

Background and History:

**Michigan's
Single
Business
Tax**



Mitchell E. Bean, Director

November 2003

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TO: Members of the House of Representatives

Michigan's single business tax (SBT) is a value-added tax (VAT), and the only major tax of its kind in the United States. For this reason, the SBT is perhaps the least well understood of the major taxes levied in Michigan.

This publication explains the rationale for the tax and its various provisions by reviewing the tax's history—including business taxes that preceded the SBT, the original adoption of the SBT, and the numerous changes that have been made to the SBT over time. This history is intended to provide context for future decision making regarding the SBT and business taxation in general.

This report was written by Kyle I. Jen, Fiscal Analyst; Jeanne Dee, Administrative Assistant, prepared the report for publication. We appreciate the review comments and suggestions of Terry Bergstrom, Legislative Service Bureau; Howard Heideman, Michigan Department of Treasury; Bob Kleine, Public Sector Consultants; and Rebecca Ross and Jim Stansell, House Fiscal Agency.

Please contact me or Rebecca Ross if you have questions regarding the information in this publication.

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TABLE OF CONTENTS

INTRODUCTION	1
ECONOMIC AND HISTORICAL BACKGROUND	3
The History of Business Taxation in Michigan	4
Debate Over the Single Business Tax	6
The Single Business Tax as Originally Enacted	7
CALCULATING SINGLE BUSINESS TAX LIABILITY	9
SINGLE BUSINESS TAX PROVISIONS/CHANGES	13
Gross Receipts Threshold	13
Tax Base	13
Costs of Capital	13
Costs of Labor	15
Apportionment Formula	15
Deductions and Exemptions	16
Capital Acquisition Deduction	17
Business Loss Deduction	18
Statutory Exemption	18
Tax Rate	18
Alternate Filing Methods	19
Labor Intensity Deduction	19
Gross Receipts Deduction	19
Alternate Tax Rate	20
Tax Credits	20
Higher Education/Public Contributions Credit	20
Unincorporated Business Credit	21
Small Business Credit	21
Child Care Credit	22
Summer Youth Employee Credit	22
Supplemental Workers Compensation Credit	22
Enterprise Zone Credit	22
Minority Venture Capital Credit	23
High Technology Activity Credit	23
Community Foundation/Homeless Shelter Credits	23
Michigan Economic Growth Authority Credit	23
Temporary Credit	24
Brownfield Zone Credit	24
Renaissance Zone Credit	24
Apprenticeship Credit	24
Historic Restoration Credit	25
Investment Tax Credit	25

Industry-Specific Provisions	26
Nonprofit and Governmental Organizations	26
Financial Organizations	26
Insurers	27
Transportation Companies	27
Utilities	28
Agriculture	28
Exemption for Certain Retailers	28
Pharmaceutical Companies	28
 SINGLE BUSINESS TAX REVENUE COLLECTIONS	 31
 DISTRIBUTION OF TAX COLLECTIONS	 35
 CONCLUSION	 37
 APPENDICES:	
APPENDIX A - Historical Single Business Tax Revenue Collections	41
APPENDIX B - Changes to the Single Business Tax	43

FIGURES

FIGURE 1	
Calculating Single Business Tax Liability	11
FIGURE 2	
Net Corporate Income Tax Collections	32
FIGURE 3	
Net SBT Collections	32
FIGURE 4	
Equivalent Corporate Income Tax Rate	33

INTRODUCTION

The single business tax (SBT) is a major source of revenue for the State of Michigan, generating \$2.0 billion and accounting for 23 percent of General Fund/General Purpose revenue in Fiscal Year 2001-02. At the same time, the SBT is the least well understood of Michigan's major state taxes due to its unique nature as a value-added tax (VAT). This publication will explain both the theory and history of the tax.

The report begins by discussing the economic rationale for value-added taxation, presenting a brief history of business taxation in Michigan prior to 1975, and summarizing the debate over the adoption of the SBT during that year. Next, a brief explanation of the SBT's mechanics is offered, and the changes to the provisions of the SBT over the last 27 years are outlined. Historical revenue collections and the distribution of those collections are also discussed. In light of the fact that the SBT will be repealed after tax year 2009, the conclusion discusses alternative methods of business taxation.

Figures are used to illustrate the calculation of tax liability as well as to show how revenue collections have changed over time. Appendices A and B present historical SBT collections and a detailed chronological listing of each public act related to the SBT. Because the text of this report does not generally cite specific public act numbers in order to maintain narrative continuity, Appendix B should be useful to those who require more detailed information.

This report accounts for all changes to the SBT made through October 2003.

ECONOMIC AND HISTORICAL BACKGROUND

The single business tax is, arguably, the most unique characteristic of the State of Michigan's fiscal structure. It holds a position in Michigan's tax system which is equivalent to the corporate income tax in most states. (Michigan is one of only six states which does not levy a corporate income tax.)¹

In the last decade, however, several states (West Virginia, Minnesota, Texas, and Louisiana) have considered adopting a tax similar to the single business tax; a VAT has also been considered by the District of Columbia.² New Hampshire adopted a value-added type tax (the business enterprise tax) in 1993, but with a much lower rate (0.25 percent) and as a complement to its business profits tax.

Because the SBT is the only major VAT levied in the United States, the theory underlying value-added taxation is often misunderstood in this country. In Europe, where the VAT is levied by most national governments, it is seen as a consumption tax which is roughly equivalent to a national sales tax. In a subnational unit of government such as Michigan, however, the SBT is generally thought of as a tax on businesses—rather than on consumers. In reality, any business tax imposes some economic costs on both producers and consumers.

There are two methods for computing the taxable value (i.e., the value added or business activity) of a firm: the subtraction method and the addition method.

' The subtraction method taxes a firm's sales of goods at each step of the production process, but allows the firm to deduct the cost of its raw materials from the base. In this way, the same goods are not taxed repeatedly. Instead, the value added by each firm in the production process is taxed.

Taxable value can be computed under the subtraction method simply by subtracting the cost of goods sold from gross receipts.

' Under the addition method of computing a firm's taxable value, the costs of inputs are summed. Broadly speaking, these costs are compensation paid, net rent paid, net interest paid, net dividends paid, income tax paid, and depreciation.

Under an unmodified value-added tax, the addition and subtraction methods of computing value added will yield the same figure.

In addition to the method of computation used, value-added taxes are also differentiated with respect to the treatment of capital expenditures.

¹ The others are Nevada, South Dakota, Texas, Washington, and Wyoming (Source: Federation of Tax Administrators).

² Gene Steuerle, "Will the Single Business Tax Catch On?" in *State Tax Notes*, Vol. 15, No. 25 (December 21, 1998).

- ' An income-type VAT does not allow for the initial deduction of capital expenditures. Instead, depreciation is deducted over time.
- ' A consumption-type VAT allows for the initial deduction of capital expenditures, but does not allow for deduction of depreciation over time.

The SBT is a consumption-type VAT.

The basic premise underlying value-added taxation is relatively straightforward: taxes should be treated as just another cost of doing business, and all business activity should be taxed at the same rate, regardless of whether a firm earns profits.

A House legislative analysis of the original SBT legislation offered the following argument with respect to low-profit firms:

Chronic low profitability can result from three major causes:

- ' A highly competitive market,
- ' Consistently poor management, and
- ' Disguising profits as wages or bonuses in order to avoid taxation. In each case, the SBT tends to rectify inequities that have existed in the current tax structure without creating undue hardships for anyone.

First, in the case of a highly competitive market, the SBT will not force firms into the red since it will be an equal cost on all competitors. The SBT in such cases will result in a price increase as the tax is passed through to the consumers; but it will not result in business failures.

Second, it is unfair to tax high profit, high efficiency firms heavily in order to provide a tax break for the inefficient firm. Tax policy should not seek to shelter inefficiency from the controls of the marketplace.

Third, firms which have in the past disguised their profits to avoid taxation are truly not low profit. The SBT will make it difficult to avoid taxation by hiding a firm's profits.³

Michigan's form of value-added taxation is, of course, far from a pure VAT. The conclusion of this publication will note several of the major provisions which depart from the theory of value-added taxation.

The History of Business Taxation in Michigan

Over time, businesses have faced a number of different taxes in the State of Michigan. Until the middle of this century, these taxes were all specific in nature, including such levies as the property tax and the annual corporate privilege fee.

³ House Legislative Analysis Section, Analysis of House Bill 4640 (August 12, 1975), 5.

The first tax of a general nature to be levied on businesses was the business activities tax (BAT) which was enacted in 1953 in the face of a budget deficit. This deficit was in part a result of a 1946 constitutional amendment which had diverted two-thirds of sales tax revenue to school districts and local governments.⁴

Governor G. Mennen Williams had proposed both a personal and corporate income tax to deal with the fiscal crisis, but this proposal was not adopted, and the proposal made by several large corporations in the state for a VAT was instead implemented.⁵

The BAT was an income-type VAT (it did not allow for the immediate deduction of expenditures for capital investment) which utilized the subtraction method of computation. The tax allowed for a \$10,000 exemption, a gross receipts deduction, a labor intensity deduction, and a net income credit. The tax rate was initially set at 0.4 percent and had risen to 0.75 percent by the time of its repeal more than a decade later. Financial institutions and insurance companies were exempt from the BAT because they were subject to various other taxes; public utilities faced a lower tax rate.⁶

Originally, the apportionment factor used to determine taxable value under the BAT was based solely on sales. Those sales made outside the state but received within the state, and vice versa, were reduced by 50 percent. This formula was altered in 1955 to include only sales made in Michigan and to add two more taxable measures— property and payroll.⁷

The BAT was adopted only after a flood of proposals—ranging from the repeal of the sales tax to an increase in the tax on horse racing—had been considered and rejected.⁸ The tax was originally intended as a temporary measure and was set to expire on March 15, 1955.⁹ Instead, the BAT was extended in 1955 and remained effective until 1967 when it was replaced with the corporate income tax.

Adoption of the corporate income tax accompanied adoption of the state personal income tax.¹⁰ Both income taxes were proposed by Governor Romney in an effort to avoid a budget deficit. In arguing for a change in the method of taxing business, Governor Romney said the following:

Business taxes hamper economic growth by levying an excessive proportion of taxes in the form of fixed charges unrelated to profit. These taxes discourage new businesses and are an unreasonable burden on those operating with a small profit margin. In addition, Michigan businesses pay more of the total tax than is paid by business in most competing industrial states.¹¹

⁴ Willis F. Dunbar and George S. May, *Michigan: A History of the Wolverine State* (Grand Rapids: Eerdmans, 1995), 551.

⁵ Robin Barlow and Jack S. Connell, Jr., "The Single Business Tax" in Harvey E. Brazer, Ed., *Michigan's Fiscal and Economic Structure* (Ann Arbor: University of Michigan Press, 1982), 675.

⁶ Barlow and Connell, 676.

⁷ Richard W. Lindhom, "The Business Activities Tax" in *Michigan Tax Study: Staff Papers* (Lansing, 1958), 272-3.

