Legislative Analysis

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

MICHIGAN BUSINESS TAX

House Bill 4367
Sponsor: Rep. Barbara Farrah

House Bill 4369
Sponsor: Rep. Terry Brown

House Bill 4370
Sponsor: Rep. Martin Griffin

House Bill 4371
Sponsor: Rep. Marc Corriveau

House Bill 4372
Sponsor: Rep. Kate Ebli

Committee: Tax Policy
Complete to 3-19-07

A SUMMARY OF HOUSE BILLS 4367, 4369-4372 AS INTRODUCED 3-1-07

House Bill 4367 would implement Governor Granholm's proposed replacement for the Single Business Tax, which is set to be repealed effective December 31, 2007. Main features of the proposed new Michigan Business Tax (MBT) are:

- The tax base would consist of (1) gross receipts, (2) assets, and (3) business income.
- The tax rate would be 0.125 percent on gross receipts and 1.875 percent on business income.
- The tax base for multi-state businesses would be apportioned to the state based entirely on the sales factor.
- The bill would retain the alternative tax on small businesses currently provided for in the SBT, but would reduce the rate from 2.0 percent to 1.8 percent.
- The bill would retain the current SBT filing threshold of $350,000 in gross receipts, but would eliminate the so-called "cliff" for businesses with gross receipts in excess of $350,000 by phasing in tax liability for businesses with gross receipts between $350,000 and $700,000.
- The bill would retain many of the current economic development credits against the SBT, including those related to the Michigan Economic Growth Authority, brownfield redevelopment, and historic preservation.
- The bill would create a new credit for research and development, and for businesses headquartered in Michigan.
- The bill would increase the premiums tax imposed on Michigan-based insurance companies from the current effective rate of 1.07 percent to 1.25 percent.
- The bill would subject insurance companies to the sales and use taxes.

The other main feature of the tax plan is a 24-mill reduction in personal property taxes for commercial and industrial property. This includes the 6-mill State Education Tax and the

18 mills levied for local school operating purposes. The property tax reductions are found in House Bills 4369-4372.

The bills are all tie-barred to one another meaning that none can take effect unless all are enacted. House Bill 4367 is also tie-barred to HB 4368 (the 2% excise tax); House Bill 4369 is also tie-barred to HB 4375 (specific tax imposed on commercial rental property), and HB's 4370-4372 are also tie-barred to HB 4377 (decoupling the estate tax from the federal estate tax). The bills apply to taxes levied after December 31, 2007.

Tax Base (Sections 9, 47, and 48)

With certain exceptions, the base of the tax would be gross receipts, plus assets, plus 15 times the amount of business income. Gross receipts are generally the total receipts a business receives for goods sold and services provided. Assets include cash, trade notes, accounts receivable, mortgage and real estate loans, the value of buildings and land, and intangible assets. It would not include inventory, securities, or tax exempt obligations. Business income generally means federal taxable income (profits) plus the federal domestic production activities deduction. The current definition of business income within the SBT does not add the amount of the deduction.

The bill would retain alternative tax base calculations for firms whose business activities consist of transportation services (MCL 208.56 and 208.57) and transportation of oil and gas by pipeline (MCL 208.58).

Tax Rate (Section 20)

The tax rate would be 0.125 percent of each component of the tax base. With business income being a weighted component of the tax base, the effective rate on that would be 1.875 percent (.125% × 15).

Apportionment Formula (Sections 40-46, 49, and 50)

To determine their tax liability, businesses that have business activity in Michigan and other states must calculate how much of their total business activity is apportioned to Michigan. Historically the apportionment formula has been 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. The bill would eliminate the payroll and property factors and base apportionment entirely on sales. However, firms that do not have sales within the state would apportion their business activities using the average of the payroll and property factors. Under the SBT Act (MCL 208.45a), the apportionment formula for tax years beginning after December 31, 2007 is 95 percent sales, 2.5 percent payroll, and 2.5 percent property.

The bill would retain a provision (MCL 208.54) permitting a spun off corporation (Delphi and Visteon) to exclude from Michigan sales and total sales, for the purposes of calculating the sales factor for apportioning business activity, sales to its immediately preceding former parent corporation. The bill would also retain a provision (MCL 208.69) providing that apportionment "fairly" represent the extent of taxpayers' business activity in the state. The tax base of multi-state financial organizations would be apportioned based on the ration of gross business in Michigan to gross business elsewhere.

