Legislative Analysis

Mitchell Bean, Director
Phone: (517) 373-8080
http://www.house.mi.gov/hfa

MICHIGAN BUSINESS TAX

Senate Bill 94 as enrolled
Sponsor: Sen. Nancy Cassis

House Bill 4369 as enrolled
Sponsor: Rep. Terry Brown

House Bill 4370 as enrolled
Sponsor: Rep. Martin Griffin

House Bill 4371 as enrolled
Sponsor: Rep. Marc Corriveau

House Bill 4372 as enrolled
Sponsor: Rep. Kate Ebli

House Committee: Tax Policy
Senate Committee: Finance

Complete to 7-1-07

A SUMMARY OF SENATE BILL 94, AND HOUSE BILLS 4369-4372 AS ENROLLED

Senate Bill 94 would create a new act, known as the Michigan Business Tax Act, which would replace the Single Business Tax, which is set to expire on December 31, 2007. The bill is tied-barred to House Bills 4369-4372, which would partially exempt commercial and industrial property from the State Education Tax and local school operating taxes. Highlights of SB 94 include:

- A tax of 4.95% on business income.
- A tax of 0.8% on gross receipts (less purchases from other firms)
- An increase in the tax on insurance companies from the current effective rate of 1.07% to 1.25%, yet still retaining a number of industry-specific credits.
- Subjecting financial institutions to a separate tax equal to 0.235% of net capital.
- A credit equal to 0.37% of compensation.
- A 2.9% investment tax credit similar to the existing credit against the SBT.
- A credit equal to 1.9% of research and development expenses.
- A credit equal to 30% of contributions made to a partnering small business engaged in research and development, capped at $300,000.
- Retaining the current SBT filing threshold of $350,000, but creating a credit that phases in tax liability for businesses with gross receipts less than $700,000.
- Retaining the alternative rate for small businesses, but reducing the rate from 2.0% to 1.8%, and increasing the limits on owner income, gross receipts, and business income.
- Retaining many of the current economic development credits, including those related to the Michigan Economic Growth Authority, brownfield redevelopment, and historic preservation.
- Retaining a number of the other miscellaneous credits from the SBT.
- A credit for firms that add at least 20 employees.

- A credit for capital expenditures at the Michigan International Speedway and certain other sports stadiums.
- A compensation-based credit for certain grocery stores.
- A credit for new automobile dealers for inventory.
- Requiring unitary filing for corporate groups.
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Business Income Tax (Section 201)

The bill would impose a tax at a rate of 4.95% on business income after allocation and apportionment, on every taxpayer with "business activity" within the state, unless prohibited by federal P.L. 86-272 (15 USC 381 to 384).[1] Business income generally means that part of federal taxable income that is derived from business activity, with a number of adjustments.

Modified Gross Receipts Tax (Section 203)

The bill would also impose a tax of 0.8% on a firm's gross receipts, less its purchases from other firms. The bill (Section 113) defines "purchased from other firms" to mean (1) inventory, including delivery charges; (2) depreciable assets, including installation costs; (3) other materials and supplies, including repair parts and fuel; (4) and, for staffing companies, compensation of personnel supplied to their customers. For the 2008 tax year, taxpayers may deduct 65% of any remaining SBT business loss carryforward incurred in 2006 or 2007.

Unitary Business Groups (Section 511)

The bill would require unitary business groups to file a combined return that includes each U.S. person included in the group. The business income base, modified gross receipts base, and the apportionment formula would not include transactions between group members and would not include any business income, modified gross receipts, or sales (for the purposes of apportionment) of a member that is subject to the separate insurance or financial institutions tax under Chapters 2A or 2B of the bill.

