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# ELi?s Voter Guide to the Income Tax [1]

Saturday, July 28, 2018, 8:08 am

**By:**

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**Registered East Lansing voters have the opportunity to vote on an East Lansing income tax proposal on August 7, 2018. This nonpartisan, factual voter guide provides information about the ballot proposal, including its background.**

**How do you find out if you can vote, and where?**

For information about how to register to vote, how to vote absentee, where your August 7 polling location will be, and so forth, visit the dedicated election page [2] of the City Clerk?s office. (July 9 was the last day to register to vote in this election.)

**What is the exact wording of the ballot proposal?**

The proposal reads:

?Shall Section 11.1 of the East Lansing City Charter be amended to authorize an excise tax on income for 12 years commencing January 1, 2019 implementing reduction of the City property taxes from a maximum of 20 mills to a maximum of 13 mills and requiring the net income tax revenue to be dedicated as follows: 20% to police and fire protection; 20% to the maintenance and improvement of streets and sidewalks, water and sewer systems, and parks, and recreation, and city-owned facilities; and, 60% to supplemental payments for unfunded pension liabilities for retired city employees.?

Voters are asked to vote ?yes? (in favor) or ?no? (against). The proposal requires a majority ?yes? vote to pass.


**What are the basics of the proposal?**

If passed, there will be an income tax levied in East Lansing for twelve years, from 2019 to 2030.

According to what City Council passed [3] as a resolution [4] on May 14, 2018, residents and corporations would pay a 1.0% tax on most income, and non-residents would pay 0.5% on income earned in East Lansing, with further limitations described below.

According to the ballot proposal, there would be a 60/20/20 split in terms of dedication of funds:

- 60% of the ?net income tax revenue? obtained would go to making supplemental payments

for the City?s unfunded pension liabilities;
- 20% would go to police and fire protection;
- 20% would go to maintenance and improvement of streets and sidewalks, water and sewer systems, parks, recreation, and City-owned facilities (infrastructure, not programming).

**How is this proposal different from the one defeated by voters in November 2017?**

What is different:

- This time the income tax would be limited to twelve years. (East Lansing voters could later vote through an extension or revoke the income tax entirely.)
- This time the proposal specifies that the ?net income tax revenue? would have the 60/20/20 split as described above.
- This time the proposal comes in the form of a City Charter amendment.

**Why is Council seeking an income tax?**

The income tax is meant primarily to address the unfunded liability pension problem. We explored this issue in depth before the vote last November in this article [5]. More recently, in this article [6], we explained the problem again, and we specifically looked at the question of whether an income tax will solve East Lansing?s budget woes.

**How serious is the financial problem of the City?**

We think we can objectively say it is very serious. If the City doesn't come up with some major new source of revenue in the next few years, basic services will have to be cut quite deeply to meet the City's pension obligations.

How did we get here? Here's part of the explanation:

The real estate crash in 2007 hit with a one-two punch, simultaneously dropping the value of the investment portfolio which backs City of East Lansing employees? pensions and dropping property values. The pension portfolio value drop left us with a bigger unfunded amount to make up to meet future obligations to City retirees. (The City?s pension plans have never lacked the funds needed to pay retirement benefits to current retirees.)

Meanwhile, the drop in value of property in East Lansing on which property tax was paid resulted in less money coming in to the public coffers, which is a real problem as about half of the City?s general fund is drawn from property taxes.

This City?s pension liability (the projected amount that East Lansing is obligated to pay out to cover the cost of retirees? pension) was funded at close to 85% before the crash. When the Financial Health Review Team prepared their Pension Legacy Cost-Summary in 2016, the City?s pension liability was funded at 58.1%. It has since gone down to about 50%. (Read more about the Financial Health Team?s review of this problem in a special ELi report [7] from Chris Root.)

The pension fund is managed by the Municipal Employee Retirement Service (MERS), which manages most municipal and county pension funds in Michigan. Many are underfunded, although East Lansing?s is worse than average. To address the continuing problem of communities coming up short on their pension fund liabilities, MERS has mandated that all communities increase their required contributions until their pension funds are 100% funded.

MERS has ?established a schedule to accomplish this which remains relatively flat for a short period of time and then ramps up dramatically,? Mayor Mark Meadows explains. ?Shortly, it will consume all of our property tax revenues, and when that happens, we will need to dramatically reduce services to our citizens, lay off more employees, reduce hours of operation, reduce trash pickups, and [implement] a host of other reductions.? (Read more. [6])

For more about the City?s economic situation and how we got here, see this ELi interview [6] with the City Manager in August 2017. To read City leaders? answers to the question of whether the income tax will really solve East Lansing?s budget problems, click here [6].

**Why does City Council think an income tax is a good way to raise revenues?**

Michigan law limits its cities in terms of opportunities to raise funds.

