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BILL ANALYSIS

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House Bill 4367 (Substitute H-4, as passed by the House)
House Bill 4369 (Substitute H-1, as passed by the House)
House Bill 4370 (Substitute H-1, as passed by the House)
House Bill 4371 (Substitute H-1, as passed by the House)
Sponsor: Representative Barbara Farrah (H.B. 4367)
Representative Terry Brown (H.B. 4369)
Representative Martin Griffin (H.B. 4370)
Representative Marc Corriveau (H.B. 4371)
House Committee: Tax Policy
Senate Committee: Finance

Date Completed: 5-10-07

CONTENT

On May 2, 2007, the House of Representatives passed four bills of a five-bill package that would change the way businesses are taxed in Michigan. This package of bills would make the following changes:

- **House Bill 4367 (H-4)** would create the "Michigan Business Tax" Act, which would establish a business income tax and a net worth tax, along with numerous tax credits, including both new tax credits and existing tax credits that would be carried over from the single business tax.

- **House Bill 4369 (H-1)** would exempt commercial and industrial personal property from the 18-mill local school property tax.

- **House Bill 4370 (H-1)** would exempt commercial and industrial personal property from the 6-mill State education tax.

- **House Bill 4371 (H-1)** would exempt personal property from a portion of the industrial facilities tax.

- **House Bill 4372** would amend the General Property Tax Act to exempt commercial and industrial personal property from the 18-mill local school property tax and the State education property tax. This bill has not yet been passed by the House of Representatives.

The content of each of the bills that has been passed by the House, along with their estimated fiscal impacts, is summarized below.

House Bill 4367 (H-4) – The Michigan Business Tax Act

This bill proposes to create the "Michigan Business Tax Act" to establish two new business taxes and various tax credits. These taxes would be effective January 1, 2008, and they would replace the single business tax, which is scheduled to expire on December 31, 2007. The key features of this bill are described below:

Business Income Tax. A new tax on business income would be created. This tax would be assessed on every taxpayer with business activity in Michigan. The base of the tax would start with Federal taxable income or a comparable measure of income for partnerships and S corporations, which would then be subject to various adjustments, including apportionment, to identify business activity in Michigan. The tax rate would equal 6.95%.

Net Worth Tax. A new tax on business net worth also would be created. This tax would be assessed on a business's total assets less total liabilities, and all businesses with activity in Michigan would be subject to the tax. The rate of this tax would be 0.488%.

Apportionment. Both the business income tax and the net worth tax would be apportioned to Michigan based on sales. The sales apportionment factor would equal a business's sales in Michigan divided by its total sales everywhere.

New Tax Credits. This bill would provide for a number of tax credits that qualifying taxpayers could claim to reduce their combined tax liability under the income and net worth taxes. Some of these credits are new and some are currently available under the single business tax. The new tax credits proposed in this bill are summarized below.

- Regulated Activities Credit – This proposed credit would reduce the net worth tax for certain "regulated" businesses. In general, this tax credit would be available to banks chartered by the State, and businesses involved in financial, insurance, and real estate activity. This credit effectively reduces the net worth tax rate for these businesses from 0.488% to 0.318%, a 35.0% reduction. This credit would be calculated using the following formula:

  Apportioned net worth tax base * 0.17% * (Sales in Michigan / Sales everywhere)

- Compensation Credit and Investment Credit – The Michigan Business Tax Act would create a compensation credit and an investment tax credit. The compensation credit would equal 0.8% of compensation paid in Michigan and the investment tax credit would equal 3.3% of the cost of net new capital assets located in Michigan. Capital investments that would qualify for this credit are the same as under the current single business tax investment credit. A taxpayer could claim these credits after claiming the regulated activities credit (if eligible to do so) and the combined amount that a taxpayer could claim under these two credits could not exceed 75.0% of the taxpayer's tax liability before these credits.

