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BILL ANALYSIS

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Senate Bill 1009 (as enacted)
Sponsor: Senator Nancy Cassis
Senate Committee: Finance
House Committee: Tax Policy

PUBLIC ACT 435 of 2008

Date Completed: 7-6-09

RATIONALE

After the Michigan Business Tax (MBT) Act went into effect on January 1, 2008, some people raised concerns that it did not honor the relationship that Michigan has had with Canada regarding reciprocal taxation. Because Michigan and Canada are connected geographically and economically, taxes that cross international borders have consequences for businesses located on both sides. It was suggested that, in order to conform to traditional practices for taxing foreign-based companies and to eliminate the tax burden on Canadian companies, the Act should exempt foreign persons from the MBT.

CONTENT

The bill amended the Michigan Business Tax Act to exempt from the tax a foreign person that is domiciled in a subnational jurisdiction that does not impose an income tax on a similarly situated person domiciled in this State whose presence in the foreign jurisdiction is the same as the foreign person's presence in the United States. If a foreign person is domiciled in a subnational jurisdiction that does not impose an income tax on businesses, but instead imposes some other type of subnational business tax, that foreign person is not subject to taxation under the Act if that subnational business tax is not imposed on a similarly situated person domiciled in this State whose presence in the foreign country is the same as the foreign person's presence in the U.S.

The bill defines "foreign person" as either an individual who is not a U.S. resident, whether or not the individual is subject to taxation under the Internal Revenue Code (IRC), or a person formed under the laws of a foreign country or a political subdivision of a foreign country, whether or not the person is subject to taxation under the IRC. "Domiciled" means the location of the headquarters of the trade or business from which the trade or business of the foreign person is principally managed and directed.

Notwithstanding any other provision of the Act to the contrary, a foreign person subject to the MBT must calculate its business income tax base and modified gross receipts tax base as provided in the bill. Except as otherwise provided, the business income tax base and modified gross receipts tax base of a foreign person are subject to all adjustments and other provisions of the Act. Neither the business income tax base nor the modified gross receipts tax base, however, may include proceeds from sales where title passes outside the U.S.

Except as otherwise provided, the modified gross receipts tax base of a foreign person includes the sum of gross receipts and the adjustments under the modified gross receipts tax in the Act that are related to United States business activity. The business income tax base includes the sum of business income and adjustments under the business income tax that are related to U.S. business activity. The sales factor for a foreign person is a fraction whose numerator is the taxpayer's total sales in this State where title passes inside the U.S. during the tax year, and whose denominator is the taxpayer's total sales in the U.S. where title passes inside the U.S. during the tax year.

The bill defines "business income" for a foreign person, as gross income attributable to the taxpayer's U.S. business activity and gross income derived from sources within the U.S. minus the deductions allowed under the IRC that are related to that gross income. Gross income includes the proceeds from sales shipped or delivered to any purchaser within the U.S. and for which title transfers within the U.S., proceeds from services performed within the U.S., and a pro rata proportion of the proceeds from services performed both within and outside the U.S. to the extent the recipient receives benefit of the services within the U.S.

The bill defines "gross receipts" for a foreign person, as gross receipts as defined in the Act from U.S. business activity or from sources within the U.S. Gross receipts include all sales for which title transfers within the U.S., proceeds from all services performed within the U.S., and a pro rata portion of proceeds from services performed both within and outside of the U.S. to the extent the recipient receives benefit of the services within the U.S.

The bill is retroactive and effective January 1, 2008, and applies to all business activity occurring after December 31, 2007.

The bill was tie-barred to Senate Bill 1038 (Public Act 433 of 2008), which amended the Michigan Business Tax Act to exclude from the definition of "gross receipts" certain proceeds, interest income, royalties, dividends, taxes, fees, and surcharges.

MCL 208.1207

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

Because Michigan and Canada are not economic competitors but are part of an economic unit, when Michigan raises taxes on Canadian businesses, citizens and businesses on both sides are affected. For example, products and manufactured parts often cross between Canada and Michigan multiple times during the manufacturing process and are frequently sold across international borders. If Michigan did not exempt Canadian businesses from taxation under the MBT Act, it is possible that Canada would tax Michigan businesses for the purpose of parity or retaliation, stifling trade and economic cooperation between the two and damaging Michigan's economy.

Canadian businesses still are subject to other applicable Michigan taxes, including the fuel tax and sales tax, and businesses with permanent establishments in Michigan are subject to the MBT.

Opposing Argument

While special considerations should be made under the MBT Act for Canadian businesses, the bill applies to all foreign persons without regard to the type of business or country of origin. In order to prevent unforeseen consequences, the countries and types of businesses that are exempt should be specified.

Legislative Analyst: Suzanne Lowe

FISCAL IMPACT

The bill will likely reduce General Fund revenue in FY 2007-08 and FY 2008-09 by an unknown amount, depending upon the specific business characteristics of the affected taxpayers. The bill will modify the tax computations for certain foreign entities and potentially exempt certain others. The number of taxpayers affected and their liability are unknown. Unlike somewhat similar provisions contained in the former Single Business Tax Act, the bill's provisions will affect all foreign entities, not just those associated with a specific country.

The bill will have no fiscal impact on local government.

Fiscal Analyst: David Zin

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