

# EXHIBIT D-1



CITY OF DETROIT  
LAW DEPARTMENT

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CONFIDENTIAL AND PRIVILEGED  
ATTORNEY-CLIENT COMMUNICATION

August 17, 2006

Honorable City Council  
City of Detroit  
1340 Coleman A. Young Municipal Center  
Detroit, MI 48226

RE: Reduction in State Revenue Sharing to the City of Detroit

Honorable City Council:

The Law Department was requested to provide an opinion regarding the tie-barring of the \$333,900,000 in annual revenue sharing initially provided in MCL 141.913(6) and the reduction in City income tax provided for in MCL 141.503(2) (City Code 18-10-3).

The issue is whether the City may properly commence a mandamus action to collect from the State the difference between the \$333,900,000.00 annual revenue sharing amount initially provided for in MCL 141.913(6) and the amounts actually given to the City over the last several years. In order to satisfy the requirements for mandamus, a clear legal right and a clear legal duty has to be established.

**Background:**

In 1998 the Legislature passed House Bill 5391 (1998 PA 500) which provided for an annual decrease of 0.1% of the resident income tax rate and an annual decrease of 0.05% for the nonresident income tax rate beginning July 1, 1999 and continuing until each rate reached 2% and 1% respectively.

To lessen the impact of the income tax rate reduction, the Legislature also passed House Bill 5989 (1998 PA 532) which purported to freeze the annual revenue sharing payments to the City at \$333,900,000.00. Pursuant to Public Act 532 this freeze was to last from the 1998-1999 fiscal year through the 2005-2006 fiscal year plus six months.

Acts 500 and 532 were "tie-barred". "Tie-barring" "is the practice of placing a provision in a bill which states that it will not become effective unless and until another specified bill is also enacted into law". OAG, 1979, NO 5478 (April 4, 1979). Both of these acts expressly provided that each act would not become effective unless the other act was enacted into law. Thus, each act had to be enacted for either one to be effective. Act 500 was enacted on January 5, 1999 and Act 532 was enacted on January 12, 1999.

Unfortunately, due to budgetary concerns, the State did not keep the annual revenue sharing amount at \$333,900,000.00. Starting with the 2002-2003 fiscal year and each year thereafter the State has readjusted the amount given to the City via revenue sharing.

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On November 14, 2005, Marge Malarney and Kenneth Cole, the City's Lansing lobbyists issued a response to a request for information regarding revenue sharing to the City by the State. This memo gives a brief legislative history of the compromise in revenue sharing and income tax reduction. The memo also identifies how much the City actually received and what it would have received under the various revenue sharing formulas. A copy of this memo is attached for informational purposes.

It has been suggested that the State should be held liable and required to pay the difference between the full amount of the annual \$333,900,000.00 payment and what the State actually paid to the City for each year the full payment was to be made under 1998 PA 532.

As discussed below, the State cannot be required to pay the amount indicated in 1998 PA 532 except for the ensuing fiscal year (1998-1999 fiscal year). As 1998 PA 532 provided for an appropriation of funds for years after the ensuing fiscal year, it is merely an intent to appropriate for the years after the ensuing fiscal year. As the Legislature and the Governor are required to provide a balanced budget, they have the legal authority to reassess all non-constitutionally dedicated expenditures on a yearly basis.

#### Discussion:

In order for the City to request a writ of mandamus and compel the State to pay the difference between the \$333,900,000.00 and amounts actually paid to the City by the State each year, the City would need to prove that the State had a clear legal duty to make the payment and that the City had a clear legal right to the payment. *Miller v Detroit*, 250 Mich 633 (1930). As discussed below, the State does not have a clear legal duty to make the payment.

The reduction of the City's income tax rate is contained in MCL 141.503(2) and mirrored in section 18-10-3 of the Detroit City Code. MCL 141.503(2) was amended by 1998 PA 500 to provide for an annual decrease of 0.1% of the resident income tax rate and an annual decrease of 0.05% for the nonresident income tax rate beginning July 1, 1999 and continuing until the rates reached 2% and 1% respectively. This provision has not been amended since.