- Research and Development Credits – Two new research and development credits would be created. The first research and development credit would equal 4.0% of the amount a business spends on research and development activity in Michigan. The second research and development credit would equal 50.0% of the "contributions" a business makes to a small business to help finance research and development that is of interest to the contributing company. The business receiving the contribution could not have more than 50 employees or gross receipts in excess of $10.0 million. The Michigan Economic Growth Authority would have to approve these credits and could not approve more than 25 credits in any given year.

- Credit to Phase-Out the Filing Threshold - The single business tax has a filing threshold equal to gross receipts of $350,000, which means a business with gross receipts of $350,000 or less does not have to file a tax return or pay any tax.

However, under this existing threshold, a business with gross receipts of $350,001 must file a return and pay the tax on its taxable business activity, not just the portion related to gross receipts in excess of $350,000. This creates what is called a tax cliff. This bill would retain the current filing threshold, but phase it out between gross receipts of $350,000 and $700,000. This "phase out" would be implemented by means of a tax credit. This tax credit would equal a business's tax liability before this credit (but after the small business credit) times a fraction whose numerator would equal the amount by which the business's gross receipts fell below $700,000 and whose denominator would equal $350,000.

- Personal Property Tax Credit – This credit would equal 50.0% of the taxes paid on industrial and telephone company personal property. This credit would be refundable.

- Motorsports Entertainment Complex Credit – This credit would equal the amount spent on capital expenditures for a motorsports entertainment complex that seats at least 70,000 people and has at least six scheduled motorsports events each year. This credit could be claimed from 2008 through 2017, but the credit could not exceed $1. (Apparently, this would provide a tax credit to the Michigan International Speedway, but the amount is yet to be decided.)

Existing Tax Credits that would be Retained. The following tax credits currently exist under the single business tax and they would continue to be available to taxpayers under the Michigan Business Tax Act:

- Startup Business Credit
- Small Business Credit
- Michigan Early Stage Venture Credit
- Public Contribution Credit
- Workers' Disability Compensation Credit
- Community Foundation Contribution Credit
- Food Bank and Homeless Shelter Contribution Credit
- Next Energy Credit
- Michigan Economic Growth Authority (MEGA) Credits
- Renaissance Zone Credit
- Historic Preservation Credit
- Brownfield Credits
- Hematite Ore Credit

Unitary Filing. Unitary business groups would be required to file a combined tax return. A unitary business group includes a group of businesses that is controlled by one of the businesses and that has activity or operations that flow between the businesses. The goal of unitary filing is to reduce tax avoidance by eliminating the effectiveness of transferring financial transactions among the businesses.

Tax on Insurance Companies. Under the single business tax, insurance companies pay a tax on adjusted receipts which include such items as rental and royalty receipts, gross direct premiums received, receipts from administrative service only contracts, and receipts from noninsurance business. This tax base is apportioned to Michigan based on the percentage of an insurance company's total direct premiums that are in Michigan. The effective tax rate on this apportioned tax base is 1.0735%. In addition, various credits are provided for fees and assessments that insurance companies pay to special insurance industry funds. Under this bill, the tax on insurance companies would be assessed on gross direct premiums written on property or risk located in Michigan and the tax rate would be 1.25%. In addition, insurance companies are currently exempt from several taxes including sales and use taxes, but under this bill they would become subject to sales and use taxes. Also, under this bill, insurance companies based in other states would pay the greater of this tax or the insurance retaliatory tax, which is unchanged from current law.

Distribution of the Michigan Business Tax Revenue. In FY 2007-08, $203.7 million would be earmarked to the School Aid Fund (SAF) and the remaining revenue would be deposited into the General Fund. In FY 2008-09, $613.7 million would be earmarked to the SAF and the balance would go to the General Fund. Beginning in FY 2009-10, the amount earmarked to the SAF would equal the previous year's earmarked level adjusted for inflation using the Detroit Consumer Price Index and the remaining amount would go to the General Fund. These earmarkings to the SAF are intended to reimburse the SAF for the loss in property tax revenue that would result due to the proposed property tax exemptions contained in House Bills 4369 (H-1), 4370 (H-1), 4371 (H-1), and H.B. 4372.