Sales tax is capped at 6% and the State collects the full amount, returning only a small portion of that money to cities in the form of revenue-sharing. The State of Michigan now ranks 50$^{th}$ in the nation in terms of State revenue-sharing.

Revenue-raising options left to cities include voter-approved bonds, like the bonds East Lansing voters have previously approved for Parks & Recreation, fees on City services such as garbage collection and sewage disposal, fees for using facilities like the Aquatic Center, property taxes, and income taxes.

About twenty percent of East Lansing?s land is taken up by a non-profit, State-owned property (Michigan State University) which pays no property taxes but which requires the City to provide emergency services. MSU has been calculated to cost the city between $1.5 million (if you go by MSU?s estimate) and $3 million a year (by East Lansing?s estimate) in public safety costs to East Lansing.


Some, but not all, of this extra cost for emergency services created by MSU is paid to East Lansing by the state. However, the City cannot anticipate how much reimbursement it will receive from the state each year, because if depends on the budget approved by the state legislature. A significant portion of this cost has been accruing to City property taxpayers for many years.

The Financial Health Team recommended consideration of an income tax as a way to spread the tax liability out to non-resident workers who commute into the City, understanding that the majority of those people work at MSU. Some Council Members have specifically said [8] they see the income tax as a way to get revenue via MSU to help East Lansing?s bottom line, because for years East Lansing taxpayers have borne the cost of providing emergency services to MSU without full compensation from the State.

**What is being done about the pension problem that is at the root of the City?s financial crisis?**

You can read an ELi investigation into what East Lansing has done so far to reduce the City?s pension costs by clicking here [9]. You can also read an ELi investigation into whether the City has followed expert recommendations on its pension problem by clicking here [10].

**How much would be obtained, in net, through this income tax?**

A 2016 study by Plante Moran [11] found that this income tax would net about $5 million extra revenue per year for the City of East Lansing.

The income tax is expected to gross $10.4 million per year. Administrative costs are expected to be about $400,000 per year. The property tax reduction is expected to come to about $5 million per year. That?s how Plante Moran came to a net revenue figure of about $5 million per year from an income tax at 1.0% on residents and corporations and 0.5% on non-residents.

That study estimated that residents would pay about $5.3 million in income tax, non-residents about $4.7 million, and businesses about $400,000 annually. That property taxes would fall about $5 million per year at the same time shows that most of the tax burden from the new income tax would really fall on people who work in East Lansing but do not live here. Most of those people work for MSU.

**So, there would be a property tax reduction?**

Yes. Voters passed a measure last November (2017) [12] that amended the City Charter so that if there?s an income tax, the property tax rate falls at the same time.

The Charter amendment that passed says that ?in fiscal years in which the City levies, assesses and collects and income tax,? property taxes will be reduced and limited to 13 mills. What does that come to, if you own property here? The City stays that, in practice, the millage reduction would mean that the average East Lansing property owner would see about a 10% reduction in their property tax bills.

Remember that this is just a reduction on City of East Lansing property tax. The proposed reduction would not impact how much you pay in taxes to your county and does not effect voter-approved millages, such as the library millage, school bonds, or the trails millage. (These other millages are part of the total property tax amount due on biannual property tax bills.)


Again, the idea behind bundling the income tax with a property tax reduction was to shift the bulk of the liability for new tax revenue on to non-residents who work within the City ? mostly MSU employees who don?t live here. On the question of whether this combination of an income tax with a property tax reduction really ?offsets? the tax burden for residents, see this article [13].

**When would the property tax reduction and the income tax start?**

In essence, the property tax reduction would start on the same day as the income tax begins, namely January 1, 2019. Property owners would *see* the lower tax rate starting on their July 1, 2019 bills. Income tax payers would file for the first time in early 2020, except for those who would be required to file quarterly estimated taxes; they would begin paying at the end of the first quarter of 2019.

The income tax could be renewed if voters want to renew it. In that case, the 13 mill property tax limit would again stay in effect. If the income tax expires without renewal, the 13 mill limit will no longer be in effect.

**Would the income tax really be used according to the 60/20/20 split?**

If the proposal passes, the language about the 60/20/20 split will be in the City Charter. The 60% specified for the pension obligations is needed to keep up with what?s going to be required in terms of payments in the coming years.

ELi recently asked Finance Director Jill Feldpausch if ?the 20% and 20% dedicated funds could replace fungible parts of the [General Fund] budget, so might not [really] increase funding? to police and fire, roads and sewers, and Parks and Rec infrastructure, just as the library millages were really used, to a large extent, to shore up the City?s General Fund. (Read more about what happened with the library millages. [14])


Feldpausch responded, ?In regards to the 20% allocations ? the public safety amount could be considered ?fungible? dollars, however the capital improvements would not necessarily be ?fungible? in whole. We do not necessarily [now] spend that much of General Fund dollars on capital improvements as we have had to rely more heavily on grants and the like to fund these types of projects recently.?

