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SBT: INVESTMENT TAX CREDIT

House Bill 5394 with committee amendment
First Analysis (3-1-00)

Sponsor: Rep. Valde Garcia
Committee: Tax Policy

THE APPARENT PROBLEM:

Public Act 115 of 1999 (House Bill 4745) amended the Single Business Tax Act to reduce the tax rate by one-tenth of one percent each year, with the rate to reach zero on January 1, 2021. At the same time, it replaced the capital acquisitions deduction (CAD) in the SBT act with an investment tax credit (ITC) beginning with the 2000 tax year. The CAD allows a firm to deduct from its tax base 100 percent of capital investments made in Michigan. For a multistate company, the CAD is apportioned using the same formula used to apportion the SBT tax base, with sales weighted 90 percent and payroll and property each weighted 5 percent. This benefits businesses whose sales are made predominantly within the state more than companies making a large number of sales out of state. The decision to replace the CAD with the ITC stemmed from fears by tax specialists that the CAD could be found unconstitutional because of its treatment of capital investments by multistate companies. Indeed, recently, a lower court ruled against the CAD.

The investment tax credit replaces the capital acquisitions deduction for tax years after December 31, 1999. This type of credit, which is deducted from a firm's tax liability (and not its tax base, as a deduction would be) is found in many other states. While the ITC was designed to be revenue neutral overall, the formula does produce "winners" and "losers" within the business sector, in that some firms will be better off under an ITC than a CAD while some other firms will be worse off. In fact, some firms will see an increased tax liability for several years until the tax rate is reduced sufficiently to offset it. Eventually, of course, all firms will be "winners" due to the declining SBT rate. Among the short-term losers are firms whose operations are entirely in Michigan, many of them smaller businesses. Acting on the grounds that smaller businesses are less able financially to withstand the short-term increase in tax liability, legislation has been introduced, supported by the Engler Administration, to modify the investment tax credit to assist smaller firms.

THE CONTENT OF THE BILL:

The bill would amend the Single Business Tax Act to revise the way in which the new investment tax credit is calculated so as to increase the amount of the credit for businesses with adjusted gross receipts of $5 million or less.

The investment tax credit was created by Public Act 115 of 1999 and is effective for tax years beginning after December 31, 1999. It replaces the capital acquisition deduction (CAD). The SBT act contains a formula for determining the allowable costs of tangible assets to be used in calculating the credit and requires that the assets be physically located in the state for use in a business activity in the state. Once the costs have been calculated, they are to be multiplied by a percentage determined by dividing the SBT tax rate (which began declining one-tenth of one percent per year as of the1999 tax year) for the year in which the credit is being claimed by 2.3 percent and multiplying that result by 0.85 percent. The bill would alter the calculation by multiplying the result as follows:

For taxpayers with adjusted gross receipts for the tax year of $1 million or less, 2.3 percent;

For taxpayers with adjusted gross receipts of more than $1 million up to $2.5 million, 1.5 percent;

For taxpayers with adjusted gross receipts of more than $2.5 million up to $5 million, 1.0 percent; and

For taxpayers with adjusted gross receipts for the tax year of more than $5 million, 0.85 percent.

The bill also would provide a definition of "adjusted gross receipts" for the purpose of calculating the investment tax credit, and would specify that a member of an affiliated group as defined in the SBT act, a controlled group of corporations under specified federal laws, or an entity under common control as defined by the Internal Revenue Code would determine adjusted gross receipts for purposes of the credit on a consolidated basis.

MCL 208.35a

BACKGROUND INFORMATION:

According to information from the Department of Treasury, about 150,000 businesses file single business tax returns (out of perhaps 250,000 businesses in the state) and about 90,000 have an SBT liability. The department says 14,100 taxpayers are estimated to face a tax increase in the year 2000, while 135,800 filers will have a tax cut or no change in taxes. Under this bill, says the department, 9,100 taxpayers will no longer have a tax increase (with 6,200 seeing an overall reduction) and 2,600 businesses will have a smaller tax increase. Of companies facing a year 2000 tax increase, about 2,400 will not be affected by the bill.

