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BILL ANALYSIS

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Senate Bill 1222 (as reported without amendment) *(as passed by the Senate)*
Sponsor: Senator Nancy Cassis
Committee: Finance

Date Completed: 3-22-10

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 at the rate of 0.8% on a taxpayer's gross receipts, subject to certain adjustments. 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 a 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 from the gross receipts tax base. 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 industry that relies heavily on subcontractors, it has been suggested that purchases from other firms also should include payments made by trucking companies to subcontractors that transport cargo.

CONTENT

The bill would amend the Michigan Business Tax Act to allow freight haulers to deduct payments to subcontractors from the modified gross receipts tax base.

Specifically, the bill would amend the definition of "purchases from other firms" to include, for a person classified under the 2002 North American Industrial Classification System (NAICS) number 484, as compiled by the United States Office of Management and Budget, payments to subcontractors to transport freight by motor vehicle under a contract specific to that freight. (The NAICS 484 classification consists of truck transportation, which includes industries that provide over-the-road transportation of cargo using motor vehicles, such as trucks and truck tractors.)

The proposed deduction would not be available to a taxpayer that qualifies for a credit under Section 417 of the Act. (That credit, commonly called the small business credit, may be taken by taxpayer with gross receipts that do not exceed $20.0 million and with adjusted business income minus a loss adjustment that does not exceed $1.3 million, as adjusted annually for inflation.)

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 bill would provide tax relief to general transportation contractors that subcontract freight-hauling projects. Since it is common for transportation companies to rely on subcontractors for 75% of their operations, tax pyramiding is a particular problem for this industry. The following example illustrates this phenomenon: A trucking company receives a $400 order to transport a load of steel, and hires an independent trucker to ship the load for $320. The company pays the trucker $320 and keeps the remaining $80 as income. The trucking company must include entire $400 in its gross receipts tax base, however, and cannot deduct the $320 paid to the subcontractor. At the same time, the subcontractor also must include the $320 in its tax base.

In testimony submitted to the Senate Finance Committee, a number of freight-hauling contractors reported significant increases in their tax liability under the MBT Act, compared with what it would have been under the former Single Business Tax (SBT) Act, and they attributed much of the increase to the gross receipts tax. For two companies, the increases were as high as 350% and 380%. Throughout the industry, the tax has contributed to layoffs, salary reductions, and benefit cuts. At least one company testified that it is not aggressively seeking new business in Michigan and has passed up capital investment opportunities, because the increased profits would be consumed by taxes. Another company that does not currently hire subcontractors would like to do so, but believes that the gross receipts tax would penalize it for expanding.

The proposed deduction for payments to subcontractors would make these companies' MBT liability manageable. While their business taxes still would be higher than they would have been under the SBT Act, the increases would be more reasonable. For the companies reporting increases of 350% and 380%, for example, the increases would be reduced to 185% and 250%, respectively. Transportation general contractors are willing to pay their fair share of business taxes, but they should not have to bear a disproportionate burden because their operations rely on subcontractors.

Opposing Argument

The annual cost of the bill is estimated to be from $1.4 million to $4.7 million (as discussed below) or $7 million to $8 million (according to the Department of Treasury). This is revenue that would not be available to support the State budget.

Response: The gross receipts tax already is costing the State in terms of fewer jobs, reduced salaries, and lost investment opportunities. The bill would help reverse this trend.

Opposing Argument

When the MBT Act was enacted in 2007 to replace the SBT Act, the modified gross receipts tax was established and decisions were made as to what should be excluded. While depreciable assets and inventory may be deducted from the gross receipts tax base, most payments for services are not deductible (subject to the exception for payments to construction subcontractors, which was enacted in 2008). This bill is one of a number of proposals to make piecemeal changes to the MBT, without integrating them into the overall structure of the tax.

Response: After the MBT Act was enacted, subsequent legislation added the surcharge, which greatly amplifies the impact of tax pyramiding.

Legislative Analyst: Suzanne Lowe

FISCAL IMPACT

The bill would reduce State General Fund revenue by an unknown amount. The bill would have no effect on local unit revenue or expenditure. The magnitude of the effect would depend upon the number of firms affected and the share of gross receipts used to compensate subcontractors to transport freight. Based on national data, gross receipts for Michigan for firms in the affected industry total $4.7 billion. It is unknown how many out-of-State firms would be affected by the bill. If the subcontracting provisions in the bill affected 5% of the estimated gross receipts for Michigan, the bill would reduce General Fund revenue by approximately $1.4 million per year; if it affected 20%, the reduction would be $5.7 million.

Fiscal Analyst: David Zin