To read more about whether Feldpausch and other City leaders think that, for example, the Hannah Community Center and the Aquatic Center can be kept open if the income tax passes, click here [6].

**Why doesn?t East Lansing just institute a local sales tax, a local tax on alcohol, or similar?**

State law doesn?t allow cities to institute local sales taxes. State law significantly limits what Michigan cities can do to raise revenue.

**What would be the exemption level?**

On July 17, 2018, Council voted to correct an error from last year and to set the exemption rate at $5,000. (Read more. [15]) According to the Michigan state law that governs local income taxes, the exemption can only be granted to an earner who is listed as a dependent on someone else?s federal tax returns. Anyone who is financially independent will not be able to get the $5,000 exemption.

Additionally, the $5,000 exemption from the income tax only happens ?if the adjusted gross income for a taxpayer for a tax year is less than $5,000.00.? That means that anyone living in or working in East Lansing earning $5,000 or more would have to pay income tax, declaring his or her full income (and then adjusting it according to other rules).

**What forms of income would not be taxed?**

The *types* of income that will and will not be taxed by a city income tax are dictated by state law and can?t be modified by local governments. According to the City of East Lansing [16], the following forms of income are not taxable under a Michigan municipal income tax: Social Security; pensions; 401K; 457; 403B, annuities, IRA distributions after age 59.5, unemployment income, military pay, and tax refunds.

**What other cities in Michigan have income taxes?**

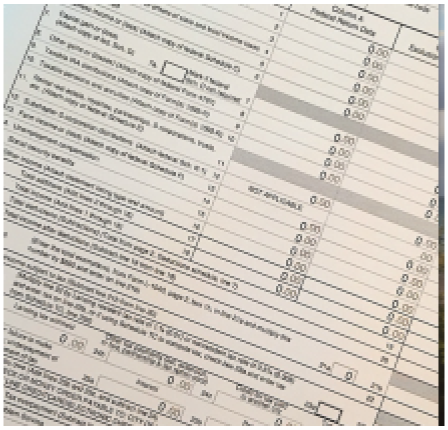
There are 22 Michigan cities that currently have income taxes. Albion, Battle Creek, Big Rapids, Flint, Grayling, Hamtramck, Hudson, Ionia, Jackson, Lansing, Lapeer, Muskegon, Muskegon Heights, Pontiac, Port Huron, Portland, Springfield, and Walker all tax at 1.0% for residents and 0.5% for non-residents.

Cities that already had already adopted income taxes at a rate higher than 1.0% prior to the passing of the Universal City Income Tax Ordinance in 1964 have been allowed to keep their higher rates. These cities are Detroit at 2.4%, Grand Rapids at 1.5%, Highland Park at 2% and Saginaw at 1.5%.

The last city to pass an ordinance was Ionia. That was in 1994.

**Why do residents have to pay twice whatever non-residents pay?**

This is dictated by Michigan?s Uniform City Income Tax Ordinance [17], the state law passed in 1964 outlining how a Michigan City can implement an income tax. This law specifies that the maximum amount a city resident can be asked to pay is 1.0% (unless their rate predates the 1964 law) and that non-residents cannot be charged more than half of what residents are required to pay.



Cities don?t have to levy the 1.0% maximum, but non-residents? tax liability is capped at half of whatever residents pay. City Council decided to go for the maximum allowable rate with this proposal, although the rate is not specified in the Charter amendment, it is only specified in the resolution that called for the vote on the Charter amendment.

**Why do residents have to pay on income NOT earned in East Lansing, but non-residents pay only on income earned in East Lansing?**

State law mandates which income is taxed under Michigan city income taxes, and it mandates that if a city income tax is passed, residents pay [18] on income earned in and out of the city, and non-residents pay [19] only on income earned in the city. Residents are generally assumed to consume more city services than non-residents.

That said, under Michigan?s income tax rules, city of employment takes precedence over city of residence when it comes to tax on a particular income. So, if you happen to live in City A which has an income tax and work in a City B which has an income tax, you would first pay City B, and then pay City A on the remainder of your tax liability. Total tax liability between both cities could not exceed the 1% limit specified by state law (unless you live in a city that has a higher tax rate because it predates the 1% limiting law).

**So, if I live in Lansing and work in East Lansing, will I have to pay tax and file tax returns in both jurisdictions?**

Yes. For example, imagine you live in East Lansing and earn 100% of your income in Lansing, which has an income tax of the kind East Lansing is considering. You would pay 0.5% on 100%

of your earnings to Lansing, and then would pay the remainder (0.5%) on 100% of your earnings to East Lansing. You would have to file returns in both places.

