



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

BILL



ANALYSIS

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

Senate Bill 633 (as enrolled)

House Bills 4342, 4972, 4973, 4980, 5095, 4096, 5097, 5098, 5106, 5107, and 5108 (as enrolled)

Sponsor: Senator Nancy Cassis (S.B. 633)

Sponsor: Representative Tim Moore (H.B. 4342)

Representative Glenn Steil (H.B. 4972)

Representative Rick Baxter (H.B. 4973)

Representative Rick Jones (H.B. 4980)

Representative Paul Condino (H.B. 5095, 5098, 5106, & 5107)

Representative Fulton Sheen (H.B. 5096, 5097, & 5108)

Senate Committee: Finance

House Committee: Tax Policy

Date Completed: 11-21-05

CONTENT

This package of bills would generate a net reduction in business taxes by making the following changes:

Tax Cuts - The single business tax would be reduced by changes to several components of the tax, including an increase in the weight of the sales component of the apportionment factor, an increase in the health care cost deduction, expansion of the small business credit, and a reduction of the tax rate.

Eliminate Tax Exemptions - Certain tax exemptions currently part of the single business, sales, and use taxes would be eliminated.

Change Tax on Commercial Rental Property - Commercial rental property would be exempt from the property tax and instead become subject to a new specific tax.

Property Tax Credits - Two new single business tax credits would be created to

help reduce property taxes on industrial and high-technology personal property.

The bills in this business tax relief package would amend (or create) the following Acts:

<u>Act</u>	<u>Bill</u>
Single Business Tax Act	S.B. 633 H.B. 4342 H.B. 4972 H.B. 5098 H.B. 5108
General Sales Tax Act	H.B. 4980 H.B. 5106
Use Tax Act	H.B. 5107
Revenue Act	H.B. 5095
General Property Tax Act	H.B. 5097
Commercial Rental Property Specific Tax Act (Proposed)	H.B. 5096

PROPOSED CHANGES TO THE SINGLE BUSINESS TAX ACT

Senate Bill 633

This bill would reduce the single business tax rate, the excess compensation deduction, and the gross receipts deduction.

- **Tax Rate.** Under current law, the single business tax is assessed at a rate of 1.9%, but under this bill the rate would fall to 1.85% effective January 1, 2009.
- **Gross Receipts Deduction.** Currently, taxpayers may deduct the amount by which their adjusted tax base exceeds 50.0% of gross receipts. The bill would reduce this deduction by increasing the gross receipts percentage from 50.0% to 51.4% on January 1, 2009.
- **Excess Compensation Deduction.** Currently, taxpayers may reduce their adjusted tax base by the percentage that compensation divided by the tax base exceeds 63.0%. The bill would reduce this deduction by making it equal to the percentage that compensation divided by the tax base exceeds 64.7%, effective January 1, 2009.

House Bill 4342

Health Care Deduction. This bill would increase the deduction for health care-related expenses employers incur for their employees. Under current law, this deduction equals 20.0% of these expenses in 2005 and is scheduled to increase to 40.0% in 2006 and to 50.0% in 2007 and after. The bill would completely eliminate health care expenses from the tax base by increasing the deduction to 60.0% in 2009, 70.0% in 2010, 80.0% in 2011, 90.0% in 2012, and 100% in 2013 and after. These increases in the health care cost deduction that would occur in 2010 and after would be included in the Single Business Tax Act despite the fact that under current law the single business will be repealed at the end of 2009.

House Bill 4972

Personal Property Tax Credit. This bill would create a new single business tax credit for property taxes paid on industrial personal property. The credit would equal 15.0% of the industrial personal property taxes. The credit would be refundable, which means that a business having no single business tax liability would receive a payment from the State equal to its 15.0% credit, and a business having a liability less than its 15.0% credit would receive a payment equal to the amount by which the credit exceeded the business's tax liability. This credit would be effective beginning in 2006.