⁸ Peter A. Firmin, *The Michigan Business Receipts Tax* (Ann Arbor: University of Michigan, 1953), 1-2.

⁹ Firmin, 143.

¹⁰ See House Fiscal Agency, *The Income Tax* (Lansing, April 1999) for a description of the corporate income tax.

¹¹ Gongwer News Service *Michigan Report*, "Governor Asks Income Tax, Record Budget" (February 2, 1967), 1.

Outside of the Governor's belief that the BAT was detrimental to the state's business climate, there were at least two other reasons why the BAT was repealed: 1) organized labor favored a corporate income tax as opposed to a VAT because it was perceived that labor bears a higher portion of the cost of a VAT and 2) many small and service businesses disliked the BAT because it ignored the ability-to-pay principle.¹²

By the time the SBT was proposed by Governor Milliken in his 1975 State of the State Address, Michigan's system of business taxation was again being questioned, and the state faced yet another fiscal crisis.

Debate Over the Single Business Tax

Debate over the Governor's proposal was described in the following manner in a 1978 Advisory Commission on Intergovernmental Relations (ACIR) report written by Robert Kleine:

The proposal was greeted with considerable skepticism by the business community and the Legislature. However, because of the economic and fiscal situation, the Legislature agreed to give the proposal a hearing although few legislators thought the proposal had any chance for passage.

The business community was split on the proposal, but those in favor of the VAT wielded enough influence to insure that the tax would be given a fair hearing by business. The VAT was generally favored by high-profit manufacturers, retailers, financial institutions, and utilities, mainly because their taxes would be reduced by the enactment of the VAT. Many multinational businesses favored the VAT because its adoption solved . . . major problems that they were concerned about.¹³

The ACIR report attributed the re-adoption of a VAT after a relatively short period of time to two factors. First, the revenue generated by the corporate income tax had fluctuated dramatically with the business cycle. Second, it was argued that the VAT would promote capital investment and improve Michigan's business climate.¹⁴

Legislative debate over the SBT was influenced by competing groups of businesses who stood to either gain or lose under the new tax and a plethora of proposals to address these concerns. The original proposal by Governor Milliken was essentially a pure VAT, but the final version of the tax contained a large number of compromises which were necessary to ensure adoption of the tax. In fact, support for the SBT was so indecisive that either a second vote or a prolonged vote was required at four stages of the legislative process—the House Taxation Committee, the full House, the Senate Taxation Committee, and the House approval of the conference committee report. In each case, members of the legislative leadership had to secure additional votes to gain passage of the proposal.

Governor Milliken signed the SBT into law on August 27, 1975, making the following statements about the new tax:

¹² Advisory Commission on Intergovernmental Relations, The Michigan Single Business Tax (Washington, D.C., March, 1978), 17-18.

¹³ Advisory Commission on Intergovernmental Relations, 19.

¹⁴ Ibid.

[The SBT] differs from any other tax in use in the United States. Unlike familiar taxes on the sale of an item or service, or on the receipt of certain types of income or ownership of assets, the Single Business Tax is specifically designed for a modern industrial market economy. . . .

[It] will promote economic expansion in Michigan by providing incentives for growth and efficiency--while still recognizing the need for profitability. The tax applies equally to every business, and the amount of the tax is independent of the legal form of the business, the nature of the business and the particular production of financing means chosen by the business.¹⁵

The Single Business Tax as Originally Enacted

Enacted as Public Act 228 of 1975, the SBT replaced the corporate income tax, corporate franchise tax, personal property tax on inventories, business intangibles tax, financial institutions tax, insurance company privilege fee, and savings and loan company privilege tax. These taxes had raised approximately \$800 million in revenue for the state annually.¹⁶

Although the SBT was designed to exactly offset this revenue loss in future years, implementation of the SBT did create a one-time cash flow advantage for the state because collection of the SBT overlapped with collection of several of the repealed taxes. This cash flow advantage was designed to total about \$210 million to offset the expected state budget deficit.

The original structure of the SBT included the following provisions:

- ' Federal taxable income as the starting point for the tax base with numerous adjustments so that the final base included interest, royalties, labor costs, and capital plus rent received.
- ' A three-part apportionment factor for the tax base based on sales, property, and payroll.
- ' A tax rate of 2.35 percent.
- ' A labor intensity deduction which limited total compensation to 65 percent of the gross tax base.
- ' A \$34,000 exemption for firms with business income of \$34,000 or less which was phased out completely at a level of \$51,000 in business income.
- ' An additional exemption of up to \$40,000 for partnerships.
- ' A deduction for the amount of the tax base exceeding 50 percent of gross receipts.
- ' A deduction for all new real property investments made in Michigan (the capital acquisition deduction).
- ' A credit for educational contributions, which was carried over from the corporate income tax.

1. ¹⁵ *Michigan Report*, "New Business Tax Becomes Law; Existing Corporate Taxes Repealed" (Lansing: Gongwer News Service, August 27, 1975).

¹⁶ Advisory Commission on Intergovernmental Relations, 4.

- ' A 5 percent credit for state property taxes paid by certain utilities.
- ' A credit for property taxes paid by farmers who agree to preserve their farmland, which was carried over from the corporate income tax.
- ' Payments to local units of governments to replace lost revenue from the repeal of the inventory property tax and lost revenue sharing payments from the repeal of the business portion of the intangibles tax.
- ' Provisions granting special treatment for a number of industries.

According to the ACIR report,

These deductions and special exemptions added by the Legislature reduced the yield of the VAT by over \$200 million and required a 0.35 percent increase in the rate and less generous treatment of depreciation on assets acquired prior to enactment of the tax.¹⁷

The SBT became effective January 1, 1976. The State of Michigan shifted its fiscal year during this time so that FY 1975-76 contained 15 months, ending with September 1976. Only two quarters of SBT revenue were collected during FY 1975-76.

¹⁷ Ibid.

CALCULATING SINGLE BUSINESS TAX LIABILITY

This section outlines the major steps in calculating SBT liability. Current provisions of the SBT have been used for the purposes of this section, but the basic mechanics are applicable throughout the tax's history. Only firms with gross receipts over a specified threshold (currently \$350,000) are required to file a return.

Figure 1 summarizes the steps in calculation of SBT liability for a firm. As noted earlier, the SBT is based on the addition method of calculating value added. The starting point for computing the tax base is federal taxable income, which is the tax base for the federal corporate income tax. Additions and subtractions are made to this figure in order to arrive at a more accurate measure of the costs of capital. Compensation costs are then added. The resulting figure represents the firm's total business activity.

Many firms subject to taxation in Michigan also do business in other states. To account for this, a formula is used to apportion a percentage of the total tax base to Michigan. This formula is a weighted average based on the percentages of a firm's sales, property, and payroll located in Michigan. The figure obtained from this formula is called the Michigan (or "apportioned") tax base. A number of deductions from the Michigan tax base are allowed, including the following:

- ' The business loss deduction and
- ' The statutory exemption.

Once the adjusted tax base has been determined, there are four methods by which SBT tax liability can be computed. The most straightforward of these is the application of the standard tax rate (1.9 percent for the year 2003) to the adjusted tax base. Three other methods are available which may be employed by certain firms:

- ' The excess compensation reduction method, under which an eligible firm may deduct a percentage of its labor costs from the adjusted tax base before applying the tax rate;
- ' The gross receipts deduction (or short) method, under which a firm may reduce its tax base to one-half of its gross receipts before applying the tax rate; and
- ' The alternate tax rate method, under which an eligible firm may calculate its tax liability by multiplying its adjusted business income by the alternate tax rate (currently 2.0 percent).

Firms may use whichever method results in the lowest tax liability and/or administrative costs. The resulting tax liability may then be reduced by a number of credits, including the following:

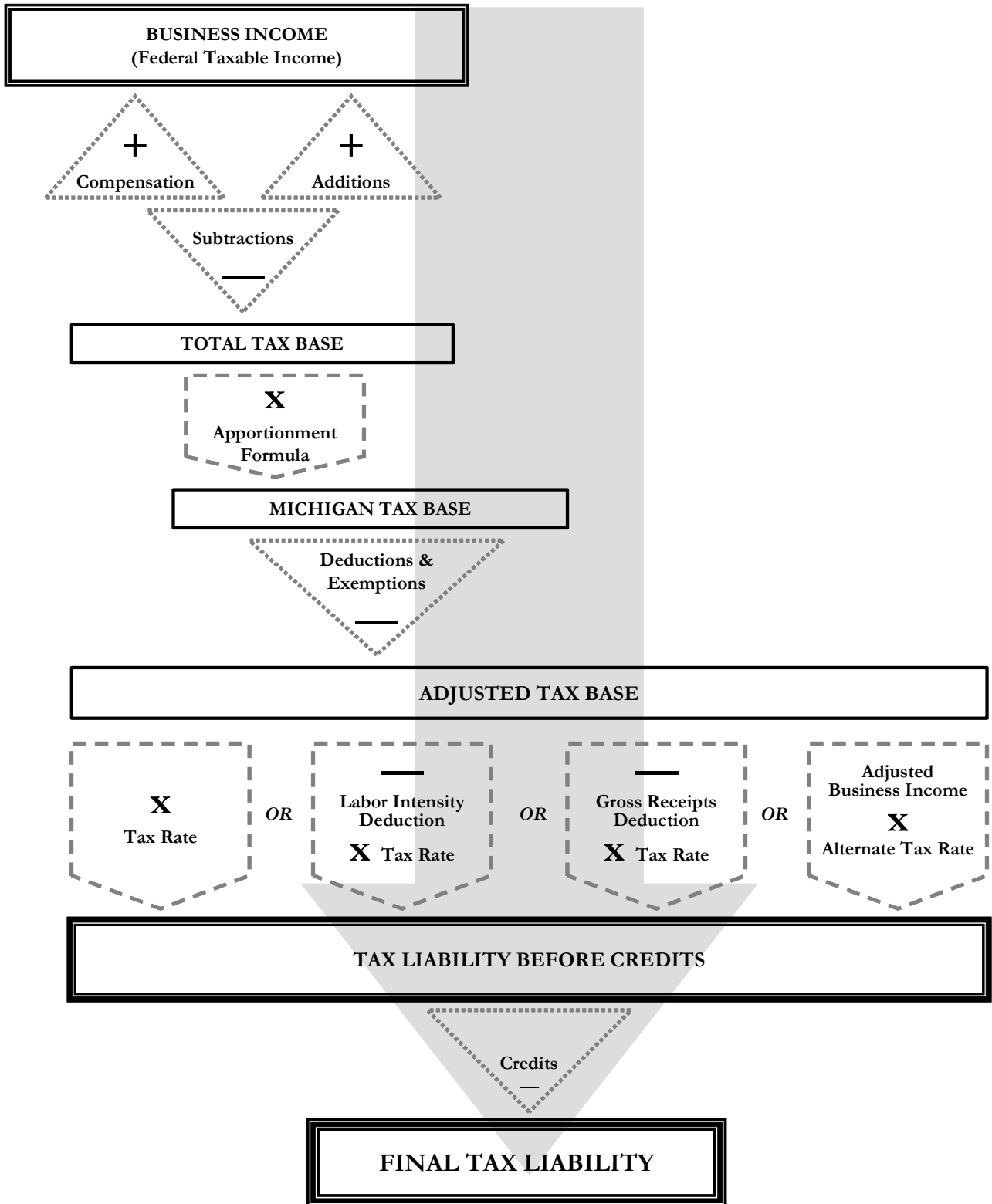
- ' The small business credit,
- ' The unincorporated business credit,

- ' The public utility credit,
- ' The credits awarded by the Michigan Economic Growth Authority, and
- ' The investment tax credit.