The department reports that of the 32,356 firms benefitting from the bill, 17,629 have adjusted gross receipts of $1 million or less; 9,112 are in the $1 million to $2.5 million bracket; and 5,616 are in the $2.5 million to $5 million bracket. (2-29-00)

FISCAL IMPLICATIONS:

The Department of Treasury estimates the revenue reduction from the bill at $12.4 million in 1999-2000 and $16.7 million in 2000-2001. The House Fiscal Agency concurs with those estimates. (The department's estimates can be found in the Review and Analysis of the Governor's FY 2000-01 Budget Proposal, issued by the House Fiscal Agency in February 2000.)

ARGUMENTS:

For:
The bill recognizes that some small businesses were "losers" under the recent legislation to switch from the use of a capital acquisition deduction to an investment tax credit in the Single Business Tax Act. This change was made in conjunction with a 23-year phase out of the tax, so in a few years, all businesses will see a steadily declining tax liability. In the short run, however, some firms face larger tax bills, particularly those who mostly conduct business within the state. Smaller businesses are seen as less capable of dealing with this short-term situation, and so this bill will expand the investment tax credit to provide them relief. The Department of Treasury says that the bill will help over 32,000 businesses, more than half of them businesses with adjusted gross receipts of $1 million or less. Most of the SBT taxpayers facing tax increases in the year 2000 will now see a tax cut or at least no tax increase as a result of this bill.

Against:
Some business representatives, while supporting this bill, would like to see it expanded to cover more businesses and to provide further tax relief. Specifically, they have recommended doubling the brackets in the bill so that companies with adjusted gross receipts up to $10 million will benefit. Otherwise, some of these larger (but still small) businesses will face tax increases. They have also argued that the legislature should address other related issues, such as raising the limit on how much compensation owners and officers of a company can earn and still qualify for the small business credit; eliminating apportionment factors from the CAD formula to be used if the current CAD is struck down; and permitting full use of the excess compensation deduction in conjunction with the investment tax credit. Labor-intensive businesses can reduce their tax base by up to 37 percent using the excess compensation credit. They used to be able to take the full deduction and the CAD. With the ITC, companies must reduce their investment tax credit if they use the excess compensation deduction.

Response:
This bill is part of a package of tax cuts designed to fit within the 2000-2001 budget as proposed by the governor. Some of the additional proposals would have serious revenue impact. While there will likely be further legislative discussions about SBT issues in the near future, this bill focuses attention on the most pressing problem and provides assistance to those companies perceived to be the ones who most need it. Department of Treasury officials, moreover, say that in devising the investment tax credit formula, tax specialists took into account the way in which the excess compensation deduction and CAD worked together.

Against:
It should be noted that some persons opposed the SBT phase out bill, pointing out at the time that only about 35 percent of the state's businesses pay the SBT and that 75 percent of revenues come from 5 percent of the state's firms. These firms, then, are the primary beneficiaries of SBT rate reductions. They argued instead for more targeted kind of SBT relief aimed at

small business (such as raising the threshold at which companies must pay the tax) or addressing specific problems (such as removing health care costs from the tax base). The problem this bill addresses would not arise under those proposals. Further, some critics argued that tax relief instead should be provided to individual taxpayers and families rather than businesses on the grounds that the state business tax structure did not seem to be impeding economic development, and others argued against the long-term revenue cuts produced by the SBT phase out.

Response:

The problem the bill addresses is temporary. Over time, businesses and the state economy as a whole will see enormous benefits from the SBT phase out.

POSITIONS:

The state treasurer testified in support of the bill on behalf of the Engler Administration. (2-22-00)

The National Federation of Independent Business (NFIB/Michigan) testified in support of the bill. (2-22-00)

The Small Business Association of Michigan has indicated its support of the bill. (2-22-00)

The Michigan Restaurant Association has indicated its support for the bill. (2-22-00)

The Michigan Hotel, Motel, and Resort Association has indicated its support for the bill. (2-22-00)

The Grand Rapids Area Chamber of Commerce supports the bill. (2-29-00)

The Michigan Grocers Association has indicated support for the bill. (2-22-00)

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.