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

House Bill 5408 (Substitute S-4 as passed by the Senate)
Sponsor: Representative Andy Coulouris
House Committee: Tax Policy

Date Completed: 11-29-07

CONTENT

The bill would amend the Michigan Business Tax (MBT) Act to do the following:

-- Impose an annual surcharge on taxpayers equal to a percentage of their MBT liability, for tax years ending before January 1, 2011.
-- Increase the amount of MBT revenue earmarked to the School Aid Fund for fiscal years 2007-08 and 2008-09.
-- Revise the income limits affecting eligibility for a credit available to taxpayers whose gross receipts do not exceed $20.0 million and whose adjusted business income does not exceed a specified amount.
-- Create a credit for compliance with the beverage container deposit law.
-- Make financial institutions eligible for certain credits for assets and compensation.
-- Remove an eligibility requirement for a credit available to insurance companies.
-- Expand the credit available to owners, lessees, and operators of motorsports entertainment complexes.
-- Increase the amount of a credit available to certain retailers meeting criteria regarding retail and warehouse space, and revise the eligibility requirements.
-- Revise a credit for new motor vehicle inventory.
-- Include property taxes paid by railroad companies and telephone and telegraph companies in a credit for property taxes.
-- Provide for the assets and compensation credit, and a research and development credit, to be calculated before the imposition of the proposed surcharge.

The bill would take effect on January 1, 2008 (the effective date of the MBT Act), and would apply to all business activity occurring after December 31, 2007.

The bill is tie-barred to Senate Bill 838, which would repeal Section 3d of the Use Tax Act immediately after the section takes effect on December 1, 2007. Section 3d extends the use tax to certain services and appropriates $100,000 to the Department of Treasury for the implementation of the section's requirements.

House Bill 5408 (S-4) is described in detail below.

Michigan Business Tax Surcharge

Under the bill, in addition to the taxes imposed and levied under the MBT Act, and subject to the limitations described below, an annual surcharge would be imposed and levied on each taxpayer equal to the following percentage of the taxpayer's MBT liability after allocation or apportionment to the State but before calculation of the various credits available under the Act:

-- For each taxpayer other than a person subject to the tax imposed under Chapter 2B, for tax years ending after December 31, 2007, and before January 1, 2011: 14.0%.

-- For a person subject to the tax imposed under Chapter 2B, for tax years ending after December 31, 2007, and before January 1, 2009: 27.7%.
-- For a person subject to the tax imposed under Chapter 2B, for tax years ending after December 31, 2008, and before January 1, 2011: 23.4%.

The amount of the surcharge imposed and levied on any taxpayer other than a person subject to the tax under Chapter 2B could not exceed $2.0 million for any single tax year. (Under Chapter 2B, every financial institution with nexus in this State is subject to a franchise tax.)

The surcharge would not apply to a person subject to the tax imposed and levied under Chapter 2A (which provides for a tax on each insurance company equal to 1.25% of gross direct premiums written on property or risk allocated or residing in the State).

The surcharge would constitute a part of the tax imposed under the Act and would have to be administered, collected, and enforced as provided under the Act.

Business Activity

The Act imposes a business income tax on taxpayers having business activity within Michigan. "Business activity" means a transfer of legal or equitable title to or rental of property, whether real, personal, or mixed, tangible or intangible, or the performance of services, or a combination thereof, made or engaged in, or caused to be made or engaged in, whether in intrastate, interstate, or foreign commerce, with the object of gain, benefit, or advantage, whether direct or indirect, to the taxpayer or to others, but does not include the services rendered by an employee to his or her employer or services as a director of a corporation.

Under the bill, "business activity" would not include an activity that did not constitute a trade or business.

Existing MBT Credits

Compensation & Assets. The Act allows certain credits based on compensation and on tangible and other assets, and requires these credits to be taken before any other credit under the Act. The total combined compensation and assets credit allowed may not exceed 65% of the total tax liability imposed under the Act. Under the bill, the total combined credit allowed could not exceed 65% of the MBT liability before the imposition and levy of the surcharge.

Subject to certain restrictions, the credit for compensation is equal to 0.37% of the taxpayer's compensation in this State. For purposes of the credit, a taxpayer includes a person subject to the tax imposed under Chapter 2A (an insurance company). Under the bill, a taxpayer also would include a person subject to the tax imposed under Chapter 2B (a financial institution).

Research & Development Credit. A taxpayer may claim a credit against the MBT equal to 1.90% of the taxpayer's research and development expenses in this State in the tax year. This credit combined with the total combined credit for assets and compensation may not exceed 75% of the total MBT liability.