The bill (Section 201) provides that the business income of a unitary business group is the sum of the business income of each member of the group, except a foreign operating person and members subject to tax under Chapters 2A and 2B, less any items of income and related deductions arising from transactions between group members. Similarly, the bill (Section 203) also provides that the modified gross receipts of a unitary business group is the sum of the modified gross receipts of each member of the group except a

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[1] Public Law 86-272, enacted in 1959, generally prohibits states from imposing a tax on the income of a corporation derived from interstate commerce if the only business activities within the state by or on behalf of the corporation are the solicitation of orders of tangible personal property where orders are sent outside of the state for acceptance or rejection and, if accepted, are filled by shipment or delivery from a point outside of the state. Additionally, PL 86-272 provides that independent contractors may engage in soliciting sales, making sales, and maintaining a sales office within a state without subjecting the corporation to taxation.

foreign operating person and members subject to tax under Chapters 2A and 2B, less any modified gross receipts arising from transactions between group members.

Nexus (Section 200)

As stated above, the business income tax would be imposed on firms with business activity in the state, to the extent consistent with federal P.L. 86-272. The modified gross receipts tax and the financial institutions tax would be imposed on firms with gross receipts sourced to the state exceeding $350,000 that have a physical presence in the state of at least one day or that actively solicit sales in the state. Physical presence would mean any activity conducted by the taxpayer or an agent, employee, or independent contractors acting on behalf of the taxpayer, but would not include professional services (an undefined phrase) not significantly associated with the taxpayer's ability to establish and maintain a market in the state.

Exemptions (Section 207)

Generally, the bill would retain exemptions from the SBT Act (MCL 208.35) for the following: (1) the U.S. government, the state, other states, and political subdivisions; (2) charitable and educational institutions exempt from federal income taxes; (3) nonprofit cooperative housing associations; (4) the production of agricultural goods; (5) farmers' cooperatives; (6) activities under the Agricultural Commodities Marketing Act; (7) services provided by an attorney-in-fact; and (8) multiple employer welfare arrangements.

Insurance Companies (Chapter 2A)

Under current law, insurance companies are liable for the SBT or the so-called retaliatory tax (if applicable) levied under the Insurance Code, whichever is greater.[2] The SBT Act (MCL 208.22a) provides that the tax base and adjusted tax base of an insurance company is 25% of the company's adjusted receipts, subject to any apportionment. Adjusted receipts generally include, among other items, gross direct premiums, rental and royalty receipts, and receipts from business activity other than the business of insurance. In addition, insurance companies are subject to a "surcharge" under MCL 208.22b equal to 1.26 times the company's tax liability before application of certain credits. The total tax of an insurance company under the SBT calculates out to be 1.0735% of the company's adjusted receipts, less certain industry-specific credits and other credits.

The bill would impose a tax on insurance companies of 1.25% of gross direct premiums on property or risk located or residing in the state, but not including premiums on policies not taken, returned premiums on cancelled policies, receipts from the sale of annuities, and receipts from reinsurance premiums if the tax has been paid on the original premium.

[2] Under the Insurance Code's retaliatory tax, MCL 500.576a, when an insurer's state of incorporation imposes a larger aggregate tax burden on a Michigan insurer doing business in that state than Michigan imposes on a company from that state doing business in Michigan, the foreign insurer must pay Michigan a tax equal to the difference in aggregate tax burdens.

The bill would exempt the first $190 million of disability insurance premiums written in the state, other than credit insurance and disability income insurance premiums. The exemption would be reduced by $2 for each $1 by which gross direct premiums from insurance carrier services within the state and outside of the state exceed $280 million.

The bill would retain industry-specific credits for amounts paid to the Michigan Worker's Compensation Placement Facility, Michigan Basic Property Insurance Association, Michigan Automobile Insurance Placement Facility, the Property and Casualty Guaranty Association, and the Michigan Life and Health Guaranty Association. (See SBT Act MCL 208.22c). The bill would also retain a credit equal to half of the examination fees paid by the company during the tax year. (See MCL 208.22e). Firms that do not make any of these payments could claim a credit equal to 0.37% of compensation, limited to 65% of the firm's tax liability after taking other credits under Chapter 2A. The bill also provides a credit equal to the amount paid pursuant to Section 352 of the Worker's Disability Compensation Act of 1969.

