

**SENATE FISCAL AGENCY
MEMORANDUM**



DATE: December 1, 2006

TO: Members of the Michigan Senate

FROM: Jay Wortley, Senior Economist
David Zin, Economist

RE: Summary of Governor's Proposed SBT Replacement – Part 1

On November 29, 2006, the Governor proposed a new business tax – the Michigan Business Tax (MBT) – to replace the single business tax. This proposed new tax represents a new approach to taxing business. The single business tax is a modified value-added tax and the primary component of the tax base is the compensation businesses pay to their workers. The Proposed MBT would not be based on value added, but instead would be based on a combination of income, gross receipts, and assets. The major features of this proposed new business tax are summarized below. The Senate Fiscal Agency is currently studying and analyzing the bills that would implement this proposed new business tax. As soon as this analysis is completed we will issue a more detailed and comprehensive description of this proposed new tax and its fiscal implications.

Tax Base

The base of the MBT would consist of three items:

- Gross Receipts: total receipts a business receives for goods sold and services provided.
- Assets: the value of such items as buildings and equipment, land, cash, trade notes and accounts receivable, mortgage and real estate loans, and intangible assets. It would not include U.S. Treasury obligations or tax-exempt securities.
- Business Income: the profit a business receives from its business activity.

The business income component of the tax base would be weighted more than gross receipts and assets. The business income portion would be multiplied by a factor of 15 and then would be added to the gross receipts and assets components to equal the tax base.

Tax Rate

The tax rate for the MBT would equal 0.125%. Given the extra weight placed on business income, the effective tax rates on each of the tax base components would be 0.125% on both gross receipts and assets, and 1.875% (0.125% times 15) on business income.

Apportionment Formula

In order to determine the portion of a multi-state's total national tax base (U.S. gross receipts, assets, and business income) that would be attributable to Michigan activity and therefore subject to the MBT, their national tax base would be apportioned using the percentage of their total U.S. sales that occur in Michigan. This 100% sales factor compares with the current

apportionment factor under the SBT equal to 92.5% sales and 3.75% each on the percentage of payroll and property in Michigan.

Alternative Small Business Tax

Under the SBT, businesses with gross receipts less than \$10.0 million and pay less than \$115,000 in compensation to their owners may pay a tax equal to 2.0% of their business income. This provision would be maintained under the MBT; however, the tax rate would be reduced to 1.8%.

Filing Threshold

Under the SBT, businesses with gross receipts of \$350,000 or less do not have to file a SBT return, but businesses with gross receipts of \$350,001 are liable for the tax on the entire \$350,001. This is referred to as a "tax cliff". The MBT would maintain the \$350,000 gross receipts filing threshold, but would eliminate this "tax cliff" by phasing in the tax liability for businesses with gross receipts between \$350,000 and \$700,000.

Insurance Companies

Under current law, insurance companies based in Michigan pay a tax equal to 1.07% of their gross receipts from selling insurance premiums, but this tax then is offset by various tax credits they receive for making required payments or assessments into special State required insurance funds. Insurance companies that sell insurance in Michigan but are based in other states pay a tax equal to the greater of this tax assessed on Michigan insurance companies or a retaliatory tax under which the out-of-state insurance company would be taxed in the same way that their home state taxes Michigan-based insurance companies. The MBT would increase the tax rate on Michigan insurance companies to 1.25% and the special tax credits would be eliminated. The retaliatory tax would not be changed.

Personal Property Tax Reduction

Under current law, personal property (including such items as equipment, machinery, furniture, and computers) owned by businesses is subject to property taxes including the 6-mill (\$6 per \$1,000 of taxable value) State education tax and the 18-mill local school tax. Under the MBT, personal property owned by industrial and commercial classified businesses would be exempt from the 6-mill State education tax and the 18-mill local school tax. The loss of State education tax revenue would directly reduce SAF revenue and the loss of the 18-mill school property tax revenue would directly reduce local school revenue, which would automatically increase State school aid payments from the SAF. In order to hold the SAF harmless from the loss in revenue and the increase in expenditures, a portion of MBT revenue would be earmarked to the School Aid Fund.

Economic Development Incentives

The MBT would retain all current Michigan Economic Growth Authority (MEGA), Brownfield, and historic preservation tax credits. Credits already granted under the SBT would be claimed under the MBT and new credits would continue to be issued. In addition, a new MEGA credit

for research and development would be created. This new credit would be granted by MEGA to existing Michigan businesses to help fund R&D activity at a partnering Michigan small business. A single credit would be capped at \$500,000.

Fiscal Impact

Based on the Treasury Department's analysis, these changes proposed in Michigan's business tax structure would not generate any net change in revenue, as summarized in the table below.

Governor's Proposed Michigan Business Tax Fiscal Impact on Businesses: Calendar Year 2008 (Millions of Dollars)	
Tax Change	Revenue Impact
SBT Repeal	(\$1,915.5)
<u>Proposed New Revenue:</u>	
Michigan Business Tax.....	2,445.5
Insurance Tax Increase	<u>90.0</u>
Subtotal: Gross New Revenue	2,535.5
Personal Property Tax Reduction.....	<u>(619.4)</u>
Net New Revenue	1,916.1
Net Revenue Change.....	<u>\$0.6</u>

Source: Michigan Department of Treasury

The Department of Treasury estimates that approximately 111,000 businesses would realize a tax reduction under this bill, while 34,000 would experience a tax increase. In addition, it is estimated that businesses based in Michigan would realize a net tax reduction of \$150.0 million.

One-Time Revenue Gain

While the proposed tax changes result in no net change in revenue on a calendar year basis, the Treasury Department is estimating that the timing of the tax changes and the SAF reimbursement would generate a one-time revenue gain of about \$200.0 million in FY 2007-08. This gain would result from the fact that the increased revenue from the new Michigan Business Tax would begin to be collected in FY 2007-08 (the first quarterly payment would be due in April 2008), but the reimbursement to the SAF would not occur until October 2008, which falls in FY 2008-09. This one-time accounting gain would only occur in FY 2007-08.

We hope you find this information helpful. If you have any questions please let us know.

/kjh

c: Gary S. Olson, Director
Ellen Jeffries, Deputy Director

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