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BILL ANALYSIS

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Senate Bill 192 (as passed by the Senate)
Sponsor: Senator Nancy Cassis
Committee: Finance

Date Completed: 3-17-10

RATIONALE

Under the Michigan Business Tax Act, taxpayers are subject to a modified gross receipts tax, as well as a business income tax. The modified gross receipts tax is imposed on a taxpayer's gross receipts, subject to certain adjustments, less purchases from other firms. Gross receipts include all amounts a taxpayer receives from any activity in intrastate, interstate, or foreign commerce carried on for direct or indirect benefit to the taxpayer or others, with some exceptions. Because the gross receipts tax applies to virtually all nonexempt transactions, including business-to-business commerce, it essentially creates an extra layer of taxation at each stage of production--often called tax "pyramiding" or "cascading". To alleviate this impact, the Act allows businesses to deduct purchases from other firms. The definition of "purchases from other firms" includes such items as inventory, depreciable assets, and other materials and supplies. As a rule, the term does not include payments for services. Under an amendment enacted in 2008, however, for certain builders and contractors, purchases from other firms include payments to subcontractors for a construction project. To reduce the impact of tax pyramiding in another area of the construction industry, it has been suggested that purchases from other firms also should include payments made by a joint venture to a partner or member for certain services.

CONTENT

The bill would amend the Michigan Business Tax Act to allow a deduction from the modified gross receipts tax base for payments by a joint venture to

a partner or member for construction management, architectural, and engineering services to the extent those payments were included in that person's gross receipts.

Except as otherwise provided, the Act imposes a modified gross receipts tax on every taxpayer with nexus in the State. The tax is imposed on the modified gross receipts tax base, after allocation or apportionment to the State, at a rate of 0.8%. The modified gross receipts tax base is a taxpayer's gross receipts, subject to certain adjustments, less purchases from other firms before apportionment under the Act.

Under the bill, for a joint venture formed for the purpose of completing a construction project and not for ownership of the project, "purchases from other firms" would include payments by the joint venture to a person that is a partner or member of the joint venture and included in Major Group 87 under the Standard Industrial Classification (SIC) Code, as compiled by the United States Department of Labor, for construction management, architectural, and engineering services, to the extent the payments are included in the gross receipts of the partner or member and billed to the joint venture under a contractual agreement specific to that project.

(Major Group 87 includes establishments that are primarily engaged in providing engineering, architectural, and surveying services; accounting, auditing, and bookkeeping services; research,

development, and testing services; and management and public relations services.)

MCL 208.1113

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

The modified gross receipts tax can have the effect of subjecting services to taxation at multiple stages. Public Act 177 of 2008 addressed this problem for one component of the construction industry, by including payments made to subcontractors for a construction project in the definition of "purchases from other firms", which removed those payments from the gross receipts tax base. Similarly, the bill would address the problem for another area, by extending the definition to payments by joint ventures to a partner or member for management, architectural, and engineering services for a construction project.

Undertaking a construction project can be risky in today's economy, and forming a joint venture is a common way to mitigate the risk, especially on large, complex, and long-term projects. In some cases, a joint venture might be necessary because the project is a public work, a local presence is needed, or the owner requires this business structure for bonding assurances. The joint venture structure operates where employees of the partner firms provide the construction management, architectural, and engineering services to a joint venture that holds the contract with the owner of a construction project. The profitability of the joint venture is reduced, however, when it must pay the gross receipts tax on payments made for these services—services that would not increase a firm's tax base if they were performed by the taxpayer absent a joint venture arrangement.

The following example, provided by the Associated General Contractors of Michigan, illustrates this situation: When an equal partner of a joint venture incurs \$200,000 for construction management, architectural, and engineering services for a project and bills it to the joint venture, the partner includes the \$200,000 in its gross receipts tax calculation. The joint venture, as the

pass-through entity to the owner, invoices the \$200,000 to the owner for payment. The joint venture cannot deduct the partner's \$200,000 invoice in calculating its gross receipts tax, since construction management, architectural, and engineering services are classified under SIC Code 87 (rather than SIC Code 15, 16, or 17, which are eligible for a deduction). As a result, the partner that provided the services pays the gross receipts tax based on its sale to the joint venture, which then pays the gross receipts tax on the same services.

By allowing a joint venture to deduct these payments from its gross receipts tax base, to the extent the payments were included in the partner's gross receipts tax base, the bill would provide fair tax treatment to the affected businesses.

Opposing Argument

The bill would cost the State approximately \$6.0 million per year. Unless funds can be identified to replace this revenue, the tax base should not be reduced.

Legislative Analyst: Suzanne Lowe

FISCAL IMPACT

The bill would reduce General Fund revenue by an unknown amount, depending upon several factors, including how much business with affected groups is accomplished through joint ventures and the specific characteristics of affected agreements and projects. Assuming that joint ventures account for approximately 10% of activity referred to by the bill, and that firms classified under SIC 15-17 (Construction) do not reclassify themselves under SIC Group 87 (the group affected by the bill), the bill would reduce MBT revenue to the General Fund by approximately \$6.0 million per year.

Fiscal Analyst: David Zin

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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.