The bill provides that the tax would be in lieu of all other privilege or franchise fees or taxes imposed by any other law, *except* taxes on real and personal property, sales and use taxes, and except as otherwise provided in the bill and in the Insurance Code. The SBT Act (MCL 208.22) provides that the SBT is imposed in lieu of all other privilege or franchise fees or taxes imposed by another law, except taxes on real and personal property. (Thus, the bill newly subjects insurance companies to sales and use taxes.) Also, as with current law, insurance companies would be subject to the MBT or the retaliatory tax imposed under the Insurance Code, whichever is greater.

Financial Institutions (Chapter 2B)

The bill subjects financial institutions to a separate tax of 0.235% on the average net capital over the last five years. The tax would be in lieu of the business income and the modified gross receipts tax imposed under the bill. Net capital would be an institution's equity capital, less the cost of goodwill and U.S. and Michigan obligations. For multi-state institutions, the tax base would be apportioned based on the gross business.

Apportionment

The bill would apportion the business income tax and modified gross receipts tax based on the sales factor (i.e. no longer utilizing the payroll and property factors), which would be a fraction where the numerator is total sales in Michigan and the denominator is total sales everywhere. The bill (Section 307) would retain a provision (MCL 208.54) permitting spun-off corporations (Delphi and Visteon) to exclude from Michigan and total sales, for the purposes of calculating the sales factor, sales to the firm's immediately preceding former parent corporation.

Sourcing

Generally, under the SBT Act, for the purposes of calculating the sales apportionment factor, the sales of services and intangible property (i.e. sales other than sales of tangible personal property) are "sourced" to Michigan if a greater proportion of business activity, based on the cost of performance, occurs within Michigan than outside of Michigan.[3] The bill, instead, uses a "market-based" method of sourcing sales to Michigan, in which sales are sourced based on the location of the purchaser or where the good or service is used. (This is similar to the sourcing of sales of tangible personal property both under the SBT and the bill.) The bill includes specific sourcing provisions for the following:

- Receipts from the lease or rental of tangible personal property.
- Receipts from the lease or rental of mobile transportation property.
- Royalties and other income received for the use of intangible personal property.
- Sales derived from securities brokerage services.
- Receipts from the origination of a loan.
- Interest from loans.
- Receipts from credit card receivables.
- Loan servicing fees.
- Receipts from the sale of securities and other assets from investment activities.
- Receipts from transportation services.
- Receipts from the sale of telecommunication services.

Compensation and Investment Tax Credit (Section 403)

The bill provides a combined compensation and investment tax credit that must be taken before any other credit and is limited to 65% of a firm's tax liability. The compensation credit would be equal to 0.37% of compensation in the state. In the case of professional employer organizations (PEOs), the compensation used to determine the credit would not include payments made for employees provided to a client. (The client could include payments made by the PEO for those employees in its calculation of the credit.)

Under the bill, compensation would include wages, salaries, fees, bonuses, and other payments made for the benefit of employees, officers, or directors, and any self-employment net earnings (as defined in the Internal Revenue Code). Other costs, including employee discounts, unemployment compensation, worker's compensation, and payments to independent contractors would not be considered as compensation. However, compensation for firms licensed under Articles 25 and 26 of the Occupational Code (real estate brokers, salespersons, and appraisers) includes payments to independent contractors licensed under the two articles.

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[3] The "cost of performance" means those costs directly related to the activity performed for a client determined in a manner consistent with the taxpayer's method of accounting for federal income tax purposes. The cost of performance is determine separately for each sale.

The investment tax credit is equal to 2.9% of net capital assets and, in general, is carried over from the Investment Tax Credit against the SBT (MCL 208.38a). Net capital assets generally include the costs (including fabrication and installation) of tangible assets located in Michigan; apportioned mobile tangible assets, wherever located; and the federal basis for eligible items moved into the state; less a recapture calculation for like assets upon their sale, disposition, or removal from the state. The assets must be of a type that are, or will become, eligible for depreciation, amortization, or accelerated capital cost recovery for federal income tax purposes.

