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Senate Bill 94 (Conference Report-1)  
Sponsor: Senator Nance Cassis  
House Committee: Tax Policy  
Senate Committee: Finance

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## **CONTENT**

Senate Bill 94 (CR-1) would create the "Michigan Business Tax" Act, which would establish a business income tax and a modified gross receipts 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. In addition, this bill is tie-barred to House Bill 4369, House Bill 4370, House Bill 4371, and House Bill 4372, which would exempt industrial and commercial personal property from various portions of the State education and local school property taxes. The major provisions of Senate Bill 94 are summarized below.

### **Senate Bill 94 (CR-1) – 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 4.95%.

Modified Gross Receipts Tax. A new tax based on a modified measure of a business' gross receipts also would be created. The base of the tax would be gross receipts less purchases from other firms. Purchases from other firms would include inventory purchased during the tax year and capital expenditures. The rate of this tax would be 0.8%. Special provisions would reduce the tax base for a variety of taxpayers including auto dealers, construction contractors, self employed individuals, and members of partnerships and limited liability companies.

Apportionment. Both the business income tax and modified gross receipt 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.

- Compensation Credit and Investment Credit – The Michigan Business Tax Act would create a compensation credit and change the investment tax credit. The compensation credit would equal 0.37% of compensation paid in Michigan and the investment tax credit would equal 2.9% 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. These two credits would have to be claimed before any other credits and the combined amount that a taxpayer could claim under these two credits could not exceed 65.0% 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 1.9% of the amount a business spends on research and development activity in Michigan. This credit together with the compensation and investment tax credits could not exceed 75.0% of a business' tax liability before these credits. The second research and development credit would equal 30.0% of the "contributions" a business makes to a small business to help finance research and development that is of interest to the contributing company, but the credit could not exceed \$300,000. This credit would only be available for the 2008 - 2010 tax years. The Michigan Economic Growth Authority would have to approve these credits and could not approve more than 20 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 35.0% of the taxes paid on industrial personal property. Together with the exemption from the 6-mill State education tax and the 18-mill local school property tax, industrial personal property would realize an average effective personal property tax reduction of 64.9%. In addition, telephone companies would receive a tax credit equal to 23.0% of taxes paid on personal property during the 2008 tax year and 6.7% of taxes paid on personal property during each subsequent year, and natural gas pipeline property would receive a credit equal to 10.0% of the taxes paid on personal property each year. This credit would be refundable.
- Michigan Entrepreneurial Credit – For tax years 2008 - 2010, a taxpayer would be able to claim a credit if they: 1) had gross receipts of less than \$25.0 million (adjusted annually by inflation) in the preceding tax year, 2) created or transferred to Michigan at least 20 new jobs during the preceding tax year, and 3) made at least \$1.25 million in capital investment in Michigan during the preceding tax year. Retail establishments are generally not eligible for the credit. The credit equals the increase in liability attributable to the employment increase.

- Special Sector Credits – Several business sectors would be given special credits, including:
  - Motor Sports Entertainment Complex Credit – This credit would apply to a motor sports entertainment complex that seats at least 70,000 people and has at least six days of motor sports events each year. This credit would apply for 2008 through 2012.
  - Sports/Entertainment Facility Credit – Owners of a facility or stadium used primarily for sporting or other entertainment events with a capacity of at least 14,000 spectators that has not received any State or local government financial assistance would be eligible for a credit for tax years 2008 - 2012.
  - Motor Vehicle Dealer Credit – New motor vehicle dealers would be able to claim a credit equal to 2.0% of the amount spent to acquire new motor vehicle inventory in a tax year, but the credit could not exceed \$10,000.
  - Special Compensation Credits – Two special compensation credits would be provided to certain very large retail establishments. Among the requirements, the business must have its headquarters in Michigan. The first credit would apply to a retailer with at least 17 million square feet of retail space and two million square feet of warehouse space, and the second credit would apply to a retailer with at least 2.5 million square feet of retail space and 1.4 million square feet of warehouse space.
  
- Small Business Provisions – Under the single business tax, qualifying firms may pay an alternative tax equal to 2.0% of adjusted business income. In order to qualify for this alternative tax, limits are placed on how much a business generates in gross receipts and business income, and how much it pays to its officers. This bill would continue to provide an alternative tax to small businesses with the following changes:
  - Tax Rate: the tax rate would be reduced from 2.0% to 1.8%.
  - Officer Compensation Limit: The eligibility phase-out range for officer compensation would be increased from the current \$95,000-\$115,000 to \$160,000-\$180,000.
  - Gross Receipts Limit: The gross receipts eligibility phase out would be increased from \$9.0 million-\$10.0 million to \$18.0 million-\$20.0 million.
  - Business Income Limit: The limit on business income would be increased from \$475,000 to \$1.3 million.

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. Any proposed modifications to these credits are noted.

- Investment Tax Credit (modifications provided above)
- Startup Business Credit
- Michigan Early Stage Venture Credit
- Public Contribution Credit – The maximum amount of the credit would be increased from \$5,000 to \$10,000.
- Workers’ Disability Compensation Credit
- Community Foundation Contribution Credit – The credit would be expanded to include contributions to education foundations.
- 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

Unused Single Business Tax Carryforward. Any unused carryforward for any credit claimed under the single business tax would be able to be applied against tax liabilities for the 2008 and 2009 tax years.

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 at an effective tax rate of 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%. Insurance companies would continue to be able to claim credits for the assessments they pay to special insurance industry funds, but insurance companies that do not make these payments would be able to claim the proposed new compensation credit. 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.

Tax on Financial Institutions. Under this bill, financial institutions would pay a franchise tax on the value of their net capital stock and the tax rate would be 0.235%. Michigan and U.S. obligations, as well as goodwill and certain amounts the bank is required to hold to maintain capitalization under banking regulations, are excluded when computing the value of net capital. Each year, the value of net capital is averaged over a five-year period.

Distribution of the Michigan Business Tax Revenue. In FY 2007-08, \$136.0 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, \$479.0 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.

Revenue Trigger. This bill includes a provision that would place a limit on the amount of revenue the Michigan Business Tax could generate in FY 2007-08, FY 2008-09, and FY 2009-10. The revenue limit is \$2,398,000,000 in FY 2007-08, \$2,398,000,000 plus 1.0% plus the increase in Michigan personal income (FY 2008-09 compared with FY 2007-08) in FY 2008-09, and \$2,398,000,000 plus 2.01% plus the increase in Michigan personal income (FY 2009-10 compared with FY 2007-08) in FY 2009-10. If revenue were to exceed the limit in any of these three years, 50.0% of the excess would be refunded to taxpayers and the remainder would go into the Budget Stabilization Fund (BSF). If the limit is exceeded by less than \$5.0 million, then all of the excess over the limit would be deposited into the BSF.

## **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 \$1.0 billion and the modified gross receipts tax would generate \$2.4 billion, for total collections before credits equal to \$3.4 billion.
- The value of the tax credits and property tax exemptions 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.
- Although revenue neutral, the bill would change the distribution of tax liabilities. Generally, manufacturing firms would experience liability reductions compared with the single business tax totaling several hundred million dollars, while nonmanufacturing firms would experience increases. Similarly, while Michigan-only firms would generally experience liability increases totaling several hundred million dollars and multistate firms based outside of Michigan would experience increases totaling approximately a hundred million dollars, Michigan-based multistate firms would generally experience liability reductions.
- 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 (FY 2007-08), there would be a one-time gain in revenue available to the State of approximately \$225.0 million.

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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.