Legislative Analysis

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SINGLE BUSINESS TAX AMENDMENTS

House Bill 5108 (Substitute H-1)
Sponsor: Rep. Fulton Sheen
Committee: Tax Policy

Complete to 8-31-05

A SUMMARY OF HOUSE BILL 5108 (H-1) AS REPORTED FROM COMMITTEE

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

- Completely phase out the health care addback.
- Reduce the standard rate by up to 0.4 percent point.
- Reduce the gross receipts reduction (which increases the tax base).
- Reduce the excess compensation reduction (which increases the tax base).
- Create a credit based on taxes paid on industrial personal property.
- Reduce the alternative tax rate available for certain, low-profit businesses.
- Increase the maximum allowable shareholder or officer-allocated income used to determine eligibility for the small business credit/alternative tax rate.
- Apportion business activity to the state based solely on sales, rather than a combination of sales, payroll, and property.

The bill is tie-barred to House Bills 4980, 5095-5098, 5106, and 5107.

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.

While the bill presumes that the act will be extended beyond its schedule elimination after December 31, 2002, the bill, at present does not extend the act. (See Enacting Section 1 of Public Act 531 of 2002 for the language repealing the act.)

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 0.1 percentage point on January 1, 2007 and again on January 1, 2008.

In addition, the rate would be reduced 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 2009 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 (meaning the rate could be reduced as far as 1.5 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. The rate reductions proposed by the bill would be in addition to the rate reduction schedule currently provided for in the act.

Gross Receipts Reduction

Under the act, if a business's adjusted tax base exceeds 50 percent of its adjusted gross receipts (that is, gross receipts apportioned to Michigan and any capital acquisition deduction recapture) the business may calculate its tax liability using the gross receipts reduction method. The bill would increase the calculation threshold from 50 percent of gross receipts to 52.7 percent of gross receipts for the 2007 tax year, and 56 percent of gross receipts for tax years beginning on or after January 1, 2008.

This method permits a business to reduce its tax base by the amount that the adjusted tax base exceeds 50 percent of adjusted gross receipts. This, in essence, reduces the tax base to an amount equivalent to 50 percent of adjusted gross receipts. Businesses may also calculate their tax liability using the gross receipts "short method" (a simplified version of the gross receipts reduction method) that calculates the adjusted tax base as being 50 percent of adjusted gross receipts.

Excess Compensation Reduction

The excess compensation reduction allows a business, in calculating its tax liability, to reduce its tax base by the amount that total compensation exceeds 63 percent of its tax base. Under this method, the adjusted tax base is reduced by amount equal to the percent by which compensation exceeds 63 percent of the tax base, up to a maximum of 37 percent. The bill would increase to calculation threshold from 63 percent to 66 percent, thereby allowing a maximum reduction of 34 percent of the tax base, for 2007 tax years.

For tax years that begin on or after January 1, 2008, the calculation threshold would be 70 percent, thereby allowing for a maximum reduction of 30 percent.

Under current law, for example, if compensation represents 80 percent of a business's total tax base, the business may reduce its tax base by 17 percent (80 percent – 63 percent = 17 percent). Under the bill, that same business would reduce its tax base by 14 percent (80 percent – 66 percent = 14 percent), in 2007 or 10 percent (80 percent – 70 percent = 10 percent) in 2008. Additionally, businesses that use the excess compensation reduction method and that also claim the Investment Tax Credit (ITC) must also reduce their ITC by an amount proportionate to their compensation reduction. (In the above example, the business would have to reduce its ITC by 17 percent or, under the bill, 14 percent or 10 percent.)

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 new and existing industrial personal property under the General Property Tax Act, the Plant Rehabilitation and Industrial Development Act, and the Obsolete Property Rehabilitation Act, and the amount of payments made to the Michigan Strategic Fund related to a renaissance zone used to reimburse local taxing units.

The credit would be available for tax years beginning after January 1, 2006, and would be calculated as follows, depending on the date of purchase.

- If purchased in Calendar Years 2006 or 2007: (1) 50 percent of personal property taxes paid in the first year after the purchase year; (2) 30 percent of personal property taxes paid in the second year after the purchase year; and (3) 20 percent of personal property taxes paid in the third year after the purchase year.

- If purchased in Calendar Year 2008 or later: 20 percent of the taxes paid in each of the three years after the year in which the property was purchased.

- For property that is not newly purchased, the tax credit would be 15 percent of personal property taxes paid in Calendar Years 2006, 2007, and 2008, and would be 20 percent of personal property taxes paid in Calendar Year 2009 and beyond.

In addition to the above credits, if the standard rate is reduced a fourth time because of projected SBT revenue (see above) and, in later years, the May Revenue Estimating Conference projects SBT revenue for the current fiscal year to exceed the previous year's SBT revenue by at least $80 million, taxpayers could claim an additional credit equal to a percentage of taxes paid on personal property purchased in a calendar year after the rate is reduced a fourth time and the subsequent two calendar years. The credit would be available as follows: 50 percent in the first year after the purchase year, 30 percent in the second year, and 25 percent in the third year.

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.

Small Business 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 2008; 1.6 percent in 2009; and 1.4 percent in 2010.

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. The bill would also increase the maximum allowable shareholder or officer-allocated income to $175,000 for tax years after December 31, 2006, and further index that amount, for tax years after December 31, 2007, to growth rate of personal income, as reported by the federal government, for the immediately preceding calendar year. (The bill doesn't specify whether that is calculated at the national level or the state level.)

Currently under the act, the amount of the credit is reduced by 20-80 percent based on the extent to which the income threshold exceeds $95,000. Under the bill, this would apply only through tax years beginning before January 1, 2007.

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 further phase out the payroll and property factors. Except for the portion of the tax base that is derived principally from transportation, financial, or insurance carrier services or specifically allocated, the apportionment factor would be as follows:

- For tax years beginning after December 31, 2005 and before January 1, 2008, the sales factor would be weighted 95 percent, and the payroll and property factors would be weighed 2.5 percent each.

- For tax years beginning after December 31, 2007, the tax based would be based entirely on 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 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.

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FISCAL IMPACT:

Impact of Proposed SBT Cuts (millions)

Proposed SBT Cuts	FY 2005-06	FY 2006-07	FY 2007-08	FY 2008-09	FY 2009-10	5-Year Total
100% Sales Apportionment Factor (3 year phase-in)	$ 21.9	$ 22.4	$ 45.7	$ 47.6	$ 49.5	$ 187.0
20% Industrial PPT Credit (50% new / existing phase-in)	$ 117.0	$ 149.8	$ 162.6	$ 168.5	$ 159.9	$ 757.8
0.1% SBT Rate Cut (incl. gross receipts /excess comp reductions)		$ 29.0	$ 69.1	$ 80.5	$ 82.4	$ 261.0
Eliminate Healthcare Addback over 4 years starting in 2008			$ 8.6	$ 13.0	$ 24.9	$ 46.5
Small Business Tax Relief (5 year phase-in)		$ 8.0	$ 12.0	$ 16.0	$ 20.0	$ 56.0
Additional SBT Rate Cuts / PPT Credits by Trigger	$ 0.0	$ 0.0	$ 0.0	$ 0.0	$ 0.0	$ 0.0
Gross Tax Cut	**$ 138.9**	**$ 209.2**	**$ 298.0**	**$ 325.6**	**$ 336.6**	**$ 1,308.2**

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