If an East Lansing resident worked two jobs, one in Lansing and one in East Lansing, the percentage owed to each municipality would not break down as an even 50/50 split.

**If I live in Lansing and work in East Lansing, will my total City income tax go up if East Lansing voters pass a new income tax?**

No. You will still pay a total of 1% of your income in municipal income tax. Instead of all of this tax going to the City of Lansing, East Lansing will now receive some of the tax and the amount that Lansing receives will be reduced. The total amount of city income tax you owe will not increase.

**So, do MSU employees and East Lansing residents who work part- or full-time in Michigan cities with income taxes already pay income tax to those cities?**

Yes. What they pay follows the same state-mandated rules that an East Lansing income tax would follow. (Again, by law, you can?t pay more than a total of 1.0% in municipal income tax in Michigan if you live in a city whose income tax post-dates the 1964 law.)

**If I change my legal residency to somewhere other than East Lansing, would I have to pay the income tax if it passes?**

If you change your legal address (change your driver's license, voter registration, etc.) to somewhere else, you would become a non-resident and would then be subject to the rules for non-residents. (See above for information on what non-residents are required to pay.)

**Will businesses in East Lansing be subject to the income tax?**

Yes. Corporations based in East Lansing will be subject to the same 1.0% tax as individual residents. The Plante Moran study from 2016 [11] found that businesses would end up paying about $400,000 per year via the income tax.

Profits from rental property will also be taxed at 1.0% if the owner is an East Lansing resident and 0.5% if they are not.

Businesses that are not based in East Lansing but derive some percentage of their profits from doing business in East Lansing will be asked to calculate the percentage of their profits that were derived from doing business in the City and will pay 0.5% income tax on that.

If a business owner pays herself a wage before her profits are calculated, she would owe personal income tax on her wages (resident or non-resident, depending on where she lives) and also on the profit of the business. (Read ELi?s report about business owners objecting [20] to the income tax proposal last year.)

**Won?t pairing an income tax with a property tax reduction disproportionately hurt people who are renters?**

In all likelihood, yes. If a landlord sees fit to refigure leases in light of receiving tax reductions on their property, renters could see reductions in their rent. Council Members have conceded that this is unlikely to happen, so it is probable that renters would be subject to the full residential income tax liability (beyond the income exemptions) without the benefit of the property tax decrease.

**Why have my property taxes gone up even though voters haven?t voted lately to raise City property taxes?**

City property taxes are only part of your property tax liability. Millages passed by voters, like the Ingham County trails millage and the East Lansing Public Schools bond millage, can raise how much you pay on your property tax bill.


It?s also worth understanding that, frequently, when property taxes go up, it is because the assessment on the property has increased. If your assessed value increases, then your property taxes go up, because what you pay is based on assessed value.

Even if property values increase, the amount the assessed value can increase is limited by the Headlee Amendment cap. The Headlee Amendment holds back increase in assessed values in a jurisdiction to the rate of inflation. (Read more about Headlee here. [21]) The Headlee Amendment has contributed to stagnation of revenue in the East Lansing general fund, contributing to the City?s financial problems. (Read more about the City?s stagnated revenues. [22])

**Some people say that, in 2017, East Lansing did not take the $20 million deal offered by MSU, so that residents wouldn?t have to be asked to consider an income tax? Is this accurate?**

In the correspondence between East Lansing Mayor Mark Meadows and MSU President Lou Anna Simon [23], Simon never indicated that she had the full approval of the Board of Trustees. The Trustees, not Simon, would have had to make the ultimate decision, just as a majority of City Council, not Meadows alone, would have had to make the decision for East Lansing.

Meadows said he and Simon were able to reach an eleventh-hour agreement whereby the University would pay a sum total of $20 million to the City over the course of eight years, and during that time the City would not pursue implementing an income tax ordinance. But MSU officials did not agree with Meadows? version of the story, saying simply ?time ran out.?

Meadows has further said that MSU told him that when that option was put to the Board of Trustees, there was not enough support among the Trustees [24] for it to pass. ELi reached out to the Trustees for a statement, and the only Trustee who responded was Diane Byrum, who indicated that she was in favor of the deal.

At present, according to what Meadows has told ELi, there are no active negotiations with MSU for a deal of this kind.

It may be worth noting that the income tax, if it passes, is estimated to net $5 million a year for East Lansing, which means that in eight years, it would raise about twice what the $20 million deal would have provided, had it gone through.

**What else will be on the August 7 ballot?**

The August 7 ballot has primary races for the Republic, Democratic, and LIbertarian parties. If you live in Ingham County, you will also see a proposal for a jail and justice millage. Click here to read ELi's explanation of that Ingham County millage. [25] If you want to read more about what to expect on the ballot, click here [26].

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