As with any tax structure, the difference between a deduction and a credit is important. All things being equal, a tax credit is worth more than a tax deduction because the credit directly reduces tax liability while the deduction merely reduces the tax base. In the case of the SBT, it is also important to note whether an exclusion/exemption/deduction is applied before or after apportionment of the firm's tax base.

Figure 1

CALCULATING SINGLE BUSINESS TAX LIABILITY



SINGLE BUSINESS TAX PROVISIONS / CHANGES

This section details the provisions of the single business tax and describes major changes that have been made to those provisions since the tax was adopted. The provisions are addressed in the order that they are applied in calculating tax liability, except for industry-specific provisions which are discussed at the end of this section.

Gross Receipts Threshold

To lower administrative costs, businesses with gross receipts below a certain level have not been required to file an SBT return. Conversely, a business with gross receipts exceeding the threshold by one dollar must pay taxes on its entire base. Gross receipts are defined by the SBT act as total sales plus rental or lease revenue and are adjusted for the recapture of the capital acquisition deduction.

Originally, the gross receipts threshold was set at \$34,000 for the 1976 tax year and \$36,000 for subsequent years. In 1977 the threshold was increased to \$40,000. It remained at this level until 1991 when it was increased to \$60,000 for tax year 1991 and to \$100,000 for 1992 and subsequent tax years. The threshold was raised again in 1994—it was set at \$137,500 for the 1994 tax year and was raised to \$250,000 beginning in the 1995 tax year. The following argument was advanced in favor of raising the threshold:

Reportedly, some small businesses pay more to tax preparers to figure out their SBT liability than they owe in taxes. The proposal helps the smallest businesses by raising the filing threshold to \$250,000 in gross receipts. Many more very small businesses will no longer have to file returns or pay the tax.¹⁸

In 2002, the gross receipts threshold was increased to \$350,000 effective with the 2003 tax year.

The gross receipts threshold is the first of several features of the SBT which reduce or eliminate tax liability for small, low-profit firms. Other such features include the standard exemption, the alternate tax rate, the small business credit, and the investment tax credit.

Tax Base

According to economic theory, the tax base for a value-added tax has two components: the costs of capital and the costs of labor. Changes to the tax base are presented along this division.

Costs of Capital

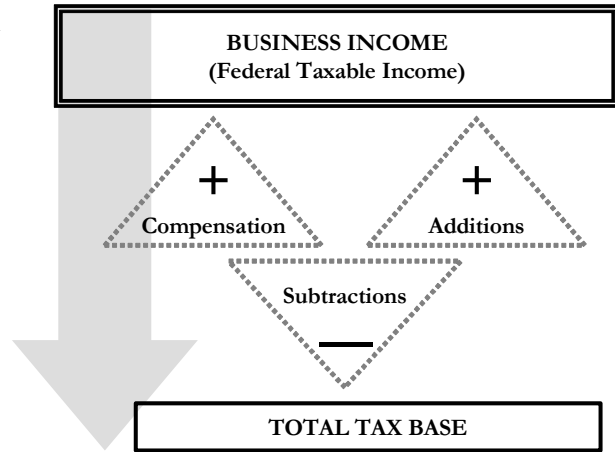
The first component of the costs of capital is profits (referred to as “business income,” which is defined as federal taxable income, in statute). Profits are the returns to investors and therefore can be thought of as the cost of using those investors’ money to purchase machinery, equipment, and other long-term investments.

¹⁸ House Legislative Analysis Section, Analysis of House Bill 4801 et al. (June 14, 1994), 2-3.

Capital can also be acquired by renting or borrowing. A pure VAT would include rent in the base, but rent was not included in the original SBT legislation with the rationale that firms which rent should be treated in the same manner as firms which own their land or equipment.

Interest paid (net of interest received) is included in the tax base. Legislation in 1985, 1989, and 1991, however, provided that auto dealers do not have to include interest paid to maintain inventory which is subsequently repaid to the dealer by a manufacturer. This provision is currently effective indefinitely.

A number of other costs of capital, to the extent that they are not included in federal taxable income, are added into the tax base. These include taxes paid, certain capital gains, depreciation, dividends and royalties paid, and losses carried back or forward.¹⁹ Similarly, certain items included in federal taxable income are deducted, including dividends, interest and royalties received and certain capital losses.



The provisions of the SBT grant exemptions for certain types of royalties. Most recently, royalties paid by television broadcasters, theaters, and film distributors were exempted by legislation in 1993 and 1996, and royalties paid for computer software under a license agreement were exempted in 1998.

By definition, depreciation spreads the cost of capital purchases out over time. Provisions were included in the SBT's original legislation that allowed firms to claim a deduction for depreciation on assets existing prior to January 1, 1976. The ACIR report stated, "This exclusion was allowed to avoid penalizing those firms that made investments prior to January 1, 1976, and were not eligible to obtain the capital acquisition deduction."²⁰ The deduction was equal to 28 percent of pre-1976 depreciation costs for 1976, 50 percent for 1977, and 60 percent for 1978 and subsequent years.

Exclusion of the depreciation costs was one of several transitional provisions in the original legislation which were designed to avoid punishing businesses which made certain decisions prior to the adoption of the SBT. In 1977, however, in order to offset other exemptions added to the SBT, the deduction for depreciation costs on assets acquired prior to 1976 was eliminated.²¹

¹⁹ By definition, federal corporate income taxes paid are included in federal taxable income. Other taxes paid, such as property taxes, are not.

²⁰ Advisory Commission on Intergovernmental Relations, 7.

²¹ House Legislative Analysis Section, Analysis of Senate Bill 734 (January 1, 1978), 1.

Costs of Labor

Originally, the cost of labor included in the SBT's tax base was quite comprehensive. The only excluded costs were employee discounts (although the labor intensity deduction was allowed as part of an alternate filing method). In 1994, however, three exclusions were applied to this part of the tax base:

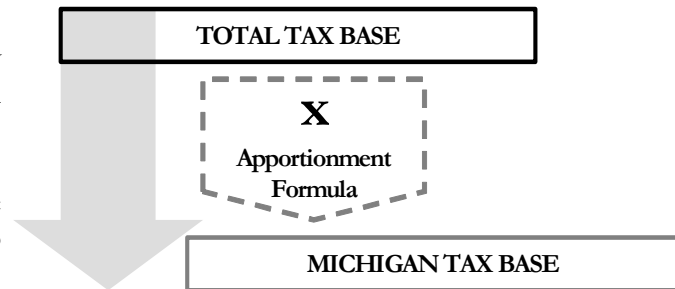
- ' The employer's portion of payments for Social Security and similar social insurance programs,
- ' Payments to state and federal unemployment compensation funds, and
- ' Payments for worker's compensation insurance and Federal Liability Act insurance.

These exclusions were part of a tax cut package designed to avoid exceeding the revenue limit specified in Michigan's Constitution. While the excluded payments represent costs of labor from an economic standpoint, the rationale for their exclusion was to eliminate double taxation since the payments are generally mandatory.²²

Apportionment Formula

Originally, the apportionment formula for the SBT was based equally on property, payroll, and sales; that is, each factor was weighted 33 1/3 percent. This formula had been used under both the corporate income and the business activities taxes.²³ It was retained until the early 1990s.

Legislation in 1991 altered the formula to weight the sales factor more heavily (40 percent) than the property and payroll factors (30 percent each) for 1991 and 1992. For 1993 and subsequent tax years, this legislation provided that the sales factor be weighted 50 percent and the other two factors be weighted 25 percent each.



The following rationale was offered for weighting the sales factor more heavily:

Multistate companies that are headquartered in Michigan . . . but have a relatively low proportion of their sales activity here would benefit, while multistate firms that are principally based elsewhere but exploit Michigan markets would not. This would serve as an inducement for capital-intensive businesses to locate here, while protecting Michigan home-based companies from other states that apportion to themselves a greater part of the companies' business activity.²⁴

²² House Legislative Analysis Section, Analysis of Senate Bill 29 et al. (April 21, 1995), 4.

²³ House Legislative Analysis Section, Analysis of House Bill 4640 (August 12, 1975), 1.

²⁴ Senate Fiscal Agency, Analysis of Senate Bill 69 (June 13, 1991), 6.

In short, the property and payroll tax factors discourage firms from physically locating their operations in Michigan, while the sales factor does not. Increasing the weight of the sales factor, therefore, decreases the tax disadvantage of locating in the state.

Apportionment Formula Weights

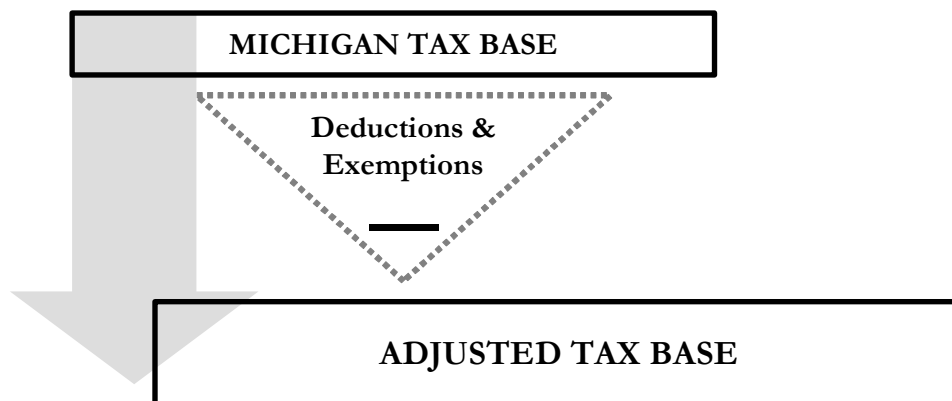
<u>Tax Year</u>	<u>Property</u>	<u>Payroll</u>	<u>Sales</u>
1976 - 1990	33 1/3%	33 1/3%	33 1/3%
1991 - 1992	30%	30%	40%
1993 - 1996	25%	25%	50%
1997 - 1998	10%	10%	80%
1999 -	5%	5%	90%

In 1995, the formula was changed to further increase the weight of the sales factor. For tax years 1997 and 1998, the formula weighted the sales factor 80 percent and the property and payroll factors 10 percent each. Separate legislation set the formula at 90 percent sales, 5 percent property, and 5 percent payroll for tax year 1999 and subsequent years. These acts provided for alternate formulas if the provisions of the capital acquisition deduction were not in effect due to a court challenge.