Filing Threshold (Sections 37 and 72)

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. The bill also phases in the tax 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 application of the small business credit (and before application of any other credit) 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. However, for taxpayers that are members of an affiliated group, controlled group of corporations, or an entity under common control whose gross receipts are between $100,000 and $200,000, the credit is equal to a firm's tax liability after application of the small business credit (and before application of any other credit) multiplied by a fraction where the numerator is the difference between $200,000 and the firm's gross receipts and the denominator is $200,000.

Small Businesses (Section 25)

The bill would retain the alternate rate calculation for small businesses currently provided for in the SBT Act (MCL 208.36), which permits firms to calculate their tax liability as 2 percent of adjusted business income. The bill would lower the rate from 2 percent to 1.8 percent. 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 $115,000.

Insurance Companies (Sections 21 and 22)

Under current law, insurance companies are liable for the SBT <u>or</u> the so-called retaliatory tax (if applicable) levied under the Insurance Code, whichever is greater. The SBT Act (MCL 208.22a) provides that the tax base and adjusted tax base of an insurance company is 25 percent 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 liability. The total tax of an insurance company under the SBT calculates out to be 1.0735 percent 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 percent of gross direct premiums written on property or risk located or residing in the state, but not including premiums on policies not taken, return premiums on canceled policies, receipts from the sale of annuities, and receipts on reinsurance premiums if the tax has been paid on the original premiums.

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 franchise fees or taxes imposed by another law, except taxes on real and personal property. (Thus, the bill 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.

[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 the aggregate tax burdens.]

Exemptions (Section 23)

The bill would retain exemptions from the SBT Act (MCL 208.35) for the following: (1) the United States 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' cooperative corporations; (6) activities under the Agricultural Commodities Marketing Act; (7) services provided by an attorney-in fact; and (8) multiple employer welfare arrangements (MEWAs) providing dental benefits.

Retained Credits

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

- Start-up businesses (MBT Section 24/SBT MCL 208.31)
- Venture capital investment (MBT Section 26/SBT MCL 208.37e)
- Charitable contributions (MBT Section 27/SBTMCL 208.38)
- Worker's compensation (MBT Section 28/SBT MCL 208.38b)
- Community foundations (MBT Section 29/SBT MCL 208.38c)
- Homeless shelters (MBT Section 30/SBT MCL 208.38f)
- Alternative energy (MBT Section 31/SBT MCL 208.39e)
- Michigan Economic Growth Authority (MBT Section 32/SBT MCL 208.37c and 208.37d)
- Renaissance Zones (MBT Section 33/SBT MCL 208.39b)

- Historic preservation (MBT Section 34/SBT MCL 208.39c)
- Brownfield development (MBT Section 35/MCL 208.38g)

Eliminated Credits

The bill would eliminate the following credits (with the appropriate section of the SBT act in parentheses):

- Research and Development (MCL 208.32)
- Capital Investment (MCL 208.35a)
- Industry personal property (MCL 208.35g and 208.35h)
- Personal property related to transferred jobs (MCL 208.35i and 208.35j)
- Investments in minority venture capital companies (MCL 208.36b)
- Unincorporated businesses/S-corporations (MCL 208.37)
- Enterprise zones (MCL 208.37a)
- High technology activity (MCL 208.37b)
- Created jobs (MCL 208.37f)
- Donated automobiles (MCL 208.37g)
- Apprenticeships (MCL 208.38e)
- Public utilities (MCL 208.39)
- Low-grade hematite (MCL 208.39d)
- Pharmaceutical research and development (MCL 208.39f)

Research and Development Credit (Section 36)

The bill would create a new credit for research and development activities generally equal to half of the amount of an "eligible contribution" (the transfer of pecuniary interest in form of cash 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 $500,000 per taxpayer. The Michigan Economic Growth Authority would approve the credit, and could not grant more than 25 credits in any one year.

The current research and development credit, which would be eliminated, basically eliminates the tax on compensation paid on research and development employees. Because the tax base of the MBT does not include compensation, the credit is no longer applicable.

Headquarters Credit (Section 38)

The bill would create a new, non-refundable credit for taxpayers headquartered in Michigan based on the wages of employees located at the headquarters. The amount of the credit would be calculated for each headquarters employee whose wages subject to federal Medicare withholding taxes exceeds the average wage subject to federal Medicare taxes for non-headquarters employee.[1] For each employee, the credit would be equal to the difference in wages subject to federal Medicare taxes for headquarters and non-headquarters staff, up to $200,000 multiplied by 0.1. The total credit would be the aggregate amount calculated for each employee. In sum, the credit calculated for individual headquarters employees would be:

$$\left(\begin{array}{c}\text{HQ employee wages subject to}\\ \text{federal Medicare taxes}\end{array} - \begin{array}{c}\text{Average Non-HQ employee wages}\\ \text{subject to federal Medicare taxes}\end{array}\right) \times 0.1$$

To qualify for the credit, taxpayers would have to have to maintain their principal or central administrative offices in the state, and have at least 500 full-time employees located at the headquarters facility. If at least 90% of a taxpayer's headquarters-related functions – i.e., financial, personnel, administrative, legal, planning, etc – are performed in the state, all sites in the state where those functions occur would considered to be one headquarters facility.

