



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 634 (Substitute S-1 as reported)
Sponsor: Senator Nancy Cassis
Committee: Finance

Date Completed: 7-13-05

RATIONALE

The Single Business Tax (SBT) Act imposes a tax on business based upon a measure of a firm's activity in Michigan. A business that conducts all of its activities in Michigan must include all of those activities in its tax base. While a large majority of SBT payers are firms that operate only in Michigan, a large portion of total SBT revenue is paid by a number of "multistate" firms; that is, businesses located outside the State that do business in the State, or businesses headquartered in Michigan that do business here and elsewhere. The Act requires a multistate firm doing business in Michigan, whether or not headquartered here, to "apportion" its tax base by determining how much of its business activity is attributable to Michigan. This is accomplished by using a three-factor formula that requires the firm to calculate the ratio of its property, payroll, and sales in Michigan to its entire property, payroll, and sales, and apply this ratio to its nationwide (or worldwide) tax base, resulting in its apportioned tax base. The property, payroll, and sales factors of the apportionment factor are weighted; that is, the Act requires the use of 5% of the property factor, 5% of the payroll factor, and 90% of the sales factor. The apportionment is determined in the following manner:

$$\frac{.05 \times \text{Property in MI}}{\text{All Property}} + \frac{.05 \times \text{Payroll in MI}}{\text{All Payroll}} + \frac{.90 \times \text{Sales in MI}}{\text{All Sales}}$$

The present apportionment formula was enacted in 1995. Previously, the payroll and property factors were 25% each, and the sales factor was 50%. It was argued that this structure favored multistate companies located outside of Michigan over those headquartered in this State, because firms

with no physical presence here also have no property or payroll to include in the calculation of their SBT. To address this concern, the payroll and property factors were reduced to their current levels.

Some people believe that the apportionment formula continues to impose an unfair tax on multistate firms with significant property and payroll in Michigan, and may discourage businesses from locating or remaining in this State. It has been suggested that the apportionment formula should be based entirely on the sales factor.

CONTENT

The bill would amend the SBT Act to provide that, for tax years beginning after December 31, 2006, all of the tax base, other than the tax base derived principally from transportation, financial, or insurance carrier services or specifically allocated, would have to be apportioned to this State by multiplying the tax base by the sales factor.

Presently, all of the tax base, other than the tax base derived principally from transportation, financial, or insurance carrier services or specifically allocated, must be apportioned to the State by multiplying the tax base by a percentage, which is the sum of the following:

- The property factor multiplied by 5%.
- The payroll factor multiplied by 5%.
- The sales factor multiplied by 90%.

Under the bill, this would apply to tax years beginning before January 1, 2007.

Under the Act, "tax base" means business income, before apportionment or allocation, even if zero or negative, subject to adjustments. The sales factor is a fraction whose numerator is the total sales of the taxpayer in the State during the tax year, and whose denominator is the total sales of the taxpayer everywhere during the tax year. The payroll and property factors are determined in the same manner as the sales factor.

MCL 208.45a

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

Changing the SBT apportionment formula to one based entirely on in-State sales would benefit those businesses that have large-scale manufacturing operations in Michigan, but make a relatively small percentage of their sales in the State. Under the current SBT apportionment formula, a company with manufacturing operations in Michigan may have a higher SBT bill than an out-of-State company with equal sales in Michigan. By implementing an apportionment formula that did not take companies' manufacturing operations (property and payroll) into account when determining their SBT obligations, the bill would make it more profitable for businesses to be located in Michigan.

The bill would reduce SBT revenue from most in-State manufacturing businesses with significant out-of-State sales, but would increase SBT revenue from out-of-State businesses with sales in Michigan. Currently, the SBT apportionment formula for companies with sales in Michigan, but no in-State operations is based on 90% of the total percentage of sales that occur in Michigan. The 100% sales factor would increase State SBT revenue from those businesses.

Supporting Argument

By making Michigan one of the few states that calculated a business's tax obligation based entirely on its sales factor, the bill would provide some incentive for out-of-State manufacturing operations with significant Michigan sales to move at least

some of their production to the State. Most states do not use a 100% sales factor when apportioning their business taxes. Therefore, if Michigan were to go to the 100% sales factor, businesses with significant Michigan sales could relocate to this State in order to reduce their tax obligations on payroll and property in other states, without increasing their Michigan SBT obligation.

Legislative Analyst: J.P. Finet

FISCAL IMPACT

The bill would reduce single business tax revenue by an estimated \$44 million on a full-year basis. All of this loss in revenue would affect the General Purpose portion of the General Fund.

Fiscal Analyst: Jay Wortley

A0506\s634a

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.