House Bill 4369 (H-1) – 18-Mill Local School Tax Personal Property Tax Exemption

This bill would exempt commercial and industrial personal property from the 18-mill local school tax. The loss of property tax revenue under this bill would reduce local school district revenue, but the fiscal impact would be felt by the SAF because of the guaranteed foundation allowance. Each school district is guaranteed a certain amount of revenue per pupil. Under this guarantee, the gap between the amount of revenue generated locally through the 18-mill property tax and the guarantee amount is made up through a payment from the School Aid Fund. As a result, the property tax exemption proposed in this bill would have no fiscal impact on local school districts, but it would increase SAF expenditures to local school districts.

House Bill 4370 (H-1) – State Education Tax Personal Property Tax Exemption

This bill would exempt commercial and industrial personal property from the 6-mill State education property tax. All revenue from the State education property tax is earmarked to the School Aid Fund.

House Bill 4371 (H-1) – Industrial Facilities Tax Personal Property Tax Exemption

Under this bill, industrial personal property would be exempt from the portion of the industrial facilities tax attributable to the State education tax and the local 18-mill school property tax.

Other Issues and Observations

This proposed Michigan business tax, consisting of a business income tax and net worth tax, closely resembles two of the taxes that were replaced by the single business tax. These types of taxes were also repealed by Ohio in 2005 and replaced with a gross receipts tax.

One reason Michigan replaced the corporate income tax with the single business tax in 1975 was the volatility in the revenue stream it produced. There were years in the early 1970s when the revenue generated from the corporate income tax had swings from one year to the next of greater than 50%.

MCL 380.1211 (H.B. 4369)
211.903 (H.B. 4370)
207.564 & 207.564a (H.B. 4371)

FISCAL IMPACT

Based on estimates from the Department of Treasury, these bills would have the following fiscal impacts on a full year basis. These estimates are based on information available in Treasury's simulation model, which includes data on businesses that pay a total of $1.6 billion in the single business tax.

- The business income tax would generate an estimated $1.6 billion and the net worth tax would generate $1.8 billion, for total collections before credits equal to $3.4 billion.
- The value of the tax credits would total an estimated $1.8 billion.
- Therefore, it appears that these proposed tax changes are very close to being revenue neutral with the revenue that will be lost under the repeal of the single business tax.
- Due to the timing of when the School Aid Fund would have to be reimbursed for the loss of personal property tax revenue, during the initial year these proposed taxes would be in effect, there would be a one-time gain in revenue available to the State of approximately $400.0 million.

