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SBT: REMOVE HEALTH BENEFIT PLANS FROM TAX BASE

House Bill 5111 (Substitute H-1)
First Analysis (5-26-98)

Sponsor: Rep. Mark Schauer
Committee: Tax Policy

THE APPARENT PROBLEM:

The tax base of Michigan's unique single business tax is typically described as composed of a firm's compensation paid (or labor costs), profits, interest, and depreciation. One of the many criticisms of the SBT from the business sector is that it is a tax on employment and that taxing companies on their labor costs discourages job creation. A related argument is that taxing companies on employee benefits, notably health insurance, discourages companies from offering or expanding those benefits. The SBT has been improved in recent years, from the business point of view, by removing from the compensation portion of the tax base such items as Social Security, workers compensation, and unemployment insurance. Business advocates say that employee benefit plan costs should similarly be removed. This, they say, would reduce the disincentive for small businesses and others who do not now provide employee health benefits. It also would help struggling businesses continue to provide such benefits, the cost of which are said to be among the major concerns of small (and other) businesses. Legislation to address this issue has been introduced.

THE CONTENT OF THE BILL:

The bill would amend the Single Business Tax Act so that gradually payments a firm made under health and welfare and noninsured benefit plans and payments of fees for the administration of such plans would not be included in compensation and, thus, not included in the SBT tax base. The full elimination of the payments from the tax base would take 10 years. The percentage of payments excluded from the tax base would be as follows:

For tax years beginning on or after January 1, 1998 and before January 1, 1999, 10 percent; for tax years after January 1, 1999 and before January 1, 2000, 20 percent; and so on, until 100 percent of payments would excluded for tax years that began after January 1, 2007.

MCL 208.4

FISCAL IMPLICATIONS:

According to the House Fiscal Agency, the bill would reduce SBT revenues by $9.4 million in the first year. The revenue loss after 2 years would be $19.7 million; after 5 years, $57.1 million; after 10 years, $145.8 million; and after 15 years, $186.1 million. (5-22-98)

ARGUMENTS:

For:

Including the cost of employee health benefits in the SBT tax base makes life that much more difficult for small companies who are struggling to provide such benefits or who cannot now afford them. Reducing the tax base this way removes a disincentive for companies to provide or improve such benefits. The old adage is that the more you tax something, the less you get of it.

Response:

There is no guarantee that any savings to business will be passed on in the form of new or improved health benefits. Moreover, many of the major beneficiaries of the bill will be companies already providing generous benefits. Additionally, a great many small businesses have little or no single business tax liability. This bill will do nothing for them and provide no assistance to them in providing employee benefits.

For:

While the SBT has been improved over the past few years, it remains from the point of view of some business representatives an unfair tax that is a barrier to growth. Any reduction in this onerous tax can only benefit Michigan business and the state's overall economic climate. The trend in recent SBT legislation is against penalizing companies for having their payroll and their property in Michigan. This is in keeping with that point of view. While the immediate elimination of health care costs from the SBT base would be preferable, this bill is a step in the right direction. Any reduction in business taxes is likely to result in some economic growth for the state.

Response:

State tax specialists defend including health benefit costs in the SBT base as consistent with the philosophy of a value-added tax. They are an element in the costs of employing labor and so are legitimately included in the value added by labor. An alternative way of determining the value added by a business, according to Department of Treasury information, is to take total sales and subtract purchases from other firms and capital investments. Further, the department has pointed out that the SBT statute contains an "excess compensation" deduction, which reduces the cost of hiring an employee, and it says that for the many firms qualifying for the small business credit, "hiring additional employees usually results in no SBT increase and may actually result in a small decrease." (August 1994 analysis of the SBT by the department's Office of Revenue and Tax Analysis.)

Against:

This bill will continue the erosion of the single business tax base and will continue the steady transformation of the SBT from a value added tax (as it was designed to be) to a tax on income. According to Department of Treasury tax specialists, the tax is becoming less stable (and less coherent) and more cyclical over time through legislation like this, eroding the compensation portion of the SBT tax base. Plus, the bill will, over time, significantly reduce SBT revenues.

POSITIONS:

The Small Business Association of Michigan supports the bill. (5-20-98)

The National Federation of Independent Business has indicated support for the bill. (5-13-98)

The Michigan Chamber of Commerce has indicated support for the bill. (5-6-98)

The Michigan Retailers Association has indicated support for the bill. (5-13-98)

The Department of Treasury opposes the bill. (5-20-98)

The Michigan Education Association has indicated opposition to the bill. (5-13-98)

Analyst: C. Couch

■This analysis was prepared by nonpartisan House staff for use by House members in their deliberations, and does not constitute an official statement of legislative intent.