While the capital acquisition deduction was recently ruled unconstitutional under the interstate commerce clause by the Michigan Court of Claims, the provision calling for an alternate apportionment formula was repealed by 1999 legislation.

Deductions and Exemptions

Firms are allowed a number of deductions and exemptions from the Michigan tax base. The deductions and exemptions presented here begin with those included in the original legislation and proceed in the order in which new provisions have been added to the SBT.



Capital Acquisition Deduction

Deduction of capital expenditures is a feature of a consumption-type VAT. This deduction was a compelling reason for the SBT's adoption since it encourages capital investment. Over the years, though, apportionment of the capital acquisition deduction for multistate firms has been a source of controversy.

It is important to make the distinction between real property and tangible personal property. *Real* property consists of land and buildings, while *tangible* property consists of machinery and equipment. Real property can easily be allocated to the state in which it is located, but tangible property is mobile and therefore presents a difficulty for determining the appropriate size of the deduction.

As the SBT was originally adopted, 100 percent of all investment in real property located in Michigan was deductible, and apportionment of the deduction for tangible property was based on a two-factor formula which weighted equally the payroll and property factors. Intangible personal property, such as financial investments, does not qualify for the deduction. In 1991, the Michigan Court of Claims ruled that the capital acquisition deduction (CAD) was unconstitutional. The rationale for this ruling was that the CAD favored Michigan-only firms over multi-state firms and therefore violated the Commerce Clause of the U.S. Constitution.

Upon appeal, the Court of Appeals ruled that only the apportionment method associated with the CAD was unconstitutional. It therefore held that businesses could continue to claim the CAD, but without apportionment; that is, multistate firms could deduct the costs of capital investment for their entire operation.²⁵

Faced with a potential revenue loss of \$450 million, the Legislature was forced to re-evaluate the apportionment formula for the CAD in 1991.²⁶ Under the new provisions adopted by the Legislature, multi-state firms were required to use the same three-factor apportionment formula for determining the CAD as they used to apportion their tax base. For tax year 1990, equal weight was given to the payroll, property, and sales factors. For 1991 and 1992, the weights were set at 30-30-40, respectively; for 1993 and subsequent years the weights were set at 25-25-50. The apportionment factor applied to all investment, regardless of whether it was located in Michigan. Michigan-only firms continued to deduct all investment costs.

In 1995, the Legislature again re-evaluated the apportionment formula for the CAD. On this occasion, a site-based formula was adopted. That is, real assets are eligible for the CAD only if they are located in Michigan. Treatment of mobile tangible assets was unchanged.

Under the new formula, then, real assets located in Michigan and all mobile tangible assets were subject to the same apportionment formula used for tax base purposes. For tax year 1998 the formula was weighted at 10 percent for payroll, 10 percent for property, and 80 percent for sales; for 1999 the formula was weighted at 5 percent for payroll, 5 percent for property, and 90 percent for sales.

²⁵ The court case was *Caterpillar Corporation v. Department of Treasury*. See Citizens Research Council of Michigan, "The Single Business Tax and the Capital Acquisition Deduction" (March 1991) for a more complete account.

²⁶ Citizens Research Council of Michigan, 1.

As noted earlier, in November 1999 the CAD was ruled unconstitutional for a second time. For tax year 2000 and beyond, though, the CAD has been replaced by an investment tax credit, which will be discussed later in this publication. This change was part of the 1999 legislation which provided for the phase-out of the SBT.

A final note with regard to the CAD: firms must add to their tax base the proceeds from the sale or other disposition of property eligible under the CAD. This addition to the Michigan tax base is referred to as the “recapture” of the CAD and has been incorporated into the SBT’s provisions since the tax’s adoption.

Business Loss Deduction

When a firm’s CAD exceeds its Michigan tax base, the firm may carry forward its negative tax base and claim a business loss deduction in a future tax year. The loss cannot be carried forward more than ten years. This provision has not been altered since the SBT’s adoption.

Statutory Exemption

The standard exemption is available to firms which earned business income lower than a specified level. For the purposes of this provision, compensation and director’s fees of shareholders plus carry-forwards and carry-backs are included in business income. As the SBT was enacted, firms with business income of \$34,000 were allowed an exemption of \$34,000 for the 1976 tax year. This exemption was reduced \$2 for each \$1 that business income exceeded \$34,000 and was phased out entirely at a level of \$51,000. For the 1977 tax year and subsequent years, the amount of the exemption—and the phase-out level—was to increase to \$36,000. Additionally, an exemption of \$10,000 was allowed for each partner or equivalent owner of a partnership or equivalent business organization, up to a maximum of \$40,000 and subject to certain requirements.

In 1977, the exemption for the 1977 tax year and subsequent years was increased to \$40,000. The additional exemption for partnerships, meanwhile, was increased to \$12,000 per partner, up to a maximum of \$48,000.

The amount of the standard exemption remained at \$40,000 until 1988 when it was increased incrementally: to \$41,000 for tax year 1989, to \$42,000 for 1990, to \$43,000 for 1991, to \$44,000 for 1992, and to \$45,000 for 1993 and thereafter. The additional exemption remains at \$12,000 per partner.

Tax Rate

Prior to 1999, the SBT rate had been changed only once. Effective October 1, 1994, the tax rate was lowered from 2.35 percent to 2.3 percent. This rate reduction was prompted by favorable economic conditions which caused the state to approach the constitutional revenue limit.²⁷

Just previous to this rate reduction, the voters of Michigan approved the school finance plan contained in Proposal A of 1994. Had this proposal been rejected, the SBT rate would have been increased to 2.75 percent as part of the alternate school finance plan.

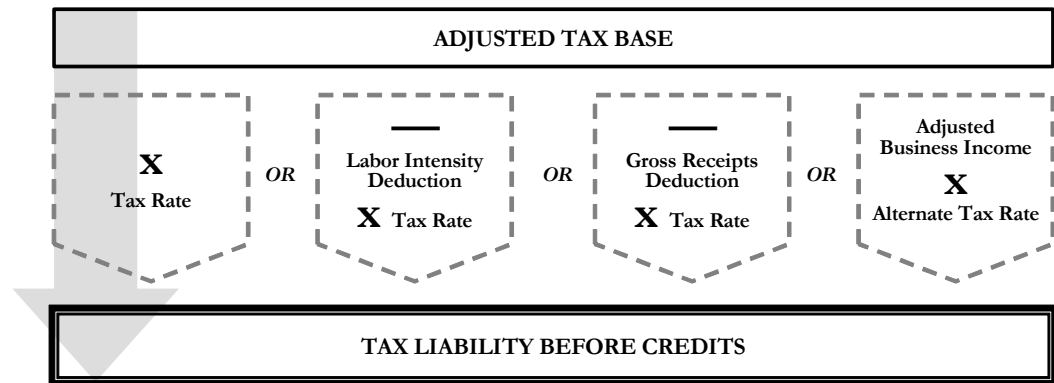
²⁷ House Legislative Analysis Section, Analysis of House Bill 4801 et al. (June 14, 1994), 1-2.

Legislation in 1999 initiated a phase-out of the SBT. This legislation provided that, retroactive to January 1, 1999, the tax rate was to be lowered by 0.1 percent annually. The rate reduction is effective each January 1 only if the ending balance of the Budget Stabilization Fund (BSF) for the prior fiscal year exceeds \$250 million. In FYs 2001-02 and 2002-03, the BSF's year-end balance has been less than \$250 million (the FY 2003-04 balance is expected to be \$0). The tax rate has been frozen at 1.9 percent, therefore, for tax years 2003 and 2004. The annual 0.1 percent rate reduction will resume when and if the BSF balance is restored to a level of at least \$250 million.

Legislation enacted in 2002 will repeal the SBT in 2010, regardless of what the tax rate is at that time.

Alternate Filing Methods

There are currently three alternate filing methods. Qualified businesses can opt to use one (and only one) of these methods for calculating tax liability if it reduces their liability and/or administrative costs. Two of these methods—the labor intensity deduction and the gross receipts deduction—were included in the original provisions of the SBT. The third method, the alternate tax rate, has been added since the tax's adoption.



*Labor Intensity Deduction*²⁸

In response to concerns that the SBT would place an excessive burden on labor, a deduction was included to offer relief to labor-intensive businesses. Originally, businesses were allowed to deduct any labor costs which exceeded 65 percent of their total tax base. For example, a business for which labor costs made up 85 percent of its tax base would have been allowed a deduction equal to 20 percent of its tax base.

In 1977, these provisions were changed to set the critical percentage at 63 percent, and the percentage remains at that level today. While the labor intensity deduction itself is based on the *total* tax base, the maximum deduction that can be claimed is equal to 37 percent of the *adjusted* tax base.

Gross Receipts Deduction

A deduction equal to the amount that the adjusted tax base exceeds 50 percent of gross receipts is allowed. In other words, firms may compute their tax base by simply multiplying their gross receipts by 50 percent. This method is also called the short method since it allows firms to bypass the standard process of computing tax liability. The deduction as included in the original legislation remains effective today.

²⁸ This provision is also referred to as the "excess compensation reduction."

Alternate Tax Rate

In 1988, an alternative tax for small, low-profit firms was established. Beginning in 1989, businesses eligible for the small business tax credit (see below) were allowed to compute their tax liability by multiplying adjusted business income by the alternate tax rate of 4 percent.²⁹ For eligible firms, then, the SBT was replaced with a tax on profits.

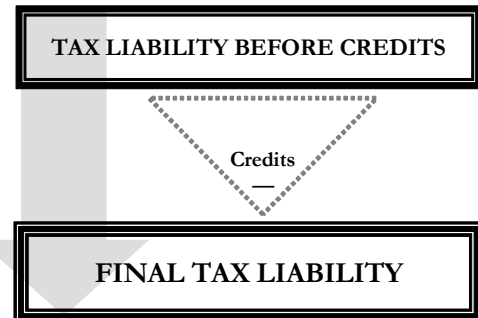
A legislative analysis of the 1988 bill offered the following rationale for the alternate tax rate:

The value-added nature of the SBT and its complicated computations have long been criticized by businesses, especially small businesses, as unfair and discouraging. . . . The bill . . . would eliminate or alleviate many of the complaints expressed about the tax. It would make computation of the tax much simpler for many taxpayers, and assure that businesses that didn't make a profit paid no taxes on losses. This would make small businesses more competitive, and ensure that businesses in their start-up years had a greater chance of success; that is, it would let firms reach a stage of profitability before they had to pay the SBT.³⁰

In 1992, the alternate tax rate was decreased to 3 percent, beginning with tax year 1992, and in 1994 the alternate rate was lowered even further to its current level of 2 percent effective October 1, 1994. The current rate is only slightly higher than the 2002 standard rate at 1.9 percent, which is levied on a much broader tax base.