The Glenn Steil State Revenue Sharing Act of 1971 (1971 PA 140), specifically MCL 141.913(6) was amended by 1998 PA 532 to provide a total contribution of \$333,900,000.00 to a city with a population of 750,000 or more. This annual payment was to be made from the 1998-1999 fiscal year through the 2005-2006 fiscal year plus six months. Subsection 6 was again modified by 2002 PA 679, 2003 PA 168, 2004 PA 77, 2004 PA 355 and 2005 PA 196.

As noted above, Acts 500 and 532 were "tie-barred". Although both public acts were "tie-barred" when enacted as to their effective dates, there was no language contained in either act that specifically linked the reduction in Detroit city income taxes to the amount of revenue sharing

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provided to the city from the state. There is also no requirement that both must be modified together in the future.

MCL 141.913(6) as amended by 1998 PA 532 providing for a set \$333,900,000.00 payment is characterized as a standing appropriation as it is not limited to a particular fiscal year. *County Road Ass'n v Governor of Michigan* (2004) 260 Mich App 299 at p. 311.

As MCL 141.913(6) purports to effect years past the "ensuing fiscal period" (the states' fiscal year commencing October 1, and closing September 30, MCL 18.1491) it is merely "an intention to appropriate". "Responsible fiscal policy consequently also requires a yearly reassessment of revenues, spending goals and priorities." *Board of Education of Oakland Schools v Superintendent of Public Schools*, 392 Mich 613, 620-621 (1974).

The Supreme Court of Michigan in *Michigan Ass'n of Counties v Department of Management & Budget* (1984) 418 Mich. 667; 345 NW2d 584 held ". . . that distribution of tax revenues to local units of government as delineated in 1971 PA 140 . . . is subject to Const. 1963, art 5, § 20."

Michigan Const. Art. V, § 20 states:

No appropriation shall be a mandate to spend. The governor, with the approval of the appropriating committees of the house and senate, shall reduce expenditures authorized by appropriations whenever it appears that actual revenues for a fiscal period will fall below the revenue estimates on which appropriations for that period were based. Reductions in expenditures shall be made in accordance with procedures prescribed by law. The governor may not reduce expenditures of the legislative and judicial branches or from funds constitutionally dedicated for specific purposes. (Emphasis added).

The only portion of revenues constitutionally dedicated is the fifteen percent of the sales tax identified in Michigan Const. Art IX § 10 which states:

Fifteen percent of all taxes imposed on retailers on taxable sales at retail of tangible personal property at a rate of not more than 4% shall be used exclusively for assistance to townships, cities and villages, on a population basis as provided by law. In determining population the legislature may exclude any portion of the total number of persons who are wards, patients or convicts in any tax supported institution.

MCL 141.913(6) is an intent to appropriate, and except for the constitutionally mandated portion, can be reevaluated and revised by the Legislature and Governor each year. To do otherwise

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"[t]he Legislature would be, in effect, appropriating in advance of its ability to accurately forecast available revenues and would thereby be unable to match revenue with appropriations . . . [i]n addition such prospective appropriations would force the Governor to approve or veto the expenditure far in advance of his ability to assess the fiscal needs of the state." *Board of Education of Oakland Schools, supra.*

**Conclusion:**

1998 PA 532 (MCL 141.913(6)) regarding revenue sharing and 1998 PA 500 (MCL 141.503(2)) regarding reduction to the City's income tax rate were "tie-barred" so neither would become effective without passage of the other. Act 500 was enacted on January 5, 1999 and Act 532 was enacted on January 12, 1999.

As 1998 PA 532 provided for a set amount of \$333,900,000.00 per year in revenue sharing for the City of Detroit for more than the ensuing fiscal year, it is a standing appropriation which only indicates an intention to appropriate the amounts specified.


