Senate Fiscal Agency
P. O. Box 30036
Lansing, Michigan 48909-7536

SFA BILL ANALYSIS

Telephone: (517) 373-5383
Fax: (517) 373-1986
TDD: (517) 373-0543

Senate Bill 1380 (as enrolled) **PUBLIC ACT 373 of 2000**
Sponsor: Senator Bill Schuette
Senate Committee: Finance
House Committee: Tax Policy

Date Completed: 1-16-01

RATIONALE

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 could have had 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 .1% 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 became subject to the SBT for business activity in this State, whether or not they had a permanent establishment in Michigan and were exempt from Federal tax on their business profits. It was suggested that Canadian truckers subject to the SBT be allowed to calculate liability at a reduced rate, under certain circumstances, so they may avoid paying a substantial tax that they had not been subject to before the enactment of Public Act 115.

CONTENT

The bill amended the Single Business Tax (SBT) Act to provide that a "foreign person" that does not have a permanent establishment in the United States, and whose business activity consists of the transportation of persons or property for others by motor vehicle, may elect to calculate compensation related to U.S. business activity by one of the following methods:

-- Calculate compensation under Section 19 and reduce the final calculation by 50%. (Section 19 provides that the person's tax base is business income, as defined in that section, plus adjustments, including compensation. Section 19 specifies that for a foreign person, compensation is the daily compensation paid to each employee, officer, and director of the foreign person multiplied by the number of days the employee, officer, or director has physical contact with the U.S.)
-- Calculate compensation by determining total compensation everywhere, apportioned to the United States by a formula, the numerator of which is revenue miles traveled in the United States and the denominator of which is revenue miles traveled everywhere.

The bill provides that a foreign taxpayer may not claim the excess compensation deduction allowed under the Act, if the foreign taxpayer calculates compensation under Section 19 and reduces the final calculation by 50%.

The bill defines "foreign person" by reference to the definition in Section 19, i.e., an individual who is not a U.S. resident, or a person formed under the laws of a foreign country, whether or not the person is subject to taxation under the Internal Revenue Code.

MCL 208.35b

ARGUMENTS

(Please note: The arguments contained in this analysis originate from sources outside the Senate Fiscal Agency. The Senate Fiscal Agency neither supports nor opposes legislation.)

Supporting Argument

The trade that passes between the United States and Canada, 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, made Canadian truckers subject to the SBT for business activity in Michigan, whether or not they had a permanent facility in the State. This meant, then, that while a Michigan trucking firm with no permanent facility in Canada had no tax liability on its business profits generated there, a Canadian trucking firm doing business in Michigan was taxed on its business activities in the State. This upset the competitive balance between Michigan and Canadian trucking firms, and could have caused Ontario or other provinces to adopt retaliatory tax policies aimed at Michigan trucking firms. By substantially reducing the inequitable tax treatment that was created, the bill returned the truckers of both countries to a relatively equal footing, and prevented such action.

Legislative Analyst: G. Towne

FISCAL IMPACT

The bill will reduce State General Fund revenues by an unknown amount. Although firms affected by the bill have not traditionally been taxable under the SBT Act, Public Act 115 of 1999 made changes to the Act that caused such businesses to become taxable. Over the 1993-1996 period, SBT receipts from firms in the transportation sector comprised 1.9% of SBT revenues. The share of SBT revenues that is attributable to firms subject to the bill is unknown, although the share is likely to be minimal. The Revenue Consensus Estimate for SBT revenues is $2.2 billion in both fiscal year (FY) 2000 and FY 2001. If firms covered by the bill account for 2% of SBT revenues from firms in the transportation sector, it is estimated that they pay approximately $800,000 per year in SBT. The bill allows affected taxpayers to reduce the compensation portion of the tax base by at least 50%. Compensation has historically comprised approximately 70% of the tax base for transportation companies. Consequently, the bill allows taxpayers to reduce the tax base by at least 35%. If the affected taxpayers, on average, exhibit a 40% reduction in the tax base, then the bill will reduce SBT revenues by approximately $320,000 per year. If the average reduction in the tax base is over 40%, the revenue reduction will be increased, although the impact will remain below the $800,000 reduction that would be experienced if the affected taxpayers were exempt from the SBT.

The bill will have no fiscal impact on local units.

Fiscal Analyst: D. Zin

A9900\s1380ea
This analysis was prepared by nonpartisan Senate staff for use by the Senate in its deliberations and does not constitute an official statement of legislative intent.