent of the first 5% of the sales tax and an amount equal to 12.3% of the first 5% of the use tax would be dedicated to the School Aid Fund. (The sales tax earmark currently applies to the first 4% of the tax; the use tax earmark would effectively be an upward adjustment to the existing earmark of one-third of revenue from the tax.)

- The distribution of use tax revenue would be changed to approximately 62.64% for the General Fund (currently 2/3), and 37.36% for the School Aid Fund (currently 1/3), as a result of earmarking 12.3% of the first 5% of the tax to the School Aid Fund.

- Fifteen percent of the first 5% of the sales tax would be used for revenue sharing with townships, cities, and villages. (This earmark currently applies to the first 4% of the tax.)

- The distribution of motor fuel tax revenue would be altered for two fiscal years (the fiscal years ending September 30, 2016, and September 30, 2017) to direct a portion of revenue raised under the bill to the pay-down of State Trunkline Fund debt.

- The School Aid Fund would have to be used exclusively for aid to school districts, public community colleges, public career and technical educations programs, scholarships for students attending either public community colleges or public career and technical educations programs, and school employees' retirement systems, as provided by law. (This effectively removes aid to public universities as an allowable use for the fund; the current language references "higher education" generally.)

- An additional $40.0 million in School Aid Fund (SAF) revenues would be appropriated to the At-Risk program in the FY 2014-15 School Aid Budget (from existing SAF resources).

Other Transportation-Related Provisions

- Amendments to Public Act 51 of 1951 (Act 51), the act that governs the distribution of funds for state and local road and bridge programs, would require the Michigan Department of Transportation and certain local road agencies to: (1) develop and implement a "performance based maintenance system;" (2) develop and implement a "performance rating system" for maintenance services; (3) provide for payment for some maintenance services based on the outputs or outcomes associated with the performance rating system; and (4) add reporting requirements associated with these new contracting requirements.

- Other amendments to Act 51 would establish new provisions regarding MDOT's Disadvantaged Business Enterprises (DBE) program; earmark up to $3.0 million from the Michigan Transportation Fund for new railroad grade crossings; revise current provisions regarding the department's authority to enter into contracts for the construction and preservation of state trunkline roads and bridges; establish new requirements related to road construction warranties and related reporting requirements for the department and local road agencies; and authorize cities that meet specific criteria to use a portion of their MTF revenue distributions for public transit purposes.

- Townships that contribute more than 50% or more of the cost of a road project could, under certain conditions, require that the county road commission contract for the work on that road project through competitive bidding. Then, the county road commission would be required to award the road project contract to a "responsive and reasonable best value" bidder.

ESTIMATED FUNDING IMPACTS:

An attached table provides estimated revenue impacts by state fund or category of local funding recipient for each bill in the package for the three-year period of FY 2015-16 to FY 2017-18. Estimates are based on January 2015 consensus revenue estimates and current projections regarding fuel prices and consumption.

Based on HFA estimates of the full-year impacts of the bills in this package, the total net impact of the package, assuming voter approval of the proposed constitutional amendment, would be an estimated increase in state revenue of $2.1 billion in FY 2015-16. In FY 2016-17, the estimated net increase in state revenue would decline to $1.8 billion (see final bullet below) before increasing to $1.9 billion in FY 2017-18.

Estimated net impacts for individual funds would be as follows:

- $367.8 million for distribution to state and local road agencies through the Michigan Transportation Fund (MTF) in FY 2015-16, with an additional $865.3 million utilized for pay-down of State Trunkline Fund (STF) debt.[1] In FY 2016-17, an estimated $763.6 million would be distributed to road agencies, and $467.5 million would be utilized for pay-down of STF debt. In FY 2017-18, $1.3 billion

[1] These estimates assume that the provisions added to Section 143 of the Motor Fuel Tax by House Bill 5477 that provide for only the first $400 million of revenue in FY 2015-16 and the first $800 million of revenue in FY 2016-17 to be deposited in the Michigan Transportation Fund, with the remaining revenue allocated to debt-related payments, are interpreted to apply only to the net increase in revenue under the bill, rather than to all revenue raised under the act. The State Budget Office and Michigan Department of Transportation have indicated that revenue will be distributed in that manner.

would be distributed to road agencies; the STF and County Road Commissions would each receive an estimated $490.8 million, and cities and villages would receive an estimated $273.6 million.

- Roughly $20 million in increased revenue per year to the Recreation Improvement Account within the Michigan Conservation and Recreation Legacy Fund.
- A net increase of $27.2 million to the Comprehensive Transportation Fund (CTF), for public transportation purposes, in FY 2015-16. This amount would increase to an estimated $64.6 million in FY 2016-17 and $116.1 million in FY 2017-18.
- $89.9 million for constitutional revenue sharing payments to cities, villages, and townships in FY 2015-16. This amount would increase to an estimated $113.8 million in FY 2016-17 and $111.1 million in FY 2017-18.
- $292.4 million to the School Aid Fund (SAF) in FY 2015-16. This amount would decline to an estimated $220.6 million in FY 2016-17 and $200.0 million in FY 2017-18.
- $463.1 million to the state General Fund in FY 2015-16. In subsequent years, the majority of those funds would be offset by the proposed increase in the EITC. Because the EITC is claimed when a taxpayer's return is filed, the increase in the credit would not be realized until 2016 tax year returns are filed in 2017, meaning FY 2016-17 would be the first year state revenues are impacted by the increase in the credit. It is estimated that the full fiscal year impact in FY 2016-17 would be to reduce income tax revenue by approximately $260 million, all of which would come from General Fund/General Purpose (GF/GP) revenue. This amount would increase to an estimated $269.1 million in FY 2017-18. The remaining estimated increase to state GF/GP revenue under the package would be $171.8 million in FY 2016-17 and $173.0 million in FY 2017-18.