The Legislature and Governor are not bound by standing appropriations which are not constitutionally dedicated. The only portion of the revenue sharing amount constitutionally dedicated is the fifteen percent of the sales tax to townships, cities and villages as provided in Michigan Const. Art. IX §10.

The Legislature and Governor may properly adjust the non-constitutionally dedicated amounts including those dedicated to the City through the Glenn Steil State Revenue Sharing Act of 1971 (1971 PA 140).

The City does not have a legally enforceable claim against the State for the difference in amounts of revenue sharing actually received and the \$333,900,000.00 initially provided in 1998 PA 532 (MCL 141.913(6)) as there is no clear legal duty incumbent on the State to provide the \$333,900,000.00.

Respectfully submitted,  
John E. Johnson, Jr.  
Corporation Counsel

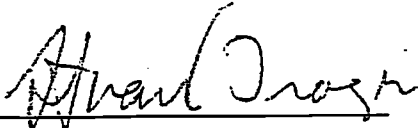
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Jack Dietrich  
Assistant Corporation Counsel

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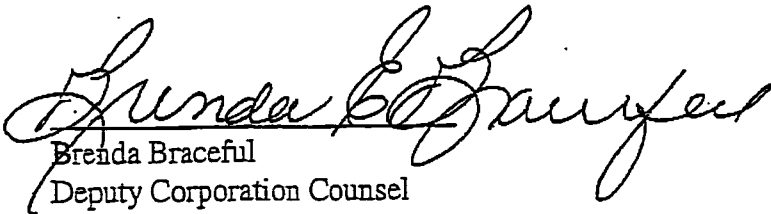
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Reviewed and approved,



Stuart Trager, Supervising  
Assistant Corporation Counsel

Approved,



Brenda Braceful  
Deputy Corporation Counsel

cc: John E. Johnson, Jr., Law Department  
Tom Killian, Law Department

TO: The Honorable Detroit City Council  
FROM: Marge Malarney and Kenneth Cole, Lansing Lobbyists  
DATE: November 14, 2005  
RE: Revenue Sharing

The following is in response to Detroit City Councilwoman JoAnn Watson's request for additional information on the recent past and future of City of Detroit revenue sharing.

### *History*

The Michigan Legislature amended the state Revenue Sharing Act in 1998, altering the formula by which sales tax dollars are distributed to local units of government.

At the time, Republicans represented the majority party in both the House and Senate. They had introduced legislation calling for a straight per-capita distribution formula for statutory revenue sharing and were confident they could pass the measure. On the surface, this legislation sounded beneficial to the City of Detroit, which was then and remains Michigan's largest municipality. But removing certain components of the existing law – such as relative tax effort provisions – would have resulted in the loss of tens of millions of dollars for Detroit and had a disastrous impact on the city.

With that threat in the background, the House and Senate appointed a task force of three senators and three representatives to work with the City of Detroit on devising a new revenue-sharing formula. After six months of intense negotiations, the parties reached a compromise in December 1998 that is spelled out in Public Act 532 of 1998 (*formerly House Bill 5989 of 1998*).

Specifically, Section 13 (6) of Public Act 532 of 1998 called for the State of Michigan to appropriate to the City of Detroit \$333.9 million in revenue sharing each state fiscal year, from October 1, 1998, through June 30, 2007. The only way the State of Michigan was to pay the City of Detroit a revenue sharing allocation less than \$333.9 million was if there was a state fiscal year in which state sales tax collections totaled less than the immediately preceding state fiscal year, pursuant Section 13 (15) of Public Act 532 of 1998.

This legislation was tie-barred reciprocally to another measure that became Public Act 500 of 1998 (*formerly House Bill 5391 of 1998*). It mandated the City of Detroit to roll back its resident and non-resident income tax rates, from 3 percent to 2 percent and 1.5 percent to 1 percent, respectively. The reductions were to occur over a period of 10 years, starting July 1, 1999, but could be suspended in any year that the City of Detroit met three of four adverse economic conditions.

