Legislative Analysis

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SINGLE BUSINESS TAX AMENDMENTS

House Bill 5108
Sponsor: Rep. Fulton Sheen
Committee: Tax Policy

Complete to 8-29-05

A SUMMARY OF HOUSE BILL 5108 AS INTRODUCED 8-24-05

The bill would amend the Single Business Tax Act to do the following:

- Completely phase out the health care addback.
- Reduce the standard rate based on projected SBT revenue.
- Create a credit based on taxes paid on industrial and commercial personal property.
- Reduce the alternative tax rate available for certain, low-profit businesses.
- Apportion business activity to the state based solely on sales, rather than a combination of sales, payroll, and property.

The provisions in thisbill are similar to House Bills 4922, 4972, and 497, which were reported from the House Committee on Tax Policy in mid-July. The following is a more detailed description of the House Bill 5108.

Health Care Addback

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" and thus from the SBT tax base: 20 percent in 2005; 40 percent in 2006; and 50 percent in 2007 and beyond.

House Bill 5108 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It should be noted, however, that at present the SBT Act is due to be repealed for tax years that begin after December 31, 2009.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 already passed legislation (HB 4324) this session that would exclude 100 percent of health care benefits for tax years that begin after December 31, 2005.

SBT Rate Reduction

The bill would also 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, if applicable. The rate could be reduced up to four times under this provision, thereby allowing a maximum rate reduction of 0.2 percentage point (to 1.7 percent).

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 237. 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, HB 4476, implementing the governor's proposed Michigan Jobs and Investment Act, 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 standard rate to 1.8 percent in 2007, and further reduce the rate by 0.1 percentage point on each January 1 thereafter beginning in 2008 until the rate is zero.]

Industrial and Commercial Personal Property Credit

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 (commonly referred to as P.A. 198), and the Obsolete Property Rehabilitation Act. For the 2006 tax year, the credit would be equal to 25 percent of the taxes paid on industrial personal property and 5 percent of the taxes paid on commercial personal property. For the 2007 tax year and beyond, the credit would be equal to 25 percent of the taxes paid on industrial personal property and 10 percent of the taxes paid on commercial personal property. To claim the credit, businesses would have to file separate personal property tax statements with the local assessor identifying industrial and commercial personal property. Businesses that are not required to file an SBT return would be eligible for the credit.

Alternative Tax Rate

Under the act, (MCL 208.36), certain small, low-profit businesses may calculate their SBT tax liability by using one of two methods: (1) claiming the small business credit, or (2) calculating their tax liability using the alternative tax rate of two percent imposed on adjusted business income. The bill would reduce the alternative 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. (Although, as noted earlier, the tax is currently set to be repealed for tax years beginning after December 31, 2009.)

Firms eligible to calculate their tax liability using the alternative rate or the small business credit 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. 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.

Apportionment Factor

To determine SBT tax liability, firms with business activity in Michigan and other states must calculate how much of the 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 is payroll, and 70 percent of its property in Michigan would apportion 25 percent – [(.90*.20)+(0.05*.70)+(0.05*70)] – of its total tax base to Michigan.

<u>House Bill 5108</u> 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.

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 sale 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 1992 established the current apportionment formula weighing sales at 90 percent, and payroll and property at 5 percent each.

FISCAL IMPACT:

Health Care Addback – Phasing out the health care addback would not begin until 2008 and, as such, would not impact SBT revenue (GF/GP) in fiscal years 2006 or 2007.

Standard Rate Reduction - SBT revenue would have to increase by over 4 percent to trigger a 0.05 percentage point rate reduction, as provided in the bill. If this were to occur, SBT revenue (GF/GP) would be reduced by approximately $50 million per 0.05 percentage point. This change would have no direct affect on local governmental units.

Personal Property Tax Credit – The refundable personal property tax credit for manufacturing and commercial firms would, on a full year basis and when fully phased-in, reduce SBT revenue (GF/GP) by an estimated $254 million. This change would have no direct affect on local governmental units

Alternative Tax Rate – Lowering the alternative tax rate would reduce SBT revenue (GF/GP) by an estimated $4 million in the first year and $8 million in the second year. This change would have no direct affect on local governmental units.

Apportionment – On a full year basis, basing the apportionment formula entirely on sales would reduce SBT revenue (GF/GP) by an estimated $43 million. This change would have no direct affect on local governmental units

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)

Change	**FY 2006**	**FY 2007**	**FY 2008**	**FY 2009**	**FY 2010**	**5-yr Total**
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)
Total	**($268.0)**	**($305.4)**	**($324.3)**	**($339.1)**	**($361.5)**	**($1,598.3)**

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