Fiscal Analyst: Jay Wortley and David Zin

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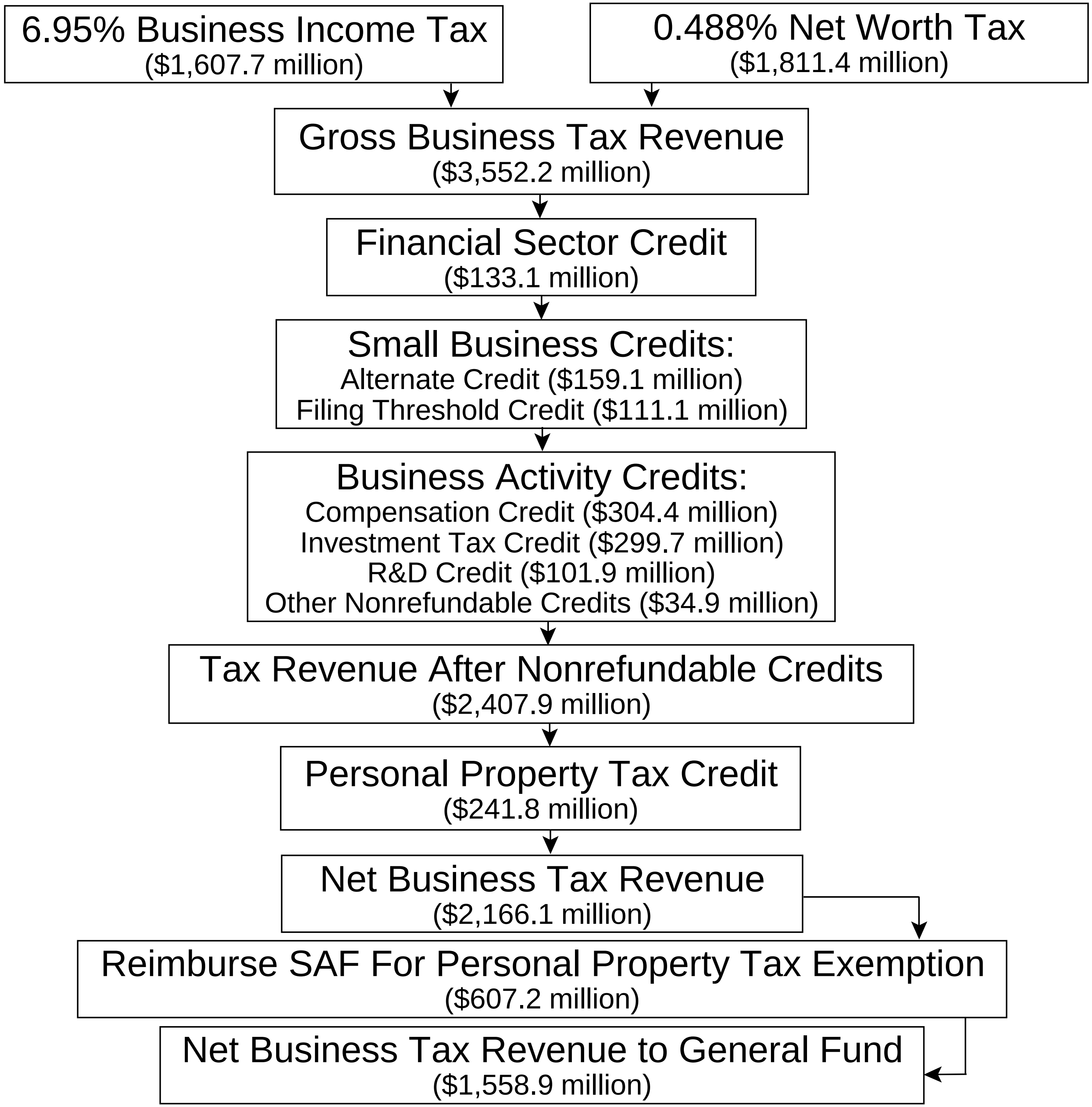

6.95% Business Income Tax
($1,607.7 million)
0.488% Net Worth Tax
($1,811.4 million)
Gross Business Tax Revenue
($3,552.2 million)
Financial Sector Credit
($133.1 million)
Small Business Credits:
Alternate Credit ($159.1 million)
Filing Threshold Credit ($111.1 million)
Business Activity Credits:
Compensation Credit ($304.4 million)
Investment Tax Credit ($299.7 million)
R&D Credit ($101.9 million)
Other Nonrefundable Credits ($34.9 million)
Tax Revenue After Nonrefundable Credits
($2,407.9 million)
Personal Property Tax Credit
($241.8 million)
Net Business Tax Revenue
($2,166.1 million)
Reimburse SAF For Personal Property Tax Exemption
($607.2 million)
Net Business Tax Revenue to General Fund
($1,558.9 million)

Table 1
Impact of House Bill 4367, as Passed by the House
Business Sectors Compared
(dollar amounts in millions)