It's important to note, too, that, during this time, casino gaming had been approved for Detroit, and the majority of the Legislature believed (wrongly) that the additional dollars from this industry would offset any losses in Detroit revenue sharing and local income tax revenue.

### *Detroit Revenue Sharing Cuts*

During the state's 2002-03 fiscal year, former Governor John Engler cut Detroit's revenue sharing by \$11,686,500, citing as justification the state's growing fiscal crisis and the fact that all other locals were being cut, too. Governor Jennifer Granholm took office in January 2003, in the midst of the 2002-03 fiscal year and ongoing financial duress, and initiated further cuts to locals' revenue sharing, including a reduction of another \$2,471,422 to the City of Detroit.

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The Michigan Legislature again cut City of Detroit revenue sharing in its 2003-04 fiscal year – this time by \$46,530,912. It can be argued, however, that only 25 percent of this reduction – \$11,632,728 – is tied to the 1998 agreement between the State of Michigan and the City of Detroit. That's because Governor Granholm, in January 2004, acted administratively to free Detroit from its obligation to roll back its income tax rates, noting that the city had, indeed, met three of the four adverse economic conditions spelled out in Public Act 500 of 1998. This, in effect, marked the end of the 1998 compromise between

the State of Michigan and the City of Detroit on revenue sharing because both parties were released from their respective obligations.

*So How Much Has The 1998 Deal Helped or Hurt Detroit?* The answer to that question is really a matter of perspective.

Everyone will agree the deal worked to the City of Detroit's benefit from the 1998-99 through the 2001-02 fiscal years. Indeed, Detroit received a total of \$1,335,600,000 in revenue sharing during those fiscal years – \$2.5 million more than the \$1,333,100,000 that it would have received had its revenue sharing been formula-based like other Michigan municipalities.

The State of Michigan will also note that, even though revenue sharing was reduced during the 2002-03 state fiscal year, the \$319,742,078 that Detroit received in revenue sharing – albeit less than the \$333.9 million prescribed in Public Act 532 of 1998 – was \$24,342,078 more than the city would have received had it been in the formula like every other Michigan municipality.

So, in all, from the state's perspective, the 1998 deal helped Detroit to the tune of about \$26,800,000, from the 1998-99 through 2002-03 fiscal years.

The State of Michigan will also argue that one Legislature is not bound by the actions of a previous Legislature. Thus, state lawmakers can justifiably amend the revenue sharing act and appropriate state resources however they see fit from one state fiscal year to the next. Case law supports this argument.

The State of Michigan may also contend that the aforementioned Sec. 13 (15) trigger for reducing Detroit's revenue sharing to an amount less than \$333.9 million was realized during its 2002-03 fiscal year. Thus, the state may argue that it was justified in reducing Detroit's revenue sharing then and that the city should consider itself fortunate to have received \$24,342,078 more in revenue sharing that fiscal year than it would have, had it been in the formula like other Michigan municipalities.

Looking at the window from December 2002 (when former Governor Engler first reduced Detroit revenue sharing) through January 2004 (when Governor Granholm freed Detroit of its obligation to roll back its income tax rates) may be the fairest way to measure the financial impact of the agreement on the City of Detroit. That's because before December 2002, both the state and the city were governed by – and lived up to – the deal, and after January 2004, both parties were freed of the agreement. In other words, what happened, deal-wise, before December 2002 is irrelevant because there was a deal; likewise, both parties were freed from the 1998 deal after January 2004.

The December 2002 to January 2004 span touches two state fiscal years, during which Detroit received \$60,688,834 less in revenue sharing than what the 1998 compromise prescribed. But only an estimated \$25,790,650 of those revenue sharing losses would have happened during the life of the 1998 deal – essentially the period from December 2002 through December 2003. That span includes all of calendar year 2003, during which Detroit lost \$10,942,151 in income tax money.