Tax Credits

When the SBT was adopted in 1975, only two tax credits were included in its provisions.³¹ Since then, the number of credits available has greatly expanded. In particular, a number of credits aimed at economic development have been created over the last decade and a half. All of the SBT's credits are presented below in the order in which they were originally adopted.



Higher Education/ Public Contributions Credit

This tax credit was originally created in 1968 as part of the corporate income tax. Incorporated into the SBT in 1975, the credit is equal to 50 percent of a contribution to an institution of higher learning or public library within Michigan. The maximum credit allowed is the lesser of 5 percent of tax liability before credits or \$5,000. The original legislation specified that for tax years 1974 to 1980, a credit could also be claimed for a contribution to a nonprofit organization whose purpose was to benefit institutions of higher learning.

In 1980, public broadcast stations were added to the list of eligible recipients, and the cutoff dates in the original legislation were removed.

²⁹ Adjusted business income is equal to business income plus the compensation and director's fees of the officers and shareholders of a corporation plus carryforwards and carrybacks.

³⁰ Senate Fiscal Agency, Analysis of Senate Bill 878 (February 27, 1989), 2-3.

³¹ One of these credits, the utility property tax credit, is discussed later in this report since it is an industry-specific provision.

Unincorporated Business Credit

Adoption of the SBT was accompanied by the creation of an income tax credit based on SBT liability. This credit was designed to alleviate double taxation of unincorporated businesses. In 1977, this credit was transferred to the provisions of the SBT. The credit remains effective today and is computed as follows:

<u>If business income is:</u>	<u>The credit is:</u>
\$20,000 or less	20% of SBT liability
more than \$20,000, but less than \$40,000	15% of SBT liability
\$40,000 or more	10% of SBT liability

Small Business Credit

In 1977, a tax credit for small business was added to the SBT's provisions. To be eligible to claim this credit, a business had to meet several requirements:

- ' The business's gross receipts could not exceed \$3 million.
- ' The business's adjusted business income could not exceed \$300,000.
- ' Compensation and director's fees of any one shareholder or officer, subject to an addition based on business income, could not exceed \$60,000.

An eligible business was allowed a percentage reduction in tax liability equal to 100 percent minus the percentage computed by dividing adjusted business income by 45 percent of the tax base. If gross receipts exceeded \$2 million, the credit was gradually reduced until it was completely phased out at a level of \$3 million gross in receipts. Finally, the credit could not exceed 50 percent of tax liability.

A number of changes have been made to the provisions of the small business credit since its creation:

- ' The gross receipts limit has been increased several times and has been set at \$10 million since 1992.
- ' The adjusted business income limit was set at its current level of \$475,000 beginning in 1985. Legislation passed in 1990 allowed a business to use negative adjusted business income from any of the previous five tax years in determining eligibility for the credit.
- ' The limit on the compensation of any one shareholder or officer has been increased on several occasions. The current \$95,000 limit became effective in 1985. Legislation in 1995 allowed for an incremental phase out of the credit between \$95,000 and \$115,000 of compensation.

If the gross receipts of a business exceed \$9 million, the credit is gradually reduced until it is completely phased out at a level of \$10 million. The provision limiting the credit to 50 percent of tax liability was altered in 1982, increasing the limit to 90 percent.³² The limit was eliminated entirely in 1988.

Since 1988, the provisions establishing eligibility for the alternate tax rate and the small business credit have been the same. A taxpayer may utilize only one of these provisions.

Child Care Credit

In 1980, a tax credit was created equal to \$45 for every 2,000 hours of child care services provided by an employer for a child under 14 years of age. This credit could only be claimed if the employer did not charge the employee for the services and was effective for the 1981 and 1982 tax years only.

Summer Youth Employee Credit

This tax credit was created in 1983 and was effective only between May 1 and September 15 of that year. The credit was a supplement to the federal Targeted Jobs Tax Credit and was equal to 15 percent of the wages paid to a summer youth employee whose family had income less than a maximum amount corresponding to the size of the family.

Supplemental Workers Compensation Credit

As part of a 1984 package designed to ensure the continued payment of supplemental workers compensation benefits, legislation was adopted which allowed employers and insurance carriers to claim a credit against the SBT equal to the amount paid in supplemental benefits to individuals injured between September 1965 and December 1979.

Enterprise Zone Credit

In 1985, the Legislature created the first state economic development tool which utilized an SBT credit: enterprise zones. These zones were first proposed by President Ronald Reagan, but rather than being adopted at the federal level, they were instead adopted by a number of states. They were intended to “encourage business to locate and expand in areas characterized by high unemployment, low income, high property tax rates, and blighted residential, commercial, and industrial property.”³³

Within an enterprise zone, businesses were exempt from property and sales taxes. Additionally, an SBT credit could be claimed equal to total tax liability multiplied by the percentage of a business’s total statewide property located in the zone. These benefits were to be effective for ten years following the certification of a qualified business.

The only city which qualified for designation as an enterprise zone in 1985 was Benton Harbor. The Benton Harbor Enterprise Zone program ceased to enlist new business after December 31, 1996.

³² The 1982 legislation contained a number of changes which expanded the small business credit. These changes were originally tied to a requirement that SBT revenue increase by \$25 million between fiscal year 1982 and 1983, but this requirement was eliminated by 1983 legislation.

³³ Senate Analysis Section, Analysis of Senate Bill 95 et al. (March 4, 1986), 1.

Minority Venture Capital Credit

Under 1986 legislation, taxpayers may claim a credit equal to 50 percent of the amount they invest in minority venture capital companies and minority enterprise small business investment companies certified under the Michigan Strategic Fund Act.

High Technology Activity Credit

This tax credit was created in 1986. To be eligible for the credit, a firm had to be located in a "central city," as defined by a set of requirements related to population, the poverty rate, property valuation, and the unemployment rate.

An eligible firm could claim a credit equal to the firm's tax liability multiplied by the average of the percentage of its Michigan property used for high technology activity and the percentage of its Michigan payroll devoted to high technology activity. The last year for which the Department of Treasury could issue a certificate qualifying a firm for the credit was 1991. The certificates were effective for ten years.

Community Foundation/Homeless Shelter Credits

A tax credit for contributions to community foundations was created in 1988. Community foundations are organizations which attract contributions to support charitable activities within a specific geographic area and meet certain other requirements. The provisions of this credit are the same as those for the higher education contribution credit; the credit is equal to 50 percent of the amount of the contribution with a maximum credit of \$5,000 or 5 percent of SBT liability before credits, whichever is less. This credit was originally available only through the 1991 tax year, but was subsequently extended on three occasions and is currently effective indefinitely.

In 1991, an additional credit with the same provisions was added for contributions to homeless shelters, food kitchens, food banks, and similar organizations. Originally effective through 1994, this credit was extended on two occasions and is currently effective indefinitely.³⁴

Michigan Economic Growth Authority Credit

In 1995, the Legislature created the Michigan Economic Growth Authority (MEGA) and gave it the authority to offer tax credits against the SBT for up to 20 years to businesses which agree to locate or expand their operations in Michigan and meet certain other requirements. This credit may not exceed the amount of payroll attributable to the jobs created under the agreement, and if the credit exceeds tax liability, the difference must be refunded to the taxpayer. An authorized business may also claim a tax credit equal to the tax liability resulting from the new business activity specified in the agreement.

Originally, the credit was available only to businesses which had been approved by December 31, 1996, but this deadline was extended to December 31, 1999, in 1996 and to December 31, 2003, in 1999.

³⁴ Total credits available under both the community foundation credit and the homeless shelter credit were originally capped; the caps have subsequently been eliminated.

In 2000, eligibility for a credit was extended to high technology firms, as well as firms meeting certain criteria regarding capital investment and job retention (as opposed to job creation) in the state.³⁵ Also in 2000, provisions of the credit were amended to require repayment of the credit if 51 percent or more of the jobs created by the taxpayer are removed from the state within three years of the first year in which the credit is claimed.

Temporary Credit

As part of the 1995 legislation which altered the apportionment of the CAD, a temporary credit was created for tax years 1997, 1998, and 1999. This credit is equal to the difference between a company's tax liability using the new CAD and the tax liability using the old CAD, minus \$5 million. Essentially, this credit limits the tax increase attributable to changes in the CAD to \$5 million.

Brownfield Zone Credit

As part of a package of bills designed to spur redevelopment of contaminated industrial sites (brownfields), a tax credit was created in 1996 for firms that developed property deemed eligible by the Brownfield Redevelopment Board. The credit is equal to 10 percent of the cost of the investment in a given tax year. If this amount exceeds total tax liability, the excess is to be carried forward for up to ten years. The credit was made available for tax years 1997 through 2000. A firm was limited to a maximum of \$1 million in total credits for all tax years.

The effective time period for credits to be awarded was extended through tax year 2002 by legislation enacted in 2000. This legislation also increased the maximum credit amount to \$30 million, with a maximum of 15 credits exceeding \$1 million allowed in a given calendar year. Among other changes to the provisions of the credit, the credit was made available for projects in certain specified core communities and a new approval process was instituted for credits exceeding \$10 million. In 2002, legislation was enacted to make new credits available through 2007, rather than 2002.

Renaissance Zone Credit

Legislation passed in 1996 allowed for creation of renaissance zones. To encourage economic growth in depressed areas, businesses and individuals within these zones are exempt from most state taxes for 10 to 15 years, depending on the zone.

Separate legislation in 1996 authorized the single business tax credit that businesses located in these zones are eligible to claim. The credit is determined by multiplying total tax liability by that percentage of the total property value of the business in the state which is located in the renaissance zone.

Apprenticeship Credit

The last of three SBT credits to be enacted in 1996 was the apprenticeship credit. This credit was proposed by Governor Engler in his 1996 State of the State address with the goal of increasing the number of skilled workers in the state.³⁶

³⁵ A legislative analysis of the relevant bills stated, regarding the investment and job retention provisions, "This is understood to apply to a new General Motors plant." (House Legislative Analysis Section, Analysis of House Bill 4400 et al. [July 10, 2000], 9)

³⁶ Senate Fiscal Agency, Analysis of Senate Bill 872 (January 15, 1997), 1.

To qualify for the credit, a business must hire an apprentice at least 16 years old but under 20 years old who has not yet obtained a high school diploma but is currently pursuing such a diploma. Additionally, the business must register with the U.S. Department of Labor and employ the apprentice for a minimum of 4,000 hours.

The credit is equal to 50 percent of compensation paid to the apprentice plus 100 percent of instructional costs; the business is responsible for the costs of tuition, fees, and books for college level courses taken while the apprentice is enrolled in high school. The maximum credit is \$2,000 per apprentice per year. Originally set to expire on January 1, 2000, the credit was extended indefinitely in 1999.

Historic Restoration Credit

In 1998, a credit was created equal to 25 percent of the cost of rehabilitating a historic site or place. To qualify, the site must be certified by the Michigan Historical Center. Additionally, if the taxpayer is qualified for the federal rehabilitation tax credit, which is equal to 20 percent of the restoration costs, that credit must first be claimed. The amount of the state credit is then reduced by the amount of the federal credit.