Sector	Est. 2006 SBT Liability	Proposed Liability: Business Income Tax	Net Worth Tax	Small Bus. Credits	Invest. Tax Credit	Compensation Credit	Other Reductions	Total	Change in Liability: Amount	Percent
Ag., Forestry, Fishing	$9.5	$9.4	$4.4	$3.5	$1.0	$1.8	$2.5	$5.0	($4.4)	-46.9%
Mining	$5.6	$12.9	$16.3	$1.2	$1.8	$1.2	$2.2	$22.7	$17.1	307.9%
Construction	$83.6	$60.5	$102.9	$35.6	$9.9	$25.3	$22.1	$70.5	($13.2)	-15.7%
Manufacturing	$360.9	$209.3	$354.5	$15.6	$79.9	$77.0	$553.5	($162.2)	($523.1)	-145.0%
Other Durable	$101.7	$55.5	$87.7	$5.7	$14.7	$22.0	$109.1	($8.3)	($110.0)	-108.2%
Non-Durable	$111.8	$86.3	$127.0	$3.9	$18.3	$23.8	$131.4	$35.8	($75.9)	-67.9%
Primary Metals	$18.1	$10.9	$18.8	$0.6	$0.5	$3.8	$14.2	$10.7	($7.4)	-40.9%
Fabricated Metals	$37.9	$19.0	$30.8	$2.8	$6.9	$9.2	$42.5	($11.6)	($49.4)	-130.5%
Machinery, Excl. Elec.	$34.8	$14.7	$25.6	$2.2	$5.8	$8.6	$41.0	($17.4)	($52.1)	-149.9%
Transportation Equip.	$56.7	$22.9	$64.5	$0.4	$33.7	$9.6	$215.3	($171.6)	($228.2)	-402.9%
Transportation	$40.4	$23.7	$17.4	$3.5	$4.1	$6.1	$8.7	$18.7	($21.6)	-53.6%
Comm. and Utilities	$83.7	$66.8	$91.5	$2.5	$22.2	$13.1	$12.4	$108.1	$24.4	29.2%
Wholesale Trade	$87.6	$64.6	$36.7	$2.7	$8.3	$15.0	$25.8	$49.4	($38.2)	-43.6%
Retail Trade	$264.0	$160.5	$134.9	$29.2	$46.0	$43.4	$62.5	$114.2	($149.7)	-56.7%
Fin., Ins., Real Estate	$149.4	$350.7	$649.9	$96.5	$88.0	$31.0	$45.2	$739.8	$590.4	395.2%
Services	$468.3	$456.7	$170.3	$60.9	$25.5	$77.4	$138.7	$324.6	($143.7)	-30.7%
Other	$78.0	$192.6	$232.6	$19.1	$12.8	$13.2	$70.1	$310.1	$232.0	297.5%
Total	$1,630.8	$1,607.7	$1,811.4	$270.2	$299.7	$304.4	$943.8	$1,600.9	($29.9)	-1.8%

Source: Tax Analysis Division, Michigan Department of Treasury
Prepared by: Michigan Senate Fiscal Agency

Updated:	05/10/2007	09:09 AM
Printed:	05/10/2007	09:52 AM

Table 2
Impact of House Bill 4367, as Passed by the House
Business Sectors Compared, Shares
(dollar amounts in millions)