House Bill 4973

Apportionment Factor. This bill would increase the weight for the sales component of the apportionment factor. Under current law, the apportionment factor, which is used to calculate an interstate business's activity in Michigan, is the weighted average of a business's percentage of sales, property, and payroll that occur in Michigan. Currently, the sales factor is weighted at 90.0% and the property and payroll factors are each weighted at 5.0%. Under this bill, the weight of the sales factor would increase to 95.0% and the weights on the property and payroll factors each would decrease to 2.5%, effective January 1, 2006.

House Bill 5098

This bill would make insurance companies liable for the use tax and eliminate the apprenticeship tax credit for most businesses.

- **Insurance Companies.** Under current law, insurance companies pay a tax under the Single Business Tax Act that is in lieu of all other privilege or franchise fees or taxes except taxes on real and personal property. This "in lieu" of provision exempts insurance companies from the use tax on items they purchase from outside of Michigan. The bill would make

insurance companies subject to the use tax.

- **Apprenticeship Credit.** The Single Business Tax Act currently allows a refundable credit for a portion of the costs incurred when a taxpayer is training an apprentice. Under the bill, this credit would be eliminated for all businesses except construction contractors, effective January 1, 2006; however, this credit would be eliminated only in those years in which a "transferred jobs/personal property" tax credit, as proposed in House Bill 5108 (described below), was in effect.
- **Out-Of-State Gains.** Businesses would be prohibited from deducting gains realized by out-of-State subsidiaries.
- **Credit/Loss Carryforward.** The bill also would restrict the extent to which credits or business losses generated by a single-owner limited liability company (LLC) may be used when for a subsequent tax year its owner makes a Federal election to treat the LLC as a disregarded entity, i.e., combines the LLC's business activity with its owner's. Under the restriction, the LLC's owner that elected to treat the LLC as a disregarded entity would not be allowed to use more of the LLC's credits/losses than the LLC could use had the owner not made the election.

House Bill 5108

This bill would create a new jobs/personal property tax credit, expand small business eligibility requirements related to compensation paid to officers or shareholders and adjusted business income, and decrease the alternative tax rate.

- **Transferred Jobs/Personal Property Tax Credit.** The bill would create a new credit against the single business tax equal to 100% of the personal property taxes paid on personal property new to Michigan used directly by workers transferred to Michigan from other states or countries. This credit could be claimed

only during the first year that the taxpayer paid property taxes on the personal property and would be available only for taxes paid in 2007 or 2008; however, businesses could claim this credit in 2009 or 2010 if they reached an agreement with Michigan Economic Development Corporation. This credit would apply to jobs and personal property directly being used for high-technology and manufacturing activity.

- **Officer Compensation.** In order to be eligible for the small business credit, an individual, partnership, or subchapter S corporation must not pay an individual, partner, or shareholder more than \$115,000 in a given year. Under the bill, this compensation cap would increase to \$125,000, effective January 1, 2006.
- **Adjusted Business Income.** Under current law, businesses also must have adjusted business income of not more than \$475,000 in order to qualify for the small business credit. Under this bill, the adjusted business income cap would be increased to \$525,000, effective January 1, 2006.
- **Alternative Tax Rate.** Businesses that qualify for the small business credit may calculate their tax using an alternative method that provides for a tax rate equal to 2.0% of adjusted business income. Under this bill, the alternative tax rate would fall to 1.9% on January 1, 2006.

PROPOSED CHANGES TO THE SALES AND USE TAX ACTS

House Bill 4980

Inmate Purchases. This bill would eliminate a current sales tax exemption on items purchased by inmates with scrip issued and redeemed by the correctional institution, beginning January 1, 2006.

House Bill 5106

Driver Education Vehicles. This bill would eliminate a current sales tax exemption for vehicles purchased by a

public or parochial school that are to be used for driver education classes.

House Bill 5107

This bill would eliminate current use tax exemptions for certain driver education vehicles and international phone calls.

- **Driver Education Vehicles.** The current use tax exemption for vehicles leased to a public or parochial school for driver education classes would be eliminated for those years in which the new "transferred jobs/personal property tax" credit (under H.B. 5108) was in effect.
- **Telecommunication Services.** Under current law, the use tax is not assessed on wide area telecommunication service, interstate private networks, or international calls. This bill would make these telecommunication items subject to the use tax as long as the new "transferred jobs/personal property tax" credit (under H.B. 5108) was in effect.

