

Analysis of the Michigan Business Tax Proposal

November 30, 2006

Governor Jennifer Granholm announced a comprehensive plan to replace the estimated \$1.9 billion budget hole when the Single Business Tax (SBT) sunsets on December 31, 2007. In a press conference on Wednesday, November 29, the Governor and State Treasurer, Robert Kleine, released a plan for a new Michigan Business Tax (MBT).

It is the objective of the proposal to offer revenue neutrality. In total, the new tax is expected to generate \$2.4 billion. The proposal incorporates a \$150 million tax cut for Michigan businesses, shifting that burden to out-of-state firms, and retains a four-year \$600 million tax credit for personal property taxes. Mr. Kleine stated that the MBT would grow at a faster rate than they can expect for the personal property tax.

Mr. Kleine stated in the press conference that the tax is expected to give manufacturers a significant cut while increasing the tax rate for the insurance industry by 25 percent. Other financial services (besides insurance) are likely to receive an increase as well, likely to be determined by locality of the business. Out-of-state businesses are expected to be the biggest losers in this plan.

Governor Granholm stated that one of the key elements of the plan is the elimination of compensation, including health care costs, from the tax base. Compensation now accounts for 73 percent of the tax base.

The Michigan Business Tax is said to:

- Benefit small business in Michigan.
- Provide personal property tax relief to industrial and commercial taxpayers.
- Retain economic development incentives.
- Benefit high tech companies by creating a research and development credit.
- Increase business tax rates to the insurance sector.
- Simplify business tax in Michigan.

Overview of the Michigan Business Tax

The proposal is a three-part factor tax that includes assets, gross receipts and profits in its base calculation. There is a gradual threshold scale, which would eliminate the cliff burden on small business. There is also an elimination of the business tax exemption for professional employee organizations and water softener companies.

The business tax is made of two components: the base, which is the elements of a business's activities that are being taxed, and the rate, which is the numerical percentage applied to the tax base. The rate multiplied by the base equals the business's tax liability.

The base is made up of three components: gross receipts, assets of the taxpayer (tangible and intangible), and business income.

The rates are as follows for the above components:

Gross Receipts ó 0.125%
Assets ó 0.125%
Business Income ó 1.875%

In addition, there is an apportionment formula that is based on 100 percent of a firm's percentage of Michigan sales, compared to the current SBT which is based 92.5 percent on sales and 3.75 percent each on the percentage of payroll and property.

Property classified as industrial and commercial would be exempt from the 6-mill state education tax and the 18-mill school operating tax imposed on non-homestead property. The local school district's property tax base is also reduced which increases expenditures from the School Aid Fund. The MBT earmarks a portion of its revenue to the School Aid Fund in order to hold it harmless from the loss of the state's share of the personal property tax.

Governor Granholm has said a majority of businesses in every business sector would pay fewer taxes under the proposal than under the SBT, and overall that covers about 77 percent, or 110,000, of the state's businesses. Insurers and others who are among the 34,000 businesses that would pay more would pick up the slack. Insurers would see their premium tax increase to 1.25 percent from 1.07 percent, while eliminating any current business tax credits on that industry.

Ninety percent of the agriculture sector would experience tax cuts with 10 percent paying more; 52 percent of the communications and utilities sector would experience tax cuts with 48 percent paying more; and, the manufacturing sector the main sector for tax relief would be seeing 83 percent getting a tax cut while 17 percent would have a tax hike.

Small businesses continue to be exempt from taxes with the continued tax threshold of \$350,000 in gross receipts. Unlike the SBT where they face full taxation once they cross that level, the MBT provides gradually higher taxes tied to higher gross receipts, with full taxation hitting at the \$700,000 mark. Even then, businesses with gross receipts up to \$10 million could use an alternative tax at 1.8 percent, giving them lower taxes than larger businesses.

Five bills were introduced by Representative Dianne Byrum (D-Onondaga) today to implement the plan:

House Bill 6676 ó Creates the Michigan Business Tax.

House Bill 6677 ó Provides exemption for certain personal property from certain operating mills.

House Bill 6678 ó Provides an exemption to the state education tax for certain industrial and commercial personal property.

House Bill 6679 ó Revises calculation of tax levied for plant rehabilitation

House Bill 6680 ó Exempts commercial and industrial property from certain taxes.

Governor Granholm's new business tax proposal received generally positive reviews as a genuine attempt to improve the state's economic climate. Business groups and legislators see the plan as a creative step forward that will take time to iron out as the bills are analyzed.