Foreword

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Executive Summary

This report provides the results of an analysis of the revenue impacts of a city income tax for Ann Arbor. We do not present a recommendation for or against the tax, but instead provide revenue projections to inform decisionmaking.

There are basic guidelines regarding a potential income tax that come directly from state legislation and the Ann Arbor city charter. First, Michigan’s Uniform City Income Tax Act (UCITA), which enables cities to levy an income tax, provides a range of parameters including a maximum tax rate of 1 percent for Ann Arbor residents and corporations, and not more than one-half of the resident rate for nonresidents who earn income in the city. UCITA specifies that the rate can be lower than 1 percent and also provides for personal exemptions at a minimum amount of $600 per exemption.

Second, the Ann Arbor city charter indicates that the enactment of an income tax requires the elimination of the city’s general operating levy. In 1996-97, the general operating levy represents 6.4515 mills of a total 16.8015 mills.

Based on this framework, we generated projections under three scenarios, each of which assumes the income tax would begin in 1998 and assumes the 1996-97 millage levels. Scenario 1 represents the status quo -- 16.8015 mills of property tax with no income tax. Scenario 2 represents a 1 percent income tax (0.5 percent for nonresidents), with a $600 exemption, combined with 10.35 mills of property tax. And Scenario 3 assumes the same income and property tax rates of Scenario 2 but within the context of a deep and lasting recession, to test the sensitivity of the income tax to the business cycle. For each of the scenarios, we drew upon data from the city, state, and the U.S. Census to project Ann Arbor’s annual taxable bases of income and property.

The results of our projections indicate that Scenario 2 generates an immediate revenue increase of $13.8 million versus Scenario 1, equivalent to a 29 percent increase in property tax revenues. The difference is projected to grow over time since taxable income is projected to increase faster than the taxable value of property. By 2006, revenue under Scenario 2 is projected to be 51 percent higher than Scenario 1, with a nine-year total increment of 40 percent. We also found that the income tax is robust with respect to the business cycle. Scenario 3 revenues are projected to grow at a slower rate than Scenario 2, but well above Scenario 1 -- generating 39 percent more revenue over the nine years of 1998-2006.

We estimate that base year revenue neutrality would occur with a 0.6 percent tax rate for residents and corporations and 0.3 percent for nonresidents, assuming the $600 minimum exemption. This initial revenue neutrality, however, is estimated to generate 6 percent greater revenues versus Scenario 1 within the time frame of 1998-2006, as a reflection of the different growth paths of income and taxable property values.
Population subgroups would be affected differently by the income tax. Based on the year 1995 and a 1 percent rate (0.5 percent for nonresidents), the only group projected to pay substantially less under Scenario 2 is businesses; this group would have paid 30 percent less on average due to its relatively large base of taxable property. The average homeowner would have paid an additional 14 percent in city taxes, though state and federal tax credits mediate that increase. Given the surprisingly low sensitivity of housing demand to income, most of these net payments would be made by upper income homeowners. The two groups of homeowners that would have paid less are those with household income under $30,000 and senior households with income under $90,000. Renters and nonresidents, each paying no property taxes to Ann Arbor, would have contributed $6.9 million and $6.8 million respectively to the total Scenario 2 revenues of $53.8 million in 1995.