PROPOSED CHANGES TO THE TAXATION OF COMMERCIAL RENTAL PROPERTY

When commercial rental property experiences a decline in occupancy, the value of the property declines. Likewise, when occupancy increases, the value increases. The courts have ruled that while the full extent of the decline in value may be reflected in taxable value as occupancy rates decline, increases in taxable value as occupancy rates increase are subject to the constitutional cap on annual increases in taxable value. Under this cap, in any given year, a parcel of property's taxable value may not increase by the more than the rate of inflation or 5.0%, whichever is less. The following two changes are designed to remedy this situation:

House Bill 5097

This bill would amend the General Property Tax Act by exempting

commercial rental property from the general property tax beginning December 31, 2005, if the property declined in value due to a change in occupancy or if the owner of the property chose to claim an exemption. Commercial rental property exempt from the property tax would be subject to the tax that would be created under House Bill 5096.

House Bill 5096

This bill would create the "Commercial Rental Property Specific Tax Act". The new tax would apply to commercial rental property that is exempt from the property tax. The new tax would be assessed at the same rate as the property tax and would be distributed the same as the property tax; however, this tax would not be subject to the constitutional cap on taxable value growth.

PROPOSED CHANGES TO TAX PENALTIES

House Bill 5095

This bill would increase penalties for late payments of certain income tax withholding, sales tax, and use tax payments.

FISCAL IMPACT

The estimated fiscal impact of these bills is summarized in the following table.

S0506\S633es

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.

BUSINESS TAX RELIEF
Passed November 10, 2005
(dollars in millions)

Tax Change	Bill Number	FY 2005-06	FY2006-07	FY 2007-08	FY 2008-09	FY 2009-10	FY 2010-11	Total
TAX POLICY CHANGES AND TAX CUTS								
Tax Policy Changes								
Sales/Use Taxes								
Eliminate Prison Scrip Exemption	HB 4980	\$0.5	\$0.7	\$0.7	\$0.8	\$0.8	\$0.8	\$4.4
Eliminate Driver Ed. Vehicle Exemption	HB 5106	0.5	0.6	0.6	0.6	0.1	0.0	2.4
	HB 5107							
Eliminate International Phone Call Exemption	HB 5107	10.6	14.5	15.0	15.4	4.0	0.0	59.4
Eliminate Insurance Company Exemption	HB 5098	2.3	3.1	3.2	3.3	0.8	0.0	12.6
Subtotal Sales/Use Taxes		13.8	19.0	19.5	20.0	5.7	0.8	\$78.8
Single Business Tax								
Reduce Small Business Credit (LLCs)	HB 5108	3.8	5.1	5.3	5.5	1.4	0.0	\$21.1
Prohibit Subsidiary Out-of-State Gains Deduction	HB 5098	8.3	11.3	11.7	12.1	3.1	0.0	46.6
Reduce Apprenticeship Credit	HB 5098	0.5	0.6	0.6	0.6	0.2	0.0	2.4
Restrict Credit/Loss Carryforward	HB 5098	3.8	5.1	5.3	5.5	1.4	0.0	21.0
Subtotal SBT		16.4	22.1	22.8	23.7	6.1	0.0	91.1
Enhanced Penalties	HB 5095	3.8	5.1	5.3	5.5	5.7	5.9	31.3
Taxes on Commercial Rental Property	HB 5096	0.0	0.0	1.0	2.0	3.0	4.0	10.0
	HB 5097							
TOTAL TAX POLICY CHANGES		\$34.0	\$46.1	\$48.6	\$51.2	\$20.6	\$10.8	\$211.2
Tax Cuts								
Single Business Tax								
Cut Tax Rate 1)	SB 633	\$0.0	\$0.0	\$0.0	(\$44.6)	(\$15.5)	\$0.0	(\$60.2)
Reduce Gross Receipts & Excess Comp Deducts 2)	SB 633	0.0	0.0	0.0	19.5	6.7	0.0	26.2
Subtotal Tax Rate, Gross Recpts & Ex Comp Deduct Cuts		0.0	0.0	0.0	(25.1)	(8.8)	0.0	(34.0)
Increase Sales Tax Apportionment Factor to 95% 3)	HB 4973	(16.1)	(22.0)	(23.0)	(24.0)	(6.2)	0.0	(91.3)
Reduce Health Care in Base 4)	HB 4342	0.0	0.0	0.0	(7.7)	(2.6)	0.0	(10.3)
Increase Small Business Credit Officer Pay 5)	HB 5108	(2.0)	(2.7)	(2.7)	(2.8)	(0.7)	0.0	(11.0)
Increase Small Business Adjusted Business Income 6)	HB 5108	(2.0)	(2.7)	(2.7)	(2.8)	(0.7)	0.0	(11.0)
Create Industrial Personal Property Tax Credit (refundable) 7)	HB 4972	(90.0)	(120.0)	(120.0)	(120.0)	(30.0)	0.0	(480.0)
Create Transferred Jobs Personal Property Tax Credit 8)	HB 5108	0.0	(25.0)	(25.0)	0.0	0.0	0.0	(50.0)
Cut Alternative Tax Rate 9)	HB 5108	(2.0)	(2.7)	(2.7)	(2.8)	(0.7)	0.0	(11.0)
TOTAL TAX CUTS		(\$112.1)	(\$175.0)	(\$176.2)	(\$185.3)	(\$49.9)	\$0.0	(\$698.6)
NET IMPACT - TAX POLICY CHANGES AND TAX CUTS		(\$78.2)	(\$128.9)	(\$127.6)	(\$134.1)	(\$29.3)	\$10.8	(\$487.3)