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■ This analysis was prepared by nonpartisan House Fiscal Agency staff for use by House members and the general public, and does not constitute an official statement of legislative intent.

Summary: Transportation Funding Package Fiscal Impacts
Millions of Dollars

FY 2015-16

Proposed Change	GF/GP	SAF	Rev Shar	CTF	# STF Debt	Other MTF	TOTAL
Exempt motor fuel sales from sales tax (HJR UU/HB 4539)	(94.9)	(479.3)	(49.0)	(30.4)			(653.6)
Increase Sales/Use Tax Rate by 1 Percent (HJR UU/HB 4539/HB 5492)	558.0	771.7	138.9	16.7			1,485.3
Increase Motor Fuel Taxes (HB 5477/HB 5493)				38.0	865.3	362.0	1,265.3
Registration taxes: phase out depreciation (HB 4630)*				1.5		13.1	14.5
Increase registration taxes for trucks > 26,000 lbs (HB 4630)**				1.3		11.9	13.2
Impose registration surtax on electric vehicles (HB 4630)***				0.1		0.5	0.6
Expand Earned Income Tax Credit (SB 847)							0.0
TOTAL	**463.1**	**292.4**	**89.9**	**27.2**	**865.3**	**387.4**	**2,125.3**

FY 2016-17

Proposed Change	GF/GP	SAF	Rev Shar	CTF	# STF Debt	Other MTF	TOTAL
Exempt motor fuel sales from sales tax (HJR UU/HB 4539)	(96.2)	(568.5)	(74.5)	(36.0)			(775.2)
Increase Sales/Use Tax Rate by 1 Percent (HJR UU/HB 4539/HB 5492)	528.0	789.1	188.3	15.8			1,521.2
Increase Motor Fuel Taxes (HB 5477/HB 5493)				78.0	467.5	722.0	1,267.5
Registration taxes: phase out depreciation (HB 4630)*				4.2		37.4	41.5
Increase registration taxes for trucks > 26,000 lbs (HB 4630)**				2.7		23.9	26.5
Impose registration surtax on electric vehicles (HB 4630)***				0.1		0.5	0.6
Expand Earned Income Tax Credit (SB 847)	(260.0)						(260.0)
TOTAL	**171.8**	**220.6**	**113.8**	**64.6**	**467.5**	**783.8**	**1,822.1**

FY 2017-18

Proposed Change	GF/GP	SAF	Rev Shar	CTF	# STF Debt	Other MTF	TOTAL
Exempt motor fuel sales from sales tax (HJR UU/HB 4539)	(101.0)	(608.1)	(81.6)	(38.6)			(829.3)
Increase Sales/Use Tax Rate by 1 Percent (HJR UU/HB 4539/HB 5492)	543.1	808.1	192.7	15.2			1,559.1
Increase Motor Fuel Taxes (HB 5477/HB 5493)				129.2		1,183.7	1,312.9
Registration taxes: phase out depreciation (HB 4630)*				6.2		56.0	62.2
Increase registration taxes for trucks > 26,000 lbs (HB 4630)**				4.0		35.8	39.8
Impose registration surtax on electric vehicles (HB 4630)***				0.1		0.5	0.6
Expand Earned Income Tax Credit (SB 847)	(269.1)						(269.1)
TOTAL	**173.0**	**200.0**	**111.1**	**116.1**	**0.0**	**1,276.0**	**1,876.2**

Estimated distribution of new MTF revenue (other than CTF and STF debt pay-down)	FY 2015-16 Other MTF	FY 2015-16 TOTAL	FY 2016-17 Other MTF	FY 2016-17 TOTAL	FY 2017-18 Other MTF	FY 2017-18 TOTAL
Recreation Improvement Account	19.6		20.2		20.9	
Distribution to road agencies	367.8		763.6		1,255.1	
State Trunkline Fund (39.1%)		143.8		298.6		490.8
County Road Commissions (39.1%)		143.8		298.6		490.8
Cities and Villages (21.8%)		80.2		166.5		273.6

Notes:

* Phase out of depreciation of vehicle registration tax rates would be effective January 1, 2016. Estimates are presented on calendar-year basis.

** Increase in truck registration taxes would be phased in over three years beginning March 1, 2016. Estimates are presented on calendar-year basis.

*** Surtax on electric vehicle registrations would be effective beginning January 1, 2016. Estimates are presented on calendar-year basis.

Allocation of motor fuel tax revenue to STF debt service assumes the distribution of only the additional revenue generated as a result of the enactment of House Bill 5477.