Under the bill, the credit could not exceed 75% of the MBT liability before the imposition and levy of the surcharge.

Retail Credit. An eligible taxpayer may claim a credit against the MBT equal to 0.535% of the taxpayer's compensation in this State, not to exceed $4.5 million. The bill would increase the credit to 1.0% of the taxpayer's compensation in the State, and would delete the $4.5 million cap. The amount of this credit could not exceed $4.5 million, however, if the limitation on the amount of the proposed surcharge imposed on a taxpayer other than one subject to Chapter 2B were $2.0 million or less.

For the purpose of this credit, "eligible taxpayer" refers to a taxpayer that operates at least 17.0 million square feet of enclosed retail space and 2.0 million square feet of enclosed warehouse space in this State; sells specified products at retail, with sales of those products representing more than 35% of the taxpayer's total sales in the tax year; and maintains its headquarters in Michigan. The bill would delete "maintains its headquarters in Michigan" from the definition and add "has more than 30,000 employees".

Insurance Company Credit. An insurance company that does not make any of the payments described under Section 237(1)(a)-(d) may claim a credit against the MBT equal to 0.37% of the taxpayer's compensation in the State, not to exceed 65% of the insurance company's tax liability for the tax year after claiming the other credits allowed by the Act. The bill would delete the requirement that an insurance company not make any of those payments in order to claim the credit.

(Section 237(1)(a)-(d) allows an insurance company to claim a credit against the tax for amounts paid to the following:

-- The Michigan Worker's Compensation Placement Facility.
-- The Michigan Basic Property Insurance Association.
-- The Michigan Automobile Insurance Placement Facility.
-- The Property and Casualty Guaranty Association.)

<u>Property Tax Credit</u>. Under the Act, a taxpayer may claim a credit against the MBT equal to the following:

-- For property taxes levied after December 31, 2007, 35% of the amount paid for property taxes on eligible personal property in the tax year.
-- Twenty-three percent of the amount paid for property taxes levied on eligible telephone personal property in the 2008 tax year and 13.5% of the amount paid for property taxes levied on such property in subsequent tax years.
-- For property taxes levied after December 31, 2007, 10% of the amount paid for property taxes on eligible natural gas pipeline property in the tax year.

"Property taxes" means taxes collected under the General Property Tax Act, the Obsolete Property Rehabilitation Act, and Public Act 198 of 1974 (the plant rehabilitation and industrial development act). Under the bill, "property taxes" also would include taxes levied under Public Act 282 of 1905 (which provides for the assessment and taxation of the property of certain railroad companies, telegraph companies, and telephone companies).

<u>Motorsports Credit</u>. For tax years beginning on or after January 1, 2008, and ending before January 1, 2013, an eligible taxpayer may claim a credit against the MBT equal to the amount of capital expenditures on infield renovation, grandstand and infrastructure upgrades, and any other construction and upgrades, subject to the following:

-- For the 2008 through 2010 tax years, the credit may not exceed \$1.7 million or the taxpayer's MBT liability, whichever is less.
-- For the 2011 tax year, the credit may not exceed \$1,180,000 or the taxpayer's MBT liability, whichever is less.
-- For the 2012 tax year, the credit may not exceed \$650,000 or the taxpayer's MBT liability, whichever is less.
-- An eligible taxpayer must spend at least \$25 million on capital expenditures before January 1, 2011.

Under the bill, for the 2008 through 2010 tax years, the credit could not exceed \$2,260,000 or the taxpayer's MBT liability, whichever was less.

The bill also would allow an eligible taxpayer to claim a credit against the MBT equal to the amount of necessary expenditures incurred including any professional fees, additional police officers, and any traffic management devices, to ensure traffic and pedestrian safety while hosting the requisite motorsports events each calendar year. If the amount of this credit exceeded the tax liability of the taxpayer for the tax year, that excess would have to be refunded.

(For purposes of the credit, an "eligible taxpayer" is any of the following:

-- A person who owns and operates a motorsports entertainment complex and has at least two days of motorsports events each calendar year that are comparable to NASCAR Nextel Cup events held in 2007 or their successor events.
-- A person who is the lessee and operator of a motorsports entertainment complex or the lessee of the land on which such a complex is located and operates that complex.
-- A person who operates and maintains a motorsports entertainment complex under an operation and management agreement.)

<u>Motor Vehicle Dealer Credit</u>. A taxpayer that is a new motor vehicle dealer licensed under

the Michigan Vehicle Code may claim a credit against the MBT equal to 2% of the amount paid by the taxpayer to acquire new motor vehicle inventory in the tax year, not to exceed $10,000. If the amount of the credit exceeds the tax liability of the taxpayer for the tax year, that excess will not be refunded and may not be carried forward as an offset to the tax liability in subsequent tax years.