Provisions were also included that require a portion of the credit to be remitted to the state if the qualified historical resource is sold within five years of the credit being claimed. Legislation enacted in 2000 eliminated the sunset of the credit following tax year 2000—as provided for in the original legislation—requiring instead that a rehabilitation plan be certified by January 1, 2003, to qualify for the credit.

Investment Tax Credit

The 1999 legislation which provided for the phase-out of the SBT and eliminated the CAD also provided for an investment tax credit (ITC). This credit was effective beginning with tax year 2000 and is determined by multiplying the amount a firm invests in tangible assets in Michigan by a percentage equal to 0.85 percent times the current tax rate divided by 2.3 percent.

The ITC was designed as a revenue-neutral replacement for the CAD; over time, the amount of the credit is unaffected by the annual reductions in the tax rate. Legislation enacted in March 2000 increased the credit for firms with adjusted gross receipts of \$5 million or less.³⁷ Under the new provisions, the amount of the credit is calculated by multiplying the amount a firm invests in tangible assets in Michigan by the percentage from the table below and dividing by 2.3 percent.

<u>Adjusted Gross Receipts</u>	<u>Percent</u>
\$1 million or less	2.30
More than \$1 million, but \$2.5 million or less	1.50
More than \$2.5 million, but \$5 million or less	1.00
More than \$5 million	0.85

³⁷ Adjusted gross receipts means gross receipts plus recapture of the capital acquisition deduction.

Industry-Specific Provisions

To this point, the SBT's provisions have been presented under the assumption that a given firm does not qualify for any industry-specific provisions. A number of industries received special treatment under the original legislation, however, and additional provisions have been adopted since 1975.

Nonprofit and Governmental Organizations

One of the premises on which value-added taxation is based is the "benefits received" principle; that is, business activity is a good measure of the government services a business uses. Based on this argument, any organization which utilizes government services should be subject to the SBT.

Nonprofit and governmental organizations, however, have never been subject to the tax. Nonprofit organizations have been exempted because they are thought to provide services which serve society as a whole, while governmental organizations have been exempted to avoid the circular process of government taxing itself.

Financial Organizations

As adopted in 1975, the SBT reversed the treatment of interest in the case of financial organizations based on the following rationale:

For a nonprofit financial firm interest paid is included in value added because it is a payment to capital, but for a financial institution interest paid is similar to the cost of goods sold, which is not a part of value added. The additive approach allows the treatment of interest to be reversed; that is, interest paid is deducted from the base and interest received is added to the base.³⁸

The original legislation also included an apportionment formula specifically designed for financial organizations. For a multistate financial organization, the Michigan tax base is determined by dividing gross business in Michigan by total gross business. The term "gross business" is defined as the total of the following:

- ' Fees, commissions, or other compensation for financial services;
- ' Gross profits from trading in stocks, bonds, or other securities;
- ' Interest charged to customers for carrying debit balances of margin accounts — without deduction of any costs incurred in carrying the accounts;
- ' Interest and dividends received; and
- ' Any other gross income resulting from operation as a financial organization.

³⁸ Advisory Commission on Intergovernmental Relations, 6-7.

Insurers

Like financial organizations, insurers have had several special provisions incorporated into the provisions of the SBT. The original legislation included an alternate apportionment formula for insurers whereby the tax base is determined by dividing the gross insurance premiums received in Michigan by total gross insurance premiums. Several adjustments to the tax base, including exemption of insurance sales commissions from the payroll portion of the tax base, were also included in the original provisions.

In 1987, the method of taxing insurers was completely altered. Under the new provisions, the tax base of an insurer is equal to 25 percent of the insurer's gross receipts (with several adjustments), as apportioned under the original formula. Insurers were also subjected to a surcharge equal to 70 percent of tax liability for the period August 3, 1987, to September 30, 1987, and 126 percent of tax liability for the 1988 and subsequent tax years. Currently, the tax on insurers is equal to 1.30 percent (25 percent times the tax rate of 2.30 percent times 226 percent) of adjusted receipts.

The 1987 provisions also allowed a credit—not to exceed 56 percent of tax liability—for the amount paid to certain insurance associations and placement facilities and exemption of the first \$130 million of disability insurance premiums (increased to the first \$162.5 million in 1992).³⁹ This exemption is reduced by \$2 for each \$1 by which an insurer's gross premiums exceed \$180 million.

The 1987 legislation required deposit of revenue collected from insurers in excess of specified amounts for fiscal years 1988 and 1989 into the Insurance Policy Holder Protection Fund. These funds were to be used to reduce the assessments of the members of the Life and Health Guaranty Association and the Property and Casualty Guaranty Association.

The 1987 legislation also altered the treatment of foreign (out-of-state) insurers. Previously, these insurers had been subject to a premiums tax. This tax was repealed, and a similar retaliatory tax was incorporated into the provisions of the SBT. In 1990, the credit for payments made to qualified associations and placement facilities was set at 40.366 percent of the normal calculation for the 1989 tax year only.

Transportation Companies

Transportation companies were also subjected to an alternate apportionment formula under the original provisions of the SBT. A multistate transportation company's tax base is determined by dividing the number of revenue miles in Michigan by total revenue miles. A "revenue mile" is the transportation of one net ton in weight or one passenger the distance of one mile. In the case of a company which transports both property and passengers, the percentages are to be computed separately and then weighted based on the amount of gross receipts from the two activities.

For tax years before 1978, the tax base was to be further reduced by 70 percent, with the requirement that tax liability not be less than the average tax liability faced under the pre-SBT set of taxes over the period of 1971 to 1975. This reduction was decreased and extended by 1977 legislation. Through tax year 1979, the reduction was 70 percent; for tax years 1980 and 1981 it was 30 percent, and for tax year 1982 it was 10 percent.

³⁹ Limits on the total amount of credits claimed by all insurers were also specified.

The original SBT provisions included yet another apportionment formula for companies engaged in the transportation of oil by pipeline. This formula is similar to that for other transportation companies, but is based on cubic feet miles of oil transported.

Utilities

The original provisions of the SBT allowed a credit equal to 5 percent of utility property tax paid. The only change made to this credit was 1977 legislation which eliminated provisions allowing utilities with net operating losses to claim the credit, effective at the end of 1982.

Agriculture

Adoption of the SBT was accompanied by an amendment to the Farmland and Open Space Preservation Act to allow a tax credit equal to the amount by which property taxes paid by a corporate owner of farmland exceed 7 percent of the taxpayer's adjusted tax base. This credit applies only to taxpayers signing development rights agreements and was originally created in 1974 under the corporate income tax.

In 1977, the production of agricultural goods was exempted from the SBT due to the "widespread feeling that farming is excessively burdened by local property taxation."⁴⁰ Legislation enacted in 1978 allows farmers to claim the farmland and open space preservation tax credit even if they face no SBT liability.

Exemption for Certain Retailers

In 1995, provisions were added which exempted a retailer meeting certain requirements from the site-based capital acquisition deduction; a qualified retailer could continue to use the provision in effect prior to the changes made in 1995. The only retailer meeting the requirements was Meijer, Inc.⁴¹ In 1998, the provisions were altered, allowing the K-Mart Corporation to also qualify for the exemption.⁴²

Pharmaceutical Companies

In 2002, a credit was created for pharmaceutical companies meeting certain criteria. It was expected that Pfizer, Inc., after taking over Pharmacia Corporation, would be the only company to qualify.⁴³ The credit is based on qualified research expenses related to the company's pharmaceutical-based business activity and is capped at \$10 million per year. Subsequent to enactment of the authorizing legislation, Pfizer declined to take the credit.

A comment made a relatively short time after the SBT's adoption could also be made today:

An ideal consumption-type VAT would require all organizations engaged in production to be taxed on their value added (minus capital expenditures). An account of the SBT's structural details is mainly an account of departures from this simple principle.⁴⁴

⁴⁰ Barlow and Connell, 704.

⁴¹ House Legislative Analysis Section, Analysis of House Bill 4359 et al. (March 7, 1996), 5.

⁴² House Legislative Analysis Section, Analysis of House Bill 5796 (June 4, 1998), 1.

⁴³ House Legislative Analysis Section, Analysis of House Bill 6073 and Senate Bill 1315 (October 21, 2002), 2.

⁴⁴ Barlow and Connell, 679.

As illustrated in this section, changes to the SBT over the last three decades have created additional differences between the SBT and a pure VAT. Changes detailed in this section are those with the most significant revenue and policy implications. There have been numerous other technical, clarifying, and administrative changes.

SINGLE BUSINESS TAX REVENUE COLLECTIONS

Perhaps the most persuasive argument in favor of the SBT's adoption was its revenue stability as compared to the corporate income tax. A legislative analysis of the original legislation identified the following line of thinking:

[Proponents of the SBT] contend that the lack of stability in revenue production by the present tax structure tends to produce tremendous pressures toward ever increasing taxes because of the need to raise taxes to make up revenue shortfalls during recessionary periods. The pressure is further increased because these new taxes generate more surplus revenues during the next boom period. These large surpluses are often translated into new programs which, in turn, tend to create larger revenue shortfalls during the next recessionary period. These persons contend that stabilizing business tax revenues will help to break the vicious circle sometimes referred to as the "spend-tax" syndrome.⁴⁵

Since business activity is likely to decrease much less than profits on a percentage basis during a recession, it was thought that the SBT would provide a more level stream of revenue which would help to guard against the so-called "spend-tax" syndrome. The relative stability of SBT collections will be discussed below.

First, however, the relative instability of the corporate income tax should be examined. **Figure 2** depicts net corporate income tax collections (gross collections minus refunds) in both actual and real terms over the nine fiscal years the tax was levied.⁴⁶ The graph shows two peaks, each followed by a substantial downturn. (The 1972 upturn was a result of an increase in the tax rate from 5.6 percent to 7.8 percent.) The second downturn was particularly severe. Between fiscal years 1973 and 1975, net collections fell 34.1 percent.

Figure 3 presents net SBT collections (collections minus refunds) over time. As evidenced in the graph, while actual SBT collections have generally increased over time, real SBT collections have remained relatively flat, although decreasing somewhat during the last three recessions—the first in the early 1980s, the second in the early 1990s, and the third in 2001.

The question that remains is how stable a source of revenue the SBT has been as compared to a corporate income tax. A conceptually useful measure of this stability is the corporate income tax rate that would be necessary to raise the same amount of revenue the SBT has raised each year. **Figure 4** presents this equivalent corporate income tax rate for fiscal years 1977 to 1999 (the necessary data is unavailable for fiscal year 1986). This rate is equal to total SBT liability divided by total federal taxable income.

⁴⁵ House Legislative Analysis Section, Analysis of House Bill 4640 (August 12, 1975), 1.

⁴⁶ See House Fiscal Agency, *The Income Tax*, (April 1999), Appendix A for the actual revenue figures.