Miscellaneous Provisions

Chapter 4 of the bill generally retains Chapter 4 of the SBT Act, which concerns the following (with the appropriate section of the bill and the SBT Act in parentheses):

- Estimated returns (MBT Section 70/SBT MCL 208.71)
- First year computations (MBT Section 71/SBT MCL 208.72)
- Annual returns (MBT Section 72/SBT MCL 208.73)
- Furnishing copies of federal returns (MBT Section 73/SBT MCL 208.75)
- Information returns (MBT Section 74/SBT MCL 208.76)
- Consolidated or combined returns (MBT Section 75/SBT MCL 208.77)
- Consolidated returns, tax base, and apportionment of two corporations (MBT Section 76/SBT MCL 208.78)

Revenue Distribution (Section 81)

The bill provides that revenue from the tax would be deposited in the General Fund.

Appropriation (Section 82)

The bill would appropriate $10 million to the Department of Treasury in FY 2006-07 to carry out the requirements of the bill. Any remaining unexpended balance at the close of the fiscal year would be carried forward in a work project account in accordance with the provisions of the Management and Budget Act.

[1] Unlike federal Social Security taxes, which are imposed at a rate of 6.2% on wages up to $97,500 beginning in 2007, there is no limit on wages subject to federal Medicare taxes (the Medicare withholding rate is 1.45%). However, there are federal rules in place specifying when certain types of compensation (stock based compensation, nonqualified deferred compensation, etc) are subject to Social Security and Medicare withholding taxes. Also contributions to a 401(k), while reducing a taxpayer's taxable income, are subject to social security and Medicare taxes.

Severability (Sections 90 and 91)

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 that is limited to the state is unconstitutional or applies to similar activity outside of the state, that provision would be severed from the bill and the remaining provisions would remain in effect.

Also, if a court determines that any provision of the bill is subject to the limitations of federal Public Law 86-272 or that the application of the apportionment provisions to the assets and business income components of the tax base is unconstitutional, the assets and business components of the tax base would be removed from the tax base, and the tax rate (applied, then, to gross receipts only) would be .375 percent.

SUMMARY OF THE OTHER BILLS:

House Bill 4369

The bill would amend the Revised School Code (MCL 380.1211) to exempt commercial and industrial personal property from the 18 local school operating mills, for taxes levied after December 31, 2007.

House Bill 4370

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

House Bill 4371

Under the Plant Rehabilitation and Industrial Development Act (MCL 207.564 and 207.564a), local governmental units may provide new, renovated, or expanded industrial facilities with property tax abatements for up to 12 years. Eligible facilities are issued an industrial facilities certificate, exempting them from general ad valorem property taxes, and subjecting them, instead, to a specific industrial facilities tax. Renovated facilities are taxed at the same local property tax rate, though based on the taxable value of the facility (excluding land and inventory) during the immediately preceding tax year (meaning, prior to the renovation). For new facilities, the tax rate is half the total mills (other than the 6-mill State Education Tax), plus the SET, based on the current taxable value of the new facility.

The bill provides that for the personal property tax component of the industrial facilities certificate for a new facility or speculative building, the industrial facilities tax would be the product of the taxable value of the facility (excluding land and inventory) and the sum of (1) half of the total mills levied by all taxing units other than the SET and (2) the number of school operating mills.

House Bill 4372

The bill would amend the General Property Tax Act (MCL 211.9k) to specify that commercial and industrial personal property would be exempt from the 6-mill State Education Tax and the 18 local school operating mills, for taxes levied after December 31, 2007.

FISCAL IMPACT:

Based on estimates provided by the Department of Treasury, after accounting for the headquarters and research innovation credits, the Michigan Business Tax (MBT) can be expected to generate approximately $1.25 billion in FY2007-08. The increase in the insurance premiums tax would yield an additional $40.0 million. The MBT and insurance premiums revenue would accrue to the General Fund.

The elimination of the 18-mill non-homestead millage and the 6-mill State Education Tax on commercial and industrial personal property is estimated to reduce School Aid Fund revenue by approximately $203.4 million in FY2007-08.

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