

# Legislative Analysis



## SINGLE BUSINESS TAX AMENDMENTS

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**House Bill 4922 (Substitute H-1)**  
**Sponsor: Rep. Fulton Sheen**

**House Bill 4972 (Substitute H-1)**  
**Sponsor: Rep. Glenn Steil, Jr.**

**House Bill 4973 (Substitute H-1)**  
**Sponsor: Rep. Rick Baxter**

**Committee: Tax Policy**

**Complete to 7-12-05**

## A SUMMARY OF HOUSE BILLS 4922, 4972, AND 4973 AS REPORTED FROM COMMITTEE 7-12-05

**BRIEF SUMMARY:** The bills would amend various provisions in the Single Business Tax Act and are, in part, the House Republican's response to Governor Granholm's proposed business tax changes contained in House Bill 4476, the Michigan Jobs and Investment Act. (See the HFA summary of HB 4476 on the details of governor's proposal.) House Bill 4922 would completely phase-out health care benefits from the SBT base, reduce the standard rate based on projected SBT revenue, and reduce the alternative tax rate to one percent. House Bill 4972 would apportion business activity to the state based solely on sales. House Bill 4973 would create a SBT credit based on taxes paid on industrial and commercial personal property.

**FISCAL IMPACT:** For Fiscal Year 2005-2006 the changes proposed by the bills would collectively reduce GF/GP revenue by an estimated \$268 million. (For additional information, see Fiscal Information later in the summary.)

### **THE CONTENT OF THE BILLS:**

#### **House Bill 4922**

House Bill 4922 would increase the percentage of health care benefits excluded from the SBT base, reduce the standard rate based on projected SBT revenue, and reduce the alternative tax rate incrementally to 1.0 percent. The bill is tie-barred to House Bills 4972 and 4973.

#### *Health Care Add Back*

The base of the Single Business Tax is composed of federal taxable income, compensation, and several additions and subtractions to federal taxable income. For the purposes of determining the SBT base, compensation includes salaries, wages, and

employee benefits, such as health insurance. Currently under the SBT Act, the following percentage of health care benefits (and related administrative costs) provided to Michigan residents are excluded from "compensation": 20 percent in 2005; 40 percent in 2006; and 50 percent in 2007 and beyond.

House Bill 4922 would amend the SBT Act (MCL 208.4a) to exclude the following percentages from the SBT base: 62.5 percent in 2008; 75 percent in 2009; 87.5 percent in 2010; and 100 percent in 2011 and beyond.

It should be noted, however, that at present the SBT Act is due to be repealed for tax years that begin after December 31, 2009. Additionally, the House has passed legislation (House Bill 4324) that would exclude 100 percent of health care benefits for tax years that begin after December 31, 2005.

#### *Rate Reduction*

The bill also would amend the SBT Act (MCL 208.31) to reduce the standard rate, currently at 1.9 percent, by 0.05 percentage point, if the May Revenue Estimating Conference estimates that SBT revenue for the current fiscal year exceeds SBT revenue for the previous fiscal year by at least \$80 million. The rate would be reduced on the January 1 immediately preceding the May conference, beginning with the 2006 Calendar Year. The rate could be reduced up to four times under this provision, thereby allowing a maximum rate reduction of 0.2 percentage point.

The SBT rate was initially set at 2.35 percent and was lowered to 2.3 percent in 1994 through the enactment of Public Act 247. In 1999, Public Act 115 began to phase-out the tax by lowering the rate by 0.1 percentage point annually, if the balance of the budget stabilization fund was greater than \$250 million. The rate dropped by 0.1 percent annually on January 1 from 1999 to 2002, and is currently at 1.9 percent.

[In comparison, House Bill 4476, introduced by Representative Condino, would reduce the standard rate to 1.2 percent, but would extend the SBT indefinitely. Additionally, Senate Bill 633 (Substitute S-1), introduced by Senator Cassis, would extend the SBT beyond its scheduled elimination at the end of 2009 and reduce the SBT rate to 1.8 percent in 2007 and by further reducing the rate by 0.1 percentage point on each January 1 thereafter beginning in 2008 until the rate is zero.]

#### *Alternative Tax Rate*

Under current law (MCL 208.36) certain small, low-profit businesses may calculate their SBT tax liability by using one of two methods: claiming the small business credit or calculating their tax liability using the alternative tax rate of two percent imposed on adjusted business income. The bill would reduce the alternative tax rate to 1.8 percent in 2006; 1.6 percent in 2007; 1.4 percent in 2008; 1.2 percent in 2009; and 1.0 percent in 2010. (Again, the tax is currently set to be repealed for tax years beginning after December 31, 2009.)