Under the bill, the taxpayer could claim a credit equal to 1% of the amount paid by the taxpayer to acquire new motor vehicle inventory, not to exceed $12,500.

Proposed Bottle Deposit Credit

Under the bill, an eligible taxpayer could claim a credit against the MBT equal to the following:

-- For tax years beginning on and after January 1, 2008, and before January 1, 2011: 28.5% of the taxpayer's expenses incurred during the tax year to comply with the beverage container deposit law.
-- For tax years beginning on and after January 1, 2011: 25% of the taxpayer's expenses incurred during the tax year to comply with that law.

If the amount of the credit exceeded the tax liability of the taxpayer for the tax year, that excess could not be refunded or carried forward as an offset to the tax liability in subsequent tax years.

"Beverage container" and "distributor" would mean those terms as defined in the beverage container deposit law. "Eligible taxpayer" would mean a distributor or manufacturer who originated a deposit on a beverage container in accordance with that law.)

Alternate Tax Eligibility

The Act allows a credit against the MBT for any taxpayer with gross receipts that do not exceed $20 million and with adjusted business income minus the loss adjustment that does not exceed $1.3 million as adjusted annually for inflation using the Detroit Consumer Price Index. The credit will be the amount by which the MBT exceeds 1.8% of adjusted business income. This credit must be taken after the credits for assets and compensation and for research and development, and before any other credit under the Act.

As described below, the bill would revise this credit (sometimes referred to as the alternate tax).

Disqualification. An individual, a partnership, a limited liability company (LLC), or a subchapter S corporation is disqualified if the individual, any one partner of the partnership, any one member of the LLC, or any one shareholder of the S corporation receives more than $180,000 as a distributive share of the adjusted business income minus the loss adjustment of the individual, the partnership, the LLC, or the S corporation.

A corporation other than an S corporation is disqualified if compensation and directors' fees of a shareholder or officer exceed $180,000 or the sum of the following amounts exceeds $180,000 for the respective tax year:

-- Compensation and directors' fees of a shareholder.
-- The product of the percentage of outstanding ownership or of outstanding stock owned by that shareholder multiplied by the difference between the sum of business income and, to the extent deducted in determining Federal taxable income, a carry back or a carry over of a net operating loss or capital loss, minus the loss adjustment.

The bill would change the $180,000 amounts to $190,000 as adjusted annually using the annual growth rate.

"Annual growth rate" would mean the percentage change in personal income as officially reported by the United States Department of Commerce, Bureau of Economic Analysis, or its successor, for the current calendar year as compared to personal income for the calendar year immediately preceding the current calendar year. The annual growth rate would be rounded off to the nearest 0.1%.

Reduction. Subject to a reduction percentage determined as described below, the credit must be reduced by the following percentages if 1) an individual, any one partner of the partnership, any one member of the LLC, or any one shareholder of the subchapter S corporation receives as a distributive share of adjusted business income minus the loss adjustment of the individual, partnership, LLC, or subchapter S corporation; 2) compensation and directors' fees of a shareholder or officer of a corporation other than a subchapter S corporation are; or 3) the sum used to determine disqualification for a corporation other than an S corporation is:

-- More than $160,000 but less than $165,000: 20%.
-- $165,000 or more but less than $170,000: 40%.
-- $170,000 or more but less than $175,000: 60%.
-- $175,000 or more but not in excess of $180,000: 80%.

Under the bill, each of the amounts described above would be increased by $10,000 adjusted annually using the annual growth rate.

(The reduction percentage for a partnership, LLC, or S corporation is based on the distributive share of adjusted business income minus loss adjustment of the partner, member, or shareholder with the greatest distributive share of adjusted business income minus loss adjustment.

The reduction percentage for a corporation other than an S corporation is the greater of the following:

-- The reduction percentage based on the compensation and directors' fees of the shareholder or officer with the greatest amount of compensation and directors' fees.
-- The reduction percentage based on sum used to determine disqualification for a corporation other than an S corporation for the shareholder or officer with the greatest sum of those amounts.

If gross receipts exceed $19 million, the credit will be reduced by a fraction, the numerator of which is the amount of gross receipts over $19 million and the denominator of which is $1 million. The credit may not exceed 100% of the MBT liability.)