Research and Development Credits (Section 405 and 407)

The bill provides two research and development credits. One credit (Section 405) is equal to 1.9% of a taxpayer's research and development expenses, as defined in the federal Internal Revenue Code. A taxpayer may not use the same R&D expenses to determine both the compensation credit and this R&D credit. The combined credit allowed under Section 403 and the R&D credit cannot exceed 75% of a firm's tax liability.

The other credit is generally equal to 30% of the amount of an "eligible contribution" (the transfer of pecuniary interest in the form of cash of at least $350,000 for the purpose of research and development and technology innovation) in a business engaged in research and development that, together with any affiliates, employs fewer than 50 employees or has gross receipts of less than $10 million and no prior financial interest with the taxpayer claiming the credit. The credit would be capped at $300,000 per taxpayer, and would be available only in the 2008-2010 tax years. The Michigan Economic Growth Authority would approve the credit, and could not grant more than 20 credits in any one year.

Michigan International Speedway Credit (Section 409)

The bill provides a credit for the 2008-2012 tax years for capital expenditures for infield renovation, grandstand and infrastructure upgrades, and any other construction and upgrades at the Michigan International Speedway. Total expenditures must exceed $25 million before January 1, 2011. The credit would not exceed the lesser of the taxpayer's tax liability in the tax year or $1.7 million in 2008-2010, $1.18 million in 2011, and $650,000 in 2012.

Stadium Credit (Section 410)

The bill also provides for a credit for the 2008-2012 tax years for the construction of a sports stadium with a capacity of at least 14,000 patrons with a cost of at least $250 million, of which no state appropriation, public bond issue, state or local tax or fee was used to finance the construction or retire debt, except for infrastructure improvements. The credit would be 65% of the firm's tax liability up to $1.7 million in 2008-2010, 45% of the firm's tax liability up to $1.18 million in 2011, and 25% of the firm's tax liability in 2012 up to $650,000.

Filing Threshold/Phase-In Liability (Sections 200, 411, and 505)

Currently under the SBT Act (MCL 208.39a), businesses with gross receipts of $350,000 or less are not required to file an SBT return. The bill retains the current filing threshold, but also phases in tax liability for firms with gross receipts between $350,000 and $700,000, by providing a credit against the tax equal to the firm's tax liability after the small business credit (Section 417) multiplied by a fraction, where the numerator is the difference between $700,000 and the firm's gross receipts and the denominator is $350,000.

Personal Property Tax Credit (Section 413)

The bill would provide a refundable credit equal to the following:

- 35% of personal property taxes levied after December 31, 2007 on industrial personal property located on industrial real property.
- For the 2008 tax year, 23% of utility property taxes levied on telephone property under 1905 PA 282 and, for subsequent years, 13.5% of utility property taxes on telephone property.
- 10% of utility property taxes levied on natural gas pipelines.

Small Business Credit (Section 417)

The bill would retain the alternate rate calculation for small businesses currently provided in the SBT Act (MCL 208.36), which permits firms to calculate their tax liability as 2% of adjusted business income. (This is actually a credit equal to the amount by which the tax exceeds 2% of adjusted business income.) Currently, firms eligible to use the alternate rate must meet the following criteria: (1) have gross receipts not exceeding $10 million; (2) have adjusted business income not exceeding $475,000; and (3) have individual or officer-allocated income not exceeding $115,00. (The credit is phased out for income levels exceeding $95,000.)

The bill would lower the rate to 1.8% and increase the thresholds of the eligibility requirements to gross receipts of not more than $20 million, adjusted business income of not more than $1.3 million, and officer income ranging from $165,000 to $180,000.

Arts Credit (Section 422)

The bill creates a nonrefundable credit for donations made to a municipality or a nonprofit corporation affiliated with a municipality and an art, historical, or zoological institute for the benefit of the institution, or to an institution "devoted to the procurement, care, study, and display of objects of lasting interest and value". The credit would be equal to half of the amount contributed above $50,000, and would be capped at $100,000.