Figure 2

Net Corporate Income Tax Collections

Millions of Dollars

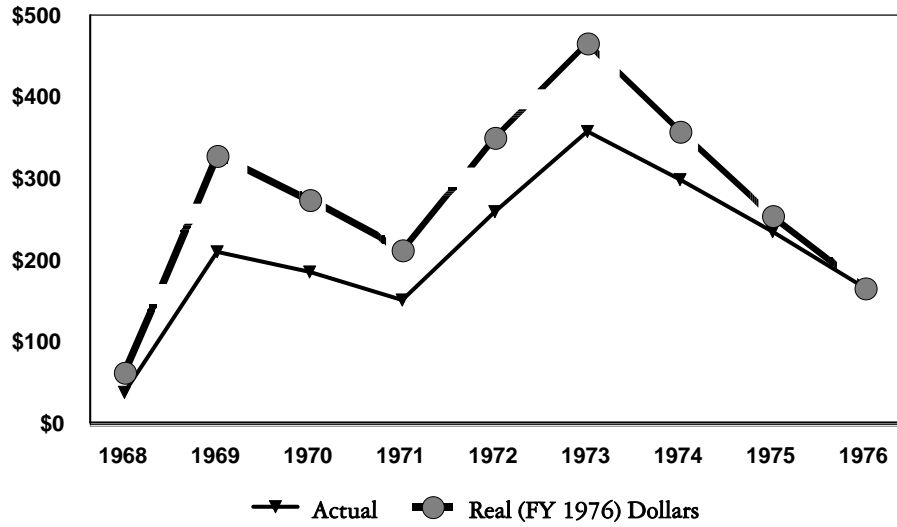
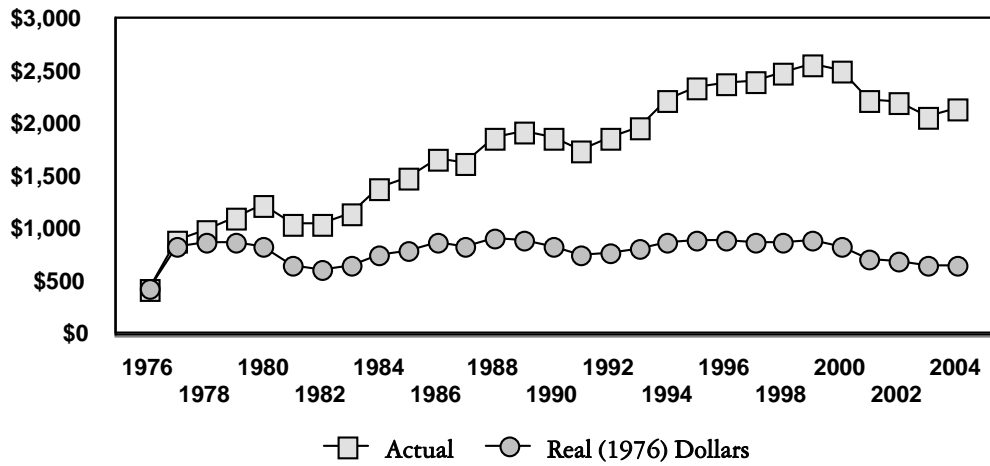


Figure 3

Net SBT Collections

Millions of Dollars

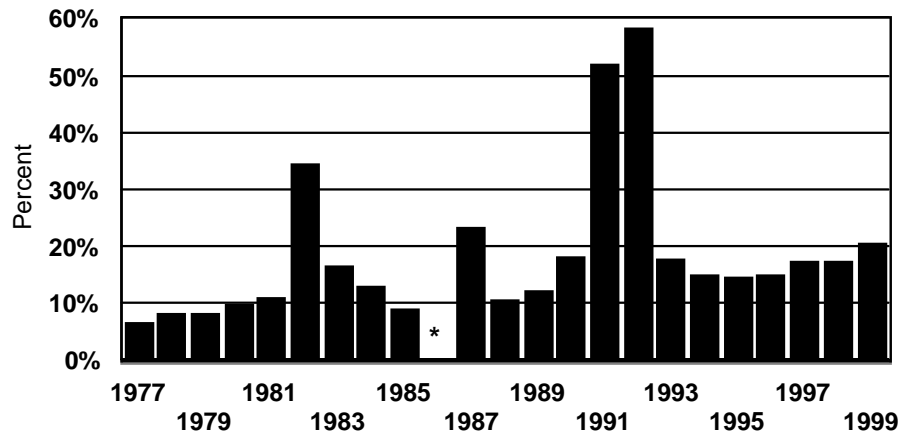


Sources: 1976 through 2002 from various Michigan Comprehensive Annual Financial Reports; 2003 and 2004 are estimates from October 2003 Consensus Revenue Estimating Conference

According to the Michigan Department of Treasury, the average equivalent rate for a corporate income tax over this time period was 14.8 percent.⁴⁷ As illustrated by the graph, though, the equivalent rate has fluctuated a great deal around this average. Of particular note are the high rates that would have been necessary during the recession years of 1982, 1991, and 1992. Under a corporate income tax, then, revenue collections would have dropped off much more dramatically than they did under the SBT.

In comparing the SBT to corporate income taxes in the nearby states of Ohio and Illinois, Gerald Miller found that the SBT was a more stable source of revenue during the recession of the early 1980s than were the corporate income taxes of those two states. He offered the following explanation: “The base of the corporate income tax (profits) is more volatile, whereas the base of the VAT is more diversified and, therefore, stable.”⁴⁸

Figure 4
Equivalent Corporate Income Tax Rate



* No data available for 1986

⁴⁷ Office of Revenue and Tax Analysis, Michigan Department of Treasury, *The Michigan Single Business Tax: 1999-2000* (August 2003).

⁴⁸ Gerald H. Miller, “Virtues of a State Value-Added Tax” in Steven D. Gold, Ed., *The Unfinished Agenda for State Tax Reform* (Denver: National Conference of State Legislatures, 1988), 229.

DISTRIBUTION OF TAX COLLECTIONS

Historically, most Michigan taxes have had some portion of their revenue dedicated to specific purposes. Throughout most of its history, the SBT was no exception. Until 1996, a portion of SBT collections were used for revenue sharing payments to local units of governments.

One of the taxes replaced by the SBT was the inventory portion of the general property tax levied by local governments. To replace this lost revenue, the SBT legislation provided for revenue sharing payments to be made to counties, cities, villages, and townships from SBT collections. These payments were based on the 1975 taxable value of inventory property in each governmental unit.

To estimate how much revenue would have been collected under the inventory property tax, each unit's taxable value was to be multiplied by the current millage rate. (For example, in 1977 the 1975 taxable value figure was multiplied by the 1977 millage rate.) For fiscal year 1978, an additional 5 percent of this amount was to be paid to local units based on the relative tax effort formula then in effect through the State Revenue Sharing Act to account for growth in the taxable value of inventory. For fiscal year 1979 and subsequent years, the growth rate was to be determined by fixing the percentage of SBT collections paid to local units at the level for the period of July 1, 1976, to June 30, 1977.

The original SBT legislation also provided for payments to cities, villages, and townships to replace revenue sharing payments lost by repeal of the business portion of the intangibles tax. These payments were based on the relative tax effort formula with total payments set at \$35 million for fiscal years 1976 and 1977. For fiscal year 1978 and subsequent years, total payments were set at a fixed percentage of gross SBT collections. This percentage was determined by dividing \$40 million by the total SBT collections for the period July 1, 1976, to June 30, 1977.

Payments based on the relative tax effort formula were reduced three times in the early 1990s:

- ' Reduced by \$11,775,000 for fiscal year 1993 (1992 legislation),
- ' Reduced by \$6,863,000 for fiscal year 1994 (1993 legislation), and
- ' Reduced by \$6,863,000 for fiscal year 1995 (1994 legislation).

Also in 1994, however, relative tax effort payments were increased by an amount equal to 0.53 percent of gross SBT collections (for the 12-month period ending with the June preceding the payment), beginning in 1996.

In 1995, the amount of payments made under the relative tax effort formula was redefined. Total payments were set at 13.91 percent of gross SBT collections, and the payments were to be reduced by \$16 million for fiscal year 1996.

In 1996, legislation was enacted that ended all revenue sharing payments made from SBT collections and income tax collections—replacing this funding at a reduced level with a statutory earmarking of sales tax revenue effective with fiscal year 1997. Inventory replacement payments continued, but were made from sales tax revenue.

Throughout the SBT's history, any revenue not designated as revenue sharing payments has gone to General Fund/General Purpose (GF/GP). Currently, 100 percent of SBT revenue is dedicated to GF/GP.

Although the SBT, which generates 23 percent of GF/GP revenue, will be repealed for tax years beginning after December 31, 2009, discussion of business taxation will persist. As future business tax decisions are made, the three major types of business taxes—value added, net income/profit, and gross receipts—will be compared.

- ' *Value Added Tax*

Value added taxes are based on the economic activity or the value that businesses add to the production of goods and services. The tax base is final sales less the cost of goods sold or the cost of materials used as inputs. The SBT is a modified VAT.

- ' *Net Income/Profits Based Tax*

Net income or profits-based taxes, which are levied in 44 states, are equal to total revenue less business expenses or total costs. Deductible business expenses include such items as cost of materials, labor, interest, rent, and depreciation. The principal argument for corporate income taxes, as opposed to other business taxes, centers around the idea that only businesses that make a profit should have to pay a business tax.

- ' *Gross Receipts Tax*

Gross receipts taxes, which are levied in only a few states, are based on gross receipts, total revenue, or gross volume of sales. Gross receipts taxes make no adjustment for or subtraction of the cost of materials used. Because materials produced by one business may be purchased for use by another business, the amount of tax tends to be compounded (i.e., the potential exists for the same item/purchase to be taxed multiple times) in this type of taxation.

In Michigan, the rationale for adopting the SBT (a modified VAT) stemmed from three main points. The first is the benefits received principle: because all businesses benefit from government services, all businesses should remit a business tax. The second is that whereas corporate income taxes are levied only on corporations, VATs are levied on all types of businesses (including sole proprietorships, partnerships, and limited liability companies) regardless of organizational structure. The third point is revenue stability: the base of VATs, which consists mainly of compensation, is broad and fairly stable.

To generate an amount of revenue similar to that generated by the SBT, multiple business taxes (the SBT replaced seven business taxes) or a relatively high corporate income tax rate would be required. An average equivalent rate for a corporate income tax to replace the SBT would be 14.8 percent; however, this rate could be lower if other business taxes were imposed along with the corporate income tax to obtain the same amount of revenue generated by the SBT.

Eliminating the SBT and implementing a new business tax, such as a corporate income tax, would result in a significant change in the distribution of business tax liability. These distributional changes would stem primarily from the different tax bases—total business activity under the SBT and profits under the corporate income tax. Businesses that are very profitable would likely pay more under a corporate income tax than under the SBT, while businesses with relatively small or no profits would generally pay less.