Revenue Distribution

Under the Act, in fiscal year (FY) 2007-08, $136.0 million of the revenue collected under the Act must be distributed to the School Aid Fund and the balance deposited in the General Fund. In FY 2008-09, $479.0 million of the revenue must be distributed to the School Aid Fund and the balance deposited in the General Fund. For each subsequent fiscal year, that amount from the immediately preceding fiscal year as adjusted by an amount equal to the growth in the United States Consumer Price Index in the immediately preceding year must be distributed to the School Aid Fund and the balance deposited in the General Fund.

Under the bill, in FY 2007-08 and FY 2008-09, respectively, $341.0 million and $729.0 million of the revenue would have to be distributed to the School Aid Fund.

Financial Institution Tax Base

Under the Act, for a financial institution, "tax base" means the financial institution's net capital. "Net capital" means equity capital as computed in accordance with generally accepted accounting principles less goodwill arising from purchase accounting adjustments for transactions that occurred after July 1, 2007, and the book value of United States obligations and Michigan obligations. The bill would delete "arising from purchase accounting adjustments for transactions that occurred after July 1, 2007", and would refer to the "average daily" book value of U.S. and Michigan obligations.

MCL 208.1105 et al.

Legislative Analyst: Craig Laurie

FISCAL IMPACT

The Department of Treasury estimates that the bill would reduce General Fund revenue by $160.8 million in FY 2007-08 and $374.3 million in FY 2008-09. The bill is tie-barred to Senate Bill 838, which would repeal an expansion of the use tax to various services. The expansion of the use tax is expected to generate $613.8 million during FY 2007-08 and $751.3 million during FY 2008-09. The impact indicated below is the net impact of both Senate Bill 838 (S-1) and House Bill 5408 (S-4), both as passed by the Senate.

The net effect of the proposed surcharge would increase revenue by approximately $260.4 million in FY 2007-08 and $421.8 million in FY 2008-09. However, the House bill also would create several new credits and/or expand existing credits. Expansion of the compensation credit to additional insurance companies and to financial institutions is expected to reduce revenue by $9.4 million in FY 2007-08 and $15.3 million in FY 2008-09, while expansion of the large retailer credit would reduce revenue by $2.5 million in FY 2007-08 and $4.1 million in FY 2008-09. Increasing the income limits to be eligible for the alternate tax is expected to lower revenue by $9.4 million during FY 2007-08 and $15.2 million during FY 2008-09.

The new credit for bottle deposit costs is expected to reduce revenue by $2.5 million in FY 2007-08 and $4.1 million in FY 2008-09, while the new credit for a motorsports complex is expected to lower revenue by $3.8 million during FY 2007-08 and $6.1 million during FY 2008-09. Both of these credits could reduce revenue by more than the estimate: The number of taxpayers that would be eligible for the credit on bottle deposit costs and the amount of the credit for which they would be eligible are unclear; and the motorsports credit would be an unlimited refundable credit for 100% of the expenditures incurred. As a result, little incentive would exist for a motorsports taxpayer to limit expenditures.

The bill also would alter the income limits affecting eligibility for the alternate tax by adjusting them over time by the growth in personal income. While the bill would use the growth in personal income for the United States as a whole rather than Michigan personal income, it is unclear what effect this provision would have on revenue or the administration of the tax. National personal income figures are not generally available until February of each year—after tax forms are usually printed and only two months before returns are due for calendar year filers. State-level personal income figures are generally not available until early April. Furthermore, personal income figures are frequently revised in subsequent years. For example, the September 2007 personal income release for the second quarter of 2007 included revisions for as far back as the first quarter of 2004. It is unclear if revisions to the data could retroactively make taxpayers eligible or ineligible for the alternate tax or if the release schedule for data used to calculate eligibility would affect the timing and amounts of taxpayers' payments.

As originally enacted, the MBT Act earmarks $136.0 million of MBT revenue to the School Aid Fund (SAF) in FY 2007-08 and $479.0 million in FY 2008-09. These earmarkings are intended to reimburse the SAF for the loss in property tax revenue that will result from the new personal property tax exemptions that are part of the MBT. Under this bill, the amount of MBT revenue earmarked to the School Aid Fund would increase to hold the SAF harmless from the impact of the repeal of the use tax on services tax. Under the services use tax, the SAF will receive one-third of the total revenue generated, and it is estimated that the SAF share will equal $205.0 million in FY 2007-08 and $250.0 million in FY 2008-09. Therefore, the bill would increase the amount earmarked to the SAF by $205.0 to $341.0 million in FY 2007-08, and by $250.0 million to $729.0 million in FY 2008-09. As under current law, in subsequent fiscal years, the amount earmarked to the SAF would be increased from the prior fiscal year's level by the percentage change in the U.S. Consumer Price Index.

Fiscal Analyst: Jay Wortley
David Zin

S0708\s5408sb
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.