Public Act 390 of 1988 established the alternative tax for small businesses. A firm's tax liability under this method is equal to two percent of adjusted business income. The alternative tax rate was initially set at four percent, and decreased to three percent for the 1992 and 1993 tax years, and lowered to the current rate for tax years beginning October 1, 1994. It should be noted that while the current alternative tax rate is slightly higher than the current standard rate of 1.9 percent, the alternative tax is levied on a much narrower tax base. According to an August 2003 report by the Office of Revenue and Tax Analysis, approximately 22 percent of businesses filing an SBT return used the alternative rate method in 1999-2000. Those returns accounted for 1.8 percent of total SBT revenue.

Firms eligible to calculate their tax liability using the alternative rate method must meet the following criteria: (1) gross receipts not exceeding \$10 million, (2) adjusted business income not exceeding \$475,000, and (3) individual shareholder or officer-allocated income not exceeding \$115,000.

Additionally, firms meeting the above criteria may alternatively calculate their tax liability using the standard method and claiming the small business credit. (A firm, cannot, however, use the alternative rate method and at the same time claim the small business credit.) The credit is based on the ratio of adjusted business income to 45 percent of the SBT base. After application of the credit, a firm's tax liability is equal to the product of (1) the tax liability before the credit, and (2) the quotient of adjusted business income and 45 percent of the tax base. The credit was first established with the enactment of Public Act 273 of 1977.

[In comparison, House Bill 4476 would make three changes to alternative tax rate and small business credit provision in the SBT Act: (1) the bill would reduce the rate of the small business alternative tax, from 2.0 percent to 1.2 percent; (2) the bill would provide that limited liability companies are subject to the same compensation limits as other businesses; and (3) the bill would provide that affiliates of out-of-state companies are subject to the same combined gross receipts limits as affiliates of in-state companies.]

## **House Bill 4972**

The bill would create a new section (MCL 208.35d) establishing a refundable credit against the SBT equal to a portion of the amount of taxes paid for industrial and commercial personal property under the General Property Tax Act, the Plant Rehabilitation and Industrial Development Act (P.A. 198), and the Obsolete Property Rehabilitation Act. For the 2006 tax year, the credit would be equal to 25 percent of taxes paid on industrial personal property and 5 percent of taxes paid on commercial personal property. For the 2007 tax year and beyond, the credit would be equal to 25 percent of taxes paid on industrial personal property and 10 percent of taxes paid on commercial personal property. To claim the credit, taxpayers would have to file separate personal property tax statements with the local assessor identifying industrial personal property and commercial personal property.

Under the General Property Tax Act, businesses in the state pay property taxes on both real property and personal property. For the purposes of administering the tax, personal

property is self-reported to local assessors by each business on a personal property tax statement that includes a list of each item and its age. Local assessors then assign a taxable value to each item using depreciation schedules. Generally speaking, personal property is taxed in the same manner as other real property in a local governmental unit.

### **House Bill 4973**

To determine SBT tax liability, firms with business activity in Michigan and other states must calculate how much of their total business activity is to be apportioned to Michigan. The apportionment formula is based on three factors: payroll, property, and sales. A weighted average of those three factors is used to determine the business activity attributable to Michigan, with sales weighted at 90 percent, and payroll and property each weighted at 5 percent. As an example, a business with 20 percent of its sales, 70 percent of its payroll, and 70 percent of its property in Michigan would apportion 25 percent –  $[(.90*.20)+(.05*.70)+(.05*.70)]$  – of its total tax base to Michigan.

House Bill 4973 would amend the SBT Act (MCL 208.45a) to eliminate the payroll and property factors and base apportionment entirely on sales, for tax years beginning after December 31, 2005, except for the portion of the tax base that is derived principally from transportation, financial, or insurance carrier services or specifically allocated. The change would not affect Michigan-only businesses; it would only apply to multi-state businesses. [In general, the bill is likely to benefit with payroll and property in Michigan and a high level of out-of-state sales.]