Sector	Est. 2006 SBT Liability	Share	Proposed Liability: Business Income Tax	Share	Net Worth Tax	Share	Other Reductions	Share	Total	Share
Ag., Forestry, Fishing	$9.5	0.6%	$9.4	0.6%	$4.4	0.2%	$8.8	0.5%	$5.0	0.3%
Mining	$5.6	0.3%	$12.9	0.8%	$16.3	0.9%	$6.4	0.4%	$22.7	1.4%
Construction	$83.6	5.1%	$60.5	3.8%	$102.9	5.7%	$92.9	5.1%	$70.5	4.4%
Manufacturing	$360.9	22.1%	$209.3	13.0%	$354.5	19.6%	$726.1	39.9%	($162.2)	-10.1%
Other Durable	$101.7	6.2%	$55.5	3.5%	$87.7	4.8%	$151.5	8.3%	($8.3)	-0.5%
Non-Durable	$111.8	6.9%	$86.3	5.4%	$127.0	7.0%	$177.5	9.8%	$35.8	2.2%
Primary Metals	$18.1	1.1%	$10.9	0.7%	$18.8	1.0%	$19.0	1.0%	$10.7	0.7%
Fabricated Metals	$37.9	2.3%	$19.0	1.2%	$30.8	1.7%	$61.4	3.4%	($11.6)	-0.7%
Machinery, Excl. Elec.	$34.8	2.1%	$14.7	0.9%	$25.6	1.4%	$57.6	3.2%	($17.4)	-1.1%
Transportation Equip.	$56.7	3.5%	$22.9	1.4%	$64.5	3.6%	$259.0	14.2%	($171.6)	-10.7%
Transportation	$40.4	2.5%	$23.7	1.5%	$17.4	1.0%	$22.4	1.2%	$18.7	1.2%
Comm. and Utilities	$83.7	5.1%	$66.8	4.2%	$91.5	5.1%	$50.2	2.8%	$108.1	6.8%
Wholesale Trade	$87.6	5.4%	$64.6	4.0%	$36.7	2.0%	$51.8	2.9%	$49.4	3.1%
Retail Trade	$264.0	16.2%	$160.5	10.0%	$134.9	7.4%	$181.2	10.0%	$114.2	7.1%
Fin., Ins., Real Estate	$149.4	9.2%	$350.7	21.8%	$649.9	35.9%	$260.7	14.3%	$739.8	46.2%
Services	$468.3	28.7%	$456.7	28.4%	$170.3	9.4%	$302.5	16.6%	$324.6	20.3%
Other	$78.0	4.8%	$192.6	12.0%	$232.6	12.8%	$115.2	6.3%	$310.1	19.4%
Total	$1,630.8	100.0%	$1,607.7	100.0%	$1,811.4	100.0%	$1,818.2	100.0%	$1,600.9	100.0%

Source: Tax Analysis Division, Michigan Department of Treasury
Prepared by: Michigan Senate Fiscal Agency
Updated: 05/10/2007 09:09 AM
Printed: 05/10/2007 09:52 AM

Table 3
Impact of House Bill 4367, as Passed by the House
Michigan and Multistate Firms Compared
(dollar amounts in millions)

	Est. 2006 SBT Liability	Proposed Liability: Business Income Tax	Net Worth Tax	Small Bus. Credits	Invest. Tax Credit	Comp. Credit	Other Reductions	Total	Change in Liability: Amount	Percent
Michigan Only Firms										
Traditional	$636.9	$949.1	$907.3	$258.5	$97.8	$121.5	$224.6	$1,154.0	$517.1	81.2%
Special	$3.3	$20.8	$44.8	$0.0	$0.1	$0.2	$1.5	$63.9	$60.6	1833.5%
Total Michigan-Only	$640.2	$969.9	$952.1	$258.5	$97.9	$121.7	$226.1	$1,217.8	$577.6	90.2%
Multistate Firms										
Michigan Based	$452.1	$303.3	$427.4	$5.7	$151.6	$116.0	$627.1	($169.6)	($621.8)	-137.5%
Out-of-State	$484.4	$278.7	$374.0	$5.6	$35.4	$58.0	$78.6	$475.1	($9.3)	-1.9%
Special	$54.1	$55.8	$57.9	$0.4	$14.9	$8.7	$12.1	$77.6	$23.5	43.4%
Total Multistate	$990.6	$637.9	$859.3	$11.7	$201.8	$182.7	$717.8	$383.1	($607.5)	-61.3%