Entrepreneurial Credit (Section 441)

The bill provides a credit in 2008-2010 equal to 100% of the increased tax liability attributable to the increase in employment. To claim the credit, firms would have to have less than $25 million (adjusted annually for inflation) in gross receipts in the prior year**,** create or transfer at least 20 new jobs into the state, and make at least $1.25 million in capital investments in the prior year. The credit would not be available to retail establishments, other than restaurants that are not part of a franchise or part of a unitary business group.

The credit would also be available to firms, described in Section 407 (R&D contribution credit) receiving a contribution if the firm has less than $25 million in gross receipts and creates or transfers at least 20 new jobs into the state.

Generally the tax liability attributable to increased employment would be the firm's total tax liability multiplied by a fraction where the numerator is payroll of the increased jobs and the denominator is the firm's total payroll.

If the new or transferred jobs are relocated outside of the state or the firm reduces employment by more than 10% of the jobs used to qualify for the tax the amount of credit must be repaid and would be subject to collection by the Department of Treasury under the provisions of the Revenue Act.

Automobile Inventory Credit (Section 445)

The bills provides new motor vehicle dealers licensed under the Michigan Vehicle Code with a credit equal to 2% of the amount paid to acquire new motor vehicles and parts. The credit would not exceed $10,000, would not be refundable, and could not be carried forward.

Grocery Store Credit (Sections 447 and 449)

The bill provides two credits to businesses that operate grocery stores. The first credit is available to firms that are headquartered in the state and operate at least 17 million square feet of enclosed retail space and 2 million square feet of enclosed warehouse space in the state. For these firms, the credit would equal 0.535% of the firm's compensation in the state, not exceeding $4.5 million.

The second credit is available to firms that are headquartered in the state and operate at least 2.5 million square feet of enclosed retail space and 1.4 million square feet of enclosed warehouse space. For these firms, the credit would equal to 0.125% of compensation paid in the state, not exceeding $300,000.

Retained Credits

The bill retains the following credits currently provided for in the SBT Act (with the appropriate section of the bill and the SBT Act in parentheses):

- Start-up businesses (Section 415/SBT MCL 208.31)
- Venture capital investment (Section 419/SBT MCL 208.37e)
- Charitable contributions (Section 421/SBT MCL 208.38)
- Worker's compensation (Section 423/SBT MCL 208.38b)
- Community foundations (Section 425/SBT MCL 208.38c)
- Homeless shelters (Section 427/SBT MCL 208.38f)
- Alternate energy (Section 429/SBT MCL 208.39e)
- Michigan Economic Growth Authority (Section 431/SBT MCL 208.37c and 37d)
- Renaissance zones (Section 433/SBT MCL 208.39b)
- Historic preservation (Section 435/SBT MCL 208.39c)
- Brownfield development (Section 437/SBT MCL 208.38g)
- Low-grade hematite (Section 439/SBT MCL 208.39d)

The bill expands the community foundations credit to include educational foundations.

Miscellaneous Provisions (Chapter 5)

Chapter 5 of the bill generally includes a number of provisions from Chapter 4 of the SBT Act, which concerns the following (with the appropriate section of the bill and the SBT Act in parentheses):

- Estimated and quarterly returns (Section 501/SBT MCL 208.71)
- First year computations (Section 503/SBT MCL 208.72)
- Annual returns (Section 505/SBT MCL 208.73)
- Furnishing copies of federal returns (Section 507/SBT MCL 208.75)
- Information returns (Section 509/SBT MCL 208.76)
- Administration and rules (Section 513/SBT MCL 208.80)

Revenue Distribution (Section 515)

The bill provides that revenue from the tax would be distributed as follows:

- FY 2007-2008: $136 million would be credited to the School Aid Fund and the balance would be credited to the General Fund.

- FY 2008-2009: $479 million would be credited to the School Aid Fund and the balance would be credited to the General Fund.

- Each subsequent fiscal year: The amount deposited in the School Aid Fund in the previous year, adjusted for inflation, would be credited to the School Aid Fund, and the balance would be credited to the General Fund.