#### Future Revenue Sharing Formula

How to allocate revenue sharing resources continues to be a source of much debate in Lansing. Originally distributed on a per capita basis, revenue sharing today continues to contain a "relative tax effort" component in its formula. Lawmakers added this provision in 1971 to acknowledge that local taxes for public services vary greatly from one municipality to the next.

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Still, many lawmakers argue that the current formula, with its emphasis on relative tax effort, unfairly rewards Detroit for having a high tax burden and that the city over the years has received far more than its "fair share" of state sales tax dollars.

Michigan's term-limitations law exacerbates this attitude. Simply put: Many lawmakers who were at the crux of the revenue-sharing-formula changes and agreement are no longer in the Legislature, having been precluded from running again by term limits. That – combined with the state's persistently bleak financial



forecast and continued Republican control in both the House and Senate – means the City of Detroit faces significant challenges in its attempt to modify the revenue-sharing formula to its favor in the future.

We trust this helps. If you have additional questions on this issue, please call us at 517-487-6902.

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### Revenue Sharing Chart

Following is a synopsis of the revenue-sharing implications of the 1998 deal since its inception:

Fiscal Year ...	Deal Prescribed ...	Actual Payment Was ...	Dollar Amount Less Than Deal ...	Formula Would Have Paid ...
1998-1999 (10/1/98 – 9/30/99)	\$333.9 million	\$333.9 million	\$0	\$332.0 million
1999-2000 (10/1/99 – 9/30/00)	\$333.9 million	\$333.9 million	\$0	\$340.9 million
2000-2001 (10/1/00 – 9/30/01)	\$333.9 million	\$333.9 million	\$0	\$339.4 million
2001-2002 (10/1/01 – 9/30/02)	\$333.9 million	\$333.9 million	\$0	\$320.8 million
2002-2003 (10/1/02 – 9/30/03)	\$333.9 million	\$319,742,078	\$14,157,922	\$295.4 million
2003-2004 (10/1/03 – 9/30/04)	\$333.9 million	\$287,369,088	\$46,530,912 (\$11,632,728)*	Not Applicable**
2004-2005 (10/1/04 – 9/30/05)	\$333.9 million	\$284,236,765	\$49,663,235	Not Applicable
2005-2006 (10/1/05 – 9/30/06)	\$333.9 million	\$284,236,765	\$49,663,235	Not Applicable
2006-2007 (10/1/06 – 9/30/07)	\$333.9 million	\$???	\$???	\$???

\* The 1998 agreement, it can be argued, remained in effect the first three months (October, November and December 2003) of the state's 2003-04 fiscal year.

\*\* The formula does not apply to state fiscal years 2003-04, 2004-05 and 2005-06 because the Legislature amended the Revenue Sharing Act to reflect a different distribution methodology.

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### Income Tax Chart

Following is an estimate of how much Detroit lost in resident, non-resident and corporate income tax revenue from calendar years 1999 to 2004. Estimates are based on pre-1999 resident (3 percent), non-resident (1.5 percent) and corporate (1.9 percent) tax rates.

	1999	2000	2001	2002	2003	2004	Totals
R	\$3,741,882	\$11,643,580	\$19,169,385	\$27,104,193	\$33,581,461	\$39,170,115	\$134.4 m
NR	\$1,746,358	\$ 5,436,631	\$ 8,917,626	\$12,638,025	\$15,658,218	\$20,500,488	\$ 64.9 m
R & NR	\$5,488,240	\$17,080,211	\$28,087,011	\$39,742,218	\$49,239,679	\$59,670,603	\$199.3 m
Corp.*	\$ 0	\$ 1,383,038	\$ 3,482,130	\$ 7,121,147	\$ 7,978,151	\$11,491,339	\$ 31.5 m
Total All	\$5,488,240	\$18,463,249	\$31,569,141	\$46,863,365	\$57,217,830	\$71,161,942	\$230.8 m

R=Residential; NR= Non-residential; Corp.=Corporate

\* The City of Detroit volunteered to reduce its corporate income tax; it was not part of the 1998 deal.