APPENDICES

Appendix A
Historical Single Business Tax Collections
(Millions of Dollars)

<u>Fiscal Year</u>	<u>Net Collections</u>	
	<u>Actual</u>	<u>Real (FY 1976 dollars)</u>
1976 *	\$425.5	\$425.4
1977	885.1	831.3
1978	999.1	878.2
1979	1,110.1	874.7
1980	1,224.6	834.9
1981	1,053.2	641.2
1982	1,047.4	513.5
1983	1,143.3	645.4
1984	1,384.0	758.2
1985	1,495.4	792.5
1986	1,674.2	868.5
1987	1,637.7	832.4
1988	1,872.6	914.1
1989	1,922.0	893.4
1990	1,877.3	930.1
1991	1,749.6	741.3
1992	1,863.4	773.5
1993	1,979.3	800.9
1994	2,229.8	874.9
1995	2,344.0	891.3
1996	2,393.4	885.4
1997	2,406.7	868.6
1998	2,491.7	879.2
1999	2,560.0	881.9
2000	2,516.8	838.7
2001	2,223.6	717.5
2002	2,210.9	698.6
2003	2,076.4	640.2
2004	2,154.9	652.6

* The SBT was collected for only two quarters of fiscal year 1976.

Sources: a) Actual collections: 1976 through 2002 from various Michigan Comprehensive Annual Financial Reports;
b) Real collections: HFA calculations (estimates from October 2003 Consensus Revenue Estimating Conference)

Appendix B Changes to the Single Business Tax*

1975 PA 228 [HB 4640] THE SINGLE BUSINESS TAX ACT OF 1975

Replaced the corporate income tax, the franchise tax, the business portion of the intangibles tax, several smaller business taxes, and the local property tax on inventory with a 2.35% levy on profits, payroll, interest, and depreciation, with a 100% credit for capital investment.

1975 PA 233 [HB 5085]

Amended the Income Tax Act to repeal the financial institutions and corporate income taxes.

Created an income tax credit for individuals subject to both the income and single business taxes.

1975 PA 236 [HB 5504]

Amended the Farmland and Open Space Preservation Act to permit partnerships and corporations to claim their property tax credit against the SBT.

1976 PA 78 [HB 6003]

Amended the Farmland and Open Space Preservation Act to remove the requirement of an on-site appraisal by the state tax commission in order to qualify for the property tax credit.

1976 PA 389 [HB 6451]

Clarified the method for calculating the labor intensity deduction and simplified the estimating provisions for small businesses.

1977 PA 41 [SB 374]

Moved the second estimating SBT payment from June 30 to July 31.

1977 PA 273 [SB 734]

Exempted agricultural production.

Lowered excess compensation reduction threshold from 65 percent to 63 percent.

Created a small business credit for firms with gross receipts of not more than \$3 million and adjusted business income to net more than \$300,000

Included in the tax base 100 percent (previously 50 percent) of prior depreciation.

Added the tax credit for unincorporated businesses previously contained in the Income Tax Act.

1978 PA 578 [SB 911]

Amended the Farmland and Open Space Preservation Act to allow the tax credit authorized by that act to be claimed even if the amount of the credit exceeds a taxpayer's liability.

Appendix B

Changes to the Single Business Tax*

1980 PA 318 [SB 1037]

Allowed a credit for contributions to certain public broadcast stations and removed the cutoff dates for certain other contributions.

1980 PA 468 [HB 4616]

Allowed a credit for child care services provided by an employer to employees.

1981 PA 208 [SB 597]

Excluded from the tax base the impact of arrangements for sale/lease-back of assets for federal income tax purposes only.

Clarified the exclusion for excess compensation.

Excluded sales tax from gross receipts for grocers.

1982 PA 216 [SB 240]

Expanded eligibility for and the value of the credit for small businesses with low profits, beginning in 1984, if the tax yield met a stated threshold.

1982 PA 376 [HB 5846]

Eliminated the ability of domestic insurers to deduct losses from gross receipts.

1982 PA 388 [HB 6140]

Updated the reference to the United States Internal Revenue Code to November 15, 1982.

1982 PA 393 [SB 360]

Added a credit for federal unemployment penalty taxes paid by new Michigan employers.

1982 PA 406 [HB 5847]

Eliminated the deduction of certain interest payments by domestic insurers.

Required the addition of certain commissions and fees to a domestic insurance sales corporation into the tax base.

1982 PA 414 [HB 5848]

Prohibited the use of certain exempt compensation to qualify for the labor intensity deduction.

1982 PA 484 [HB 5845]

Added to the definition of compensation any payments under health/welfare/noninsured benefit plans and fees for their administration.

Appendix B Changes to the Single Business Tax*

1983 PA 85 [SB 259]

Allowed taxpayers liable under the act, as well as farmers, to claim a 15 percent credit for wages paid to qualified summer youth employees.

1983 PA 234 [HB 4572]

Required the state to pay interest on delayed revenue sharing payments to counties and required the governor to give adequate notice of delays.

1983 PA 235 [HB 4570]

Required the state to pay interest on delayed revenue sharing payments to cities, villages, and townships and required the governor to give adequate notice of delays.

1983 PA 250 [HB 5160]

Removed the stipulation that the expanded small business credits could take effect on January 1, 1984, only if the revenue from the tax for fiscal year 1983 exceeded that for fiscal year 1982 by \$25 million.

1984 PA 45 [HB 4766]

Allowed employers and insurance carriers subject to the Worker's Disability Compensation Act to claim credits against the tax equal to the amounts they pay in supplemental benefits as certified by the director of the Worker's Compensation Bureau.

1984 PA 281 [SB 474]

Raised from \$10,000 to \$20,000 the maximum tax liability level at which a business may make equal estimated quarterly payments without being subject to interest charges.

1984 PA 360 [HB 4939]

Allowed a financial organization to deduct from its SBT base the interest it earns from federal obligations to the extent that the interest is included in federal taxable income. At the same time, a company must add to its tax base expenses deducted from federal taxable income, and not otherwise included in the SBT base, in an amount equaling the deduction on the interest from federal obligations.

1985 PA 27 [SB 67]

Gradually shifted franchise fee payments made to franchisers from the tax bases of the franchisees to those of the franchisers.

Required persons who receive royalty payments that qualify for the federal oil and gas depreciation allowance to include those payments in their tax bases as of July 1, 1985.

Specified that cable television franchise fees are not taxable.

Appendix B Changes to the Single Business Tax*

1985 PA 80 [HB 4481]

Declared that taxable interest expenses do not include payments made to or on behalf of an automobile dealer by a manufacturer to reduce floor plan interest if the payments are not claimed on federal tax returns, effective for tax years 1979 to 1984. Floor plan is inventory purchased from manufacturers.

1985 PA 139 [HB 4707]

Transferred enforcement of the SBT to the revenue commissioner.

1985 PA 226 [SB 100]

Provided a credit for qualified businesses for the amount of tax liability attributable to qualified business activity within an enterprise zone.

1986 PA 136 [HB 4275]

Established a tax credit to implement the Michigan Strategic Fund's center for minority venture capital. Allowed a credit against the SBT equal to 50 percent of certified investments in minority venture capital companies and minority enterprise small business investment companies.

1986 PA 160 [HB 4788]

Amended the Farmland and Open Space Preservation Act to require that a person applying for a credit under that act against the income tax or SBT include with the application a copy of a receipt showing payment of property taxes for the year for which the credit is claimed or the prior year.

1986 PA 283 [SB 630]

Allowed a credit against the SBT for persons engaged in high technology (an activity that has as its primary purpose research, product development, engineering, laboratory testing, or development of industrial technology) who comply with specific criteria.

1987 PA 39 [HB 4398]

Specified that the apportionment provisions of the act fairly represented the extent of a taxpayer's business activity in this state taken as a whole and without a separate examination of the specific components, unless it could be demonstrated that the business activity attributed to the taxpayer was out of appropriate proportion to the actual business in Michigan, and led to a grossly distorted result. Specified that its provisions were "curative" (i.e., they reversed a court decision) and expressed the original intent of the Legislature that the SBT is an indivisible value-added tax and not a combination or series of several smaller taxes and that relief from the act's three-factor formula should be granted only under extreme circumstances.

1987 PA 253 [SB 9]

Updated the reference to the Internal Revenue Code to January 1, 1987.

Appendix B

Changes to the Single Business Tax*

1987 PA 262 [SB 448]

Subjected all authorized (both in-state and out-of-state) insurers to the SBT and provided the formula for calculating an insurer's tax base.

Created the Insurance Policyholders Protection Fund.

1987 PA 267 [HB 5106]

Specified that the SBT inventory reimbursements due in February 1988 and February 1989, to a local unit whose 1987 reimbursement was based (improperly) on including special assessments in the local tax rates (i.e., Redford Township) not be less than the 1987 payment. The 1989 payment, however, was not to be made unless the township became a charter township or city prior to February 1, 1989.

1988 PA 390 [SB 878]

Allowed a taxpayer who qualified for the small business credit to choose to pay a tax of 4 percent on adjusted business income rather than using the value-added method of taxation. To qualify for the small business credit, a taxpayer must have had gross receipts of under \$7 million in 1989, under \$7.25 million in 1990, and under \$7.5 million in 1991 and beyond. Further, the credit could not exceed 100 percent of a taxpayer's tax liability in the 1988 tax year and beyond (raised from 90 percent of tax liability in the 1987 tax year).

Raised the limit at which a taxpayer was exempt from the tax from \$40,000 (in gross receipts) in tax year 1988 to \$41,000 in 1989; \$42,000 in 1990; \$43,000 in 1991; \$44,000 in 1992; and \$45,000 in 1993 and thereafter.

1988 PA 514 [SB 476]

Allowed a taxpayer not subject to the Income Tax Act to claim a credit against his or her SBT liability equal to 50 percent of the amount the taxpayer contributes to a community foundation. The total credit could not exceed 5 percent of the taxpayer's tax liability for the year or \$5,000, whichever is less. The credit cannot apply in a tax year for which the aggregate amount of such credits claimed by all taxpayers for all prior tax years (together with the income tax credit allowed under 1988 PA 515) exceeded \$3 million.

1989 PA 285 [HB 4987]

Allowed two farmers' cooperatives to regain the exemptions from the SBT which were lost when federal exemptions were lost.

1989 PA 294 [SB 397]

Provided that an auto dealership did not have to include payments or credits for floor plan interest in its tax base, effective for tax years after 1989.

1990 PA 36 [SB 386]

Changed the way in which financial institutions calculate SBT liability in those cases in which an institution carries back a loss for federal tax purposes, which in turn requires (or may require in the future) an adjustment of the institution's SBT base.

Appendix B

Changes to the Single Business Tax*

1990 PA 65 [HB 5362]

Specified that a financial organization defined or treated as a regulated investment company under the federal Internal Revenue Code (i.e., a mutual fund) may exclude from its tax base any dividends received or paid, or interest earned on obligations or securities of other states. (In practice, this means that mutual funds do not have to pay the SBT unless they have employees codifying state Treasury Department practice.)

1990 PA 135 [HB 5526]

Allowed a taxpayer to claim a credit for a contribution made to a community foundation if the foundation had been incorporated or established before September 1 