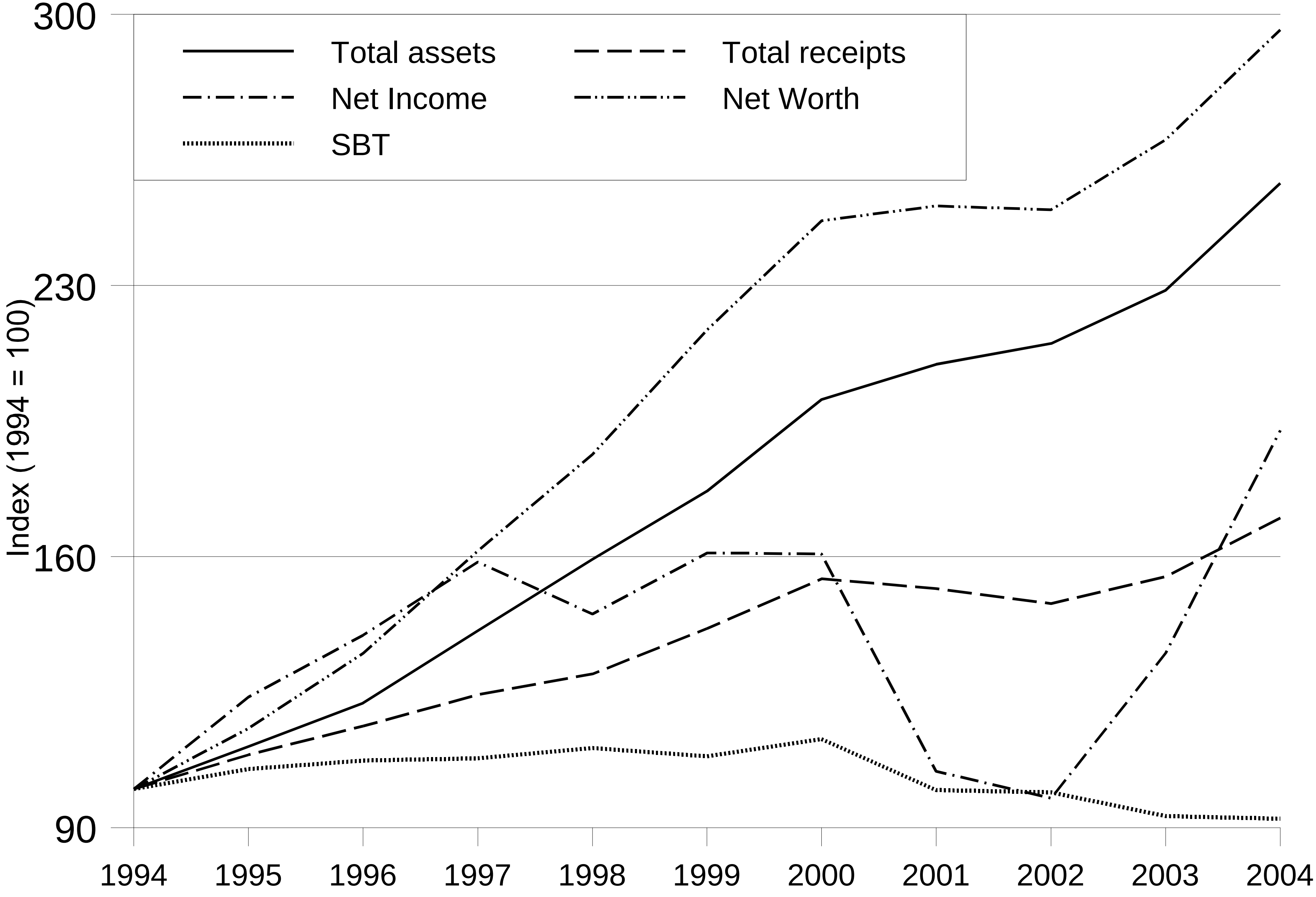
Source: Tax Analysis Division, Michigan Department of Treasury

Prepared by: Michigan Senate Fiscal Agency

Updated: 05/10/2007 09:09 AM

Printed: 05/10/2007 09:51 AM

Volatility of Tax Base Starting Points Compared



Volatility of Tax Revenue Compared