When the SBT was first enacted, each apportionment factor was weighted equally (33 1/3 percent). Public Act 77 of 1991 altered the formula to weight the sales factor more heavily (40 percent) than payroll and property (30 percent each) for 1991 and 1992. For 1993 and subsequent years, Public Act 77 weighted the sales factor at 50 percent, and payroll and property at 25 percent each. Public Act 283 of 1995 weighted the sales factor at 80 percent, and payroll and property at 10 percent each. Public Act 282 of 1995 established the current apportionment formula weighing sales at 90 percent, and payroll and property at 5 percent each.

### ***FISCAL INFORMATION:***

#### **House Bill 4922**

The bill would amend the Single Business Tax Act to phase-out from the tax base health care costs paid by taxpayers for Michigan residents, reduce the alternate tax rate to 1 percent over 5 years, and reduce the SBT rate as specified in the bill. A maximum of four 0.05 percentage point rate reductions would occur if the estimated SBT revenue, based on the Consensus Revenue Estimating Conference, were \$80 million or more above the previous year revenue. SBT revenue would have to increase by over 4 percent to trigger a 0.05 percentage point rate reduction. If this were to occur, SBT revenue would be reduced by approximately \$50 million (per 0.05 percentage point). Without a rate reduction and on a full year basis, this bill would reduce SBT revenue by an estimate \$4 million in the first year and \$8 million in the second year. All SBT revenue is General

fund/General Purpose revenue. This bill would have no direct affect on local units of government.

#### **House Bill 4972**

The bill would amend the Single Business Tax Act to provide a refundable personal property tax credit for manufacturing and commercial firms. On a full year basis and when fully phased-in, this bill would reduce SBT revenue (GF/GP) by an estimated \$254 million. This bill would have no direct affect on local units of government.

#### **House Bill 4973**

The bill would amend the Single Business Tax Act to base the apportionment formula entirely on sales. On a full year basis, this bill would reduce SBT revenue (GF/GP) by an estimated \$43 million. This bill would have no direct affect on local units of government.

The estimated state full year fiscal impact of these bills is depicted in the table below. Under current law, the SBT will be repealed for tax years that begin after December 31, 2009, however these estimates assume that the repeal would be extended.

#### **Impact of Proposed SBT Cuts (millions)**

| <b>Change</b>                  | <b>FY 2006</b>   | <b>FY 2007</b>   | <b>FY 2008</b>   | <b>FY 2009</b>   | <b>FY 2010</b>   | <b>5-yr Total</b>  |
|--------------------------------|------------------|------------------|------------------|------------------|------------------|--------------------|
| 100% Sales Factor @ 1.9% Rate  | (\$42.5)         | (\$43.1)         | (\$43.6)         | (\$44.2)         | (\$44.7)         | (\$218.1)          |
| 25% Manufacturing PPT Credit   | (\$194.3)        | (\$198.7)        | (\$203.2)        | (\$207.8)        | (\$212.5)        | (\$1,016.6)        |
| 5% & 10% Commercial PPT Credit | (\$27.2)         | (\$55.6)         | (\$56.8)         | (\$58.1)         | (\$59.4)         | (\$257.2)          |
| Eliminate Healthcare Add Back  | \$0.0            | \$0.0            | (\$8.6)          | (\$13.0)         | (\$24.9)         | (\$46.5)           |
| Reduce Alternative Tax Rate    | (\$4.0)          | (\$8.0)          | (\$12.0)         | (\$16.0)         | (\$20.0)         | (\$60.0)           |
| <b>Total</b>                   | <b>(\$268.0)</b> | <b>(\$305.4)</b> | <b>(\$324.3)</b> | <b>(\$339.1)</b> | <b>(\$361.5)</b> | <b>(\$1,598.3)</b> |

***POSITIONS:***

The Michigan Chamber of Commerce supports the bills. (7-12-05)

The Insurance Institute of Michigan supports the bills. (7-12-05)

The National Federation of Independent Business supports the bills. (7-12-05)

The Small Business Association of Michigan supports the bills. (7-12-05)

The Detroit Regional Chamber supports the bills. (7-12-05)

The Michigan Bankers Association supports the bills. (7-12-05)

The Coalition for Tax Relief and Jobs supports the bills. According to its website, the Coalition includes the Michigan Association of Home Builders, the Michigan Association of Insurance Agents, Freedom Works, the Michigan Business & Professional Association, the Car and Truck Rental and Leasing Association of Michigan, the Life Insurance Association of Michigan, Auto-Owners Insurance, and the Michigan Insurance Coalition, as well as the NFIB, IIM, and MBA listed separately above. (7-12-05)

The Department of Treasury is opposed to the bills. (7-12-05)

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■ 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.