House Legislative Analysis Section
House Office Building, 9 South
Lansing, Michigan 48909
Phone: 517/373-6466

FOREIGN TRUCKING

Senate Bill 1380 as passed by the Senate
First Analysis (12-5-00)

Sponsor: Sen. Bill Schuette
House Committee: Tax Policy
Senate Committee: Finance

THE APPARENT PROBLEM:

The volume of goods, services, and income from investment that flows between the United States and Canada constitutes the largest bilateral exchange in the world, according to information from the Canadian Embassy's Department of Foreign Affairs and International Trade in Washington, D.C. Among the states, Michigan is Canada's leading trade partner, with more than half of the state's exports purchased by Canada. An enormous amount of the goods transported between Michigan and Canada moves by truck. Apparently, amendments to the Single Business Tax (SBT) Act made by Public Act 115 of 1999 may have negative tax consequences for Canadian motor carriers.

On a national level, a treaty between the United States and Canada exempts from taxation by either country business profits that are not directly attributable to a permanent establishment; that is, a Canadian firm that does business in the United States is not taxed by the federal government on its profits, except for profits derived from a permanent establishment in the United States (if the firm has one). The same exemption is granted by Canada for U.S. firms doing business in Canada. This means, then, that the business profits of a Canadian trucking company derived from shipping between the countries are exempt from U.S. federal tax, unless the firm has a permanent facility in the United States; and the profits of a Michigan trucking company are exempt from Canadian taxes, unless the Michigan firm has a permanent facility in Canada.

The SBT is levied on the adjusted tax base of a taxpayer with business activity in the state; the "tax base" is business income before allocation or apportionment; and "business income" is federal taxable income. Thus, until the enactment of Public Act 115, a Canadian trucking firm with no permanent facility in the United States paid no SBT, because it had no "business income" for purposes of the tax.

Public Act 115 of 1999 made several major changes to the SBT, including reducing the tax by one-tenth of one percent each year until it is eliminated, and replacing the capital acquisition deduction with an investment tax credit. Public Act 115 also added Section 19 to the SBT Act to prescribe the application of the tax to foreign companies. Among other things, Section 19 provides that the tax base of a foreign person includes the sum of business income and adjustments that are related to United States business activity, "whether or not the foreign person is subject to tax under the Internal Revenue Code". Thus, evidently, Canadian trucking firms doing business in Michigan are now subject to the SBT for business activity in this state, whether or not they have a permanent establishment in Michigan and are exempt from federal tax on their business profits. Legislation has been proposed that would lessen the impact of recent changes in the SBT on Canadian truckers.

THE CONTENT OF THE BILL:

The bill would amend the Single Business Tax Act to allow a “foreign person” that did not have a permanent establishment in the United States and whose business activity consisted of the transportation of persons or property for others by motor vehicle to calculate its compensation related to U.S. business activity by one of the following methods:

1) calculate compensation under Section 19 of the SBT and then reduce the final calculation by 50 percent; or

2) calculate compensation by determining total compensation everywhere, apportioned to the U.S. by a formula the numerator of which is revenue miles traveled in the U.S. and the denominator of which is revenue miles traveled everywhere. (That is to say, compensation would be based on the proportion of total revenue miles traveled that were revenue miles traveled in the U.S.)

A person who used the first method of calculating compensation described above would not be eligible to claim an excess compensation reduction under Section

31 of the act. (Compensation is one component of the SBT tax base, along with profits, interest, and depreciation.)

Definitions. The term “foreign person” is defined in Section 19(6) to mean either 1) an individual who is not a U.S. resident, whether or not the person is subject to taxation under the federal Internal Revenue Code; or 2) a person formed under the laws of a foreign country or a political subdivision of a foreign country, whether or not the person is subject to taxation under the Internal Revenue Code. The term “revenue mile” is defined in Section 57 of the act to mean “the transportation for consideration of one net ton in weight or one passenger the distance of one mile”. The term “permanent establishment” would mean either 1) the term as defined in an income tax treaty between the U.S. and another nation, if there was such a treaty applying to the foreign person; or 2) the term as defined in the U.S. model income tax convention, if no income tax treaty applied to the foreign person.

MCL 208.35b

FISCAL IMPLICATIONS:

The Senate Fiscal Agency has said that the bill would reduce General Fund revenues from the SBT by an unknown amount. The agency has calculated, however, that if affected taxpayers saw their tax bases reduced by 40 percent on average, the bill would reduce SBT revenues by about $320,000 per year. This is based on an assumption that the companies in question would otherwise produce two percent of the revenue from the transportation sector. The transportation sector is said to produce 1.9 percent of SBT revenues, which in total are $2.2 billion annually. A full exemption, contained in earlier versions of the bill, would have reduced revenues by $800,000, based on the same set of assumptions. (SFA floor analysis dated 11-28-00)

ARGUMENTS:

For:

The bill would reduce the tax base on which Canadian trucking companies will pay the single business tax or SBT. It allows a reduction of at least 50 percent in the compensation portion of the tax base, and allows companies to determine compensation based on revenue miles traveled in the U.S. (Otherwise, according to tax specialists, a trucking firm would have to include a full day’s compensation for a truck driver in the Michigan tax base even if the driver spent only an hour delivering in the state.) According to the Senate Fiscal Agency, the compensation portion has traditionally constituted about 70 percent of the tax base for transportation companies, so the bill represents a substantial tax base reduction from what would otherwise be the case. A representative of Canadian trucking has described this approach as fair and equitable. The trade that passes between the United States and Canada, and particularly between Michigan and Ontario, represents the world's largest trading partnership. This trade relationship supports thousands of jobs in both countries. It also generates enormous truck traffic between Michigan and Ontario, mostly for transporting products related to auto manufacturing. Until recently, Canadian trucking firms that shuttled goods between Michigan and Canada were not subject to the state's SBT, except on profits and business activity generated at a permanent facility in Michigan. A change in the state SBT, however, now makes Canadian truckers subject to the SBT for business activity in Michigan, whether or not they have a permanent facility in Michigan. This means, then, that a Michigan trucking firm with no permanent facility in Canada has no tax liability on its business profits generated there, while a Canadian trucking firm doing business in Michigan is taxed on its business activities in the state. This upsets the competitive balance between Michigan and Canadian trucking firms, and might cause Ontario or other provinces to adopt retaliatory tax policies aimed at Michigan trucking firms. This bill addresses the problem in a way representatives of Canadian trucking and state treasury officials are said to find acceptable.

POSITIONS:

The Department of Treasury supports the bill. (12-5-00)

A representative of the Canadian Trucking Alliance and Ontario Trucking Association testified in support of the bill. (12-5-00)

The Michigan Trucking Association had indicated support for the bill. (12-5-00)

The Detroit Regional Chamber of Commerce has indicated support for the bill. (12-5-00)

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.