Appropriation (Section 517)

The bill would appropriate $1 million to the Department of Treasury to begin implementing the tax. Any unexpended balance at the close of the fiscal year would not lapse to the General Fund, but would be carried forward as a work project in accordance with the provisions of the Management and Budget Act.

Severability (Section 519)

The bill provides that if a court of competent jurisdiction determines that any of the provisions of the bill providing a deduction, credit, or exemption with respect to employment, persons, services, investments, or other activity in the state is unconstitutional or applies to a similar activity outside of the state, that provision would be severed from the bill and the remaining provisions would remain in effect.

Revenue Limit (Section 601)

The bill would limit revenue from the tax in FY 2008-FY 2010 and place half of the excess revenue above the limit in the Budget Stabilization Fund and return the other half to taxpayers. For FY 2008 (combining revenue from both the SBT and the MBT, but excluding revenue from the MBT's tax on insurance companies), the revenue limit would be $2.398 billion. For FY 2009, the revenue limit (excluding revenue from the tax on insurance companies) would b $2.398 billion increased by 1% and the percentage change in personal income from FY 2008 to FY 2009. For FY 2010, the revenue limit (excluding the tax on insurance companies) would be $2.398 billion increased by 2.01% and the percentage change in personal income from FY 2009 to FY 2010. If the revenue limit is exceeded by less than $5 million, all of the excess would be credited to the BSF.

SUMMARY OF THE OTHER BILLS:

House Bill 4369 – Local School Operating Mills

The bill would amend the Revised School Code (MCL 380.1211) to exempt industrial personal property from the 18 school operating mills and to exempt commercial personal property from 12 of the 18 school operating mills.

House Bill 4370 – State Education Tax

The bill would amend the State Education Tax Act (MCL 211.903) to exempt industrial personal property from the 6-mill state education tax.

House Bill 4371 – Industrial Facilities Tax

The bill would amend the Plant Rehabilitation and Industrial Development Act (MCL 207.564 and 207.564a) to exempt industrial personal property subject to the Industrial Facilities Tax from that portion of the IFT attributable to the 18 school operating mills and the State Education Tax.

House Bill 4372 – General Property Tax Act

The bill would amend the General Property Tax Act (MCL 211.9k) to specify that commercial and industrial personal property would be exempt from school taxes as provided in HB 4369 and HB 4370. The bill adds, "it is the intent of the legislature to address potential revenue shortfalls for the payment of tax increment financing obligations that may result from the exemptions provided by this amendatory act and to evaluate the impact of this exemption on tax increment financing projects in the future."

FISCAL IMPACT:

The intent of SB 94 is to be close to revenue neutral to taxpayers relative to the Single Business Tax (SBT) and the property tax cuts specified in HB 4369 through HB 4372. Based on estimates provided by the Department of Treasury, these bills would generate enough revenue to offset the SBT repeal and would increase state finances by an estimated $219 million in FY 2007-08 and reduce state finances by an estimated $2 million in FY 2008-09. The one-time revenue gain in FY 2007-08 is due to the timing of the collection of the new MBT and the reimbursement of the 12/18 mills to the School Aid Fund (SAF). Essentially, the increased revenue from the MBT would begin in FY 2007-08 (quarterly payments would be collected in April 2008), while the reimbursement to the SAF would begin in FY 2008-09 (October 2008). The SAF would receive $136 million in FY 2007-08, $479 million in FY 2008-09, and in FY 2009-10 and beyond, the SAF earmark would equal $479 million adjusted annually for inflation. The bill also specifies an appropriation of $1 million to the Department of Treasury in FY 2006-07 for the implementation of the MBT. The remainder of the MBT would accrue to the General Fund/General Purpose (GF/GP). In addition, SB 94 contains a trigger to limit the amount collected from the MBT in FY's 2008-09 through 2010-11.

Legislative Analyst: Mark Wolf
Fiscal Analyst: Rebecca Ross
Jim Stansell

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