Notes:

SBT - The scheduled repeal of the single business tax beginning 1/1/2010 would not be changed.

- 1) Tax rate would be cut 0.05 percentage point to 1.85% 1/1/09.
- 2) Excess compensation deduction would be reduced from excess over 63% to excess over 64.7%, and gross receipts deduction would be reduced from excess over 50% to excess over 51.4%.
- 3) Sales factor would increase from 90% to 95% on 1/1/06.
- 4) Health care cost deduction would be increased to 60% in 2009.
- 5) Small business credit officer pay limit would increase from \$115,000 currently to \$125,000 in 2006.
- 6) Small business adjusted business income threshold would increase from the current \$475,000 to \$525,000 in 2006.
- 7) Industrial personal property tax credit would be refundable at 15% of personal property taxes paid.
- 8) Tax credit would be created for 100% of personal property taxes on new manufacturing/high-tech property in Michigan being used by workers transferred to Michigan.
This credit could be claimed only for qualifying property during first year property taxes were due on the property, but in 2007 or 2008 only.
- 9) Alternative tax rate would be reduced from current 2.0% to 1.9% 1/1/06.

	FY 2005-06	FY2006-07	FY 2007-08	FY 2008-09	FY 2009-10a	FY 2010-11
Summary of Tax Changes (effective Jan. 1):						
SBT Tax Rate (currently 1.9%)	1.90%	1.90%	1.90%	1.85%	1.85%	No SBT
Alternate SBT Tax Rate (currently 2.0%)	1.90%	1.90%	1.90%	1.90%	1.90%	No SBT
Excess Comp Deduction threshold % (currently 63%)	63.0%	63.0%	63.0%	64.5%	64.5%	No SBT
Gross Receipts Deduction threshold % (currently 50%)	50.0%	50.0%	50.0%	51.4%	51.4%	No SBT
Apportionment Sales Factor (currently 90%)	95.0%	95.0%	95.0%	95.0%	95.0%	No SBT
Health Care Cost % Deducted (currently 40% '06, 50% '07)	40.0%	50.0%	50.0%	60.0%	60.0%	No SBT
Small Business Credit Officer Pay Limit (currently \$115,000)	\$125,000	\$125,000	\$125,000	\$125,000	\$125,000	No SBT
Small Business Adjusted Business Income Threshold (\$475,000)	\$525,000	\$525,000	\$525,000	\$525,000	\$525,000	No SBT
a) SBT would be repealed 1/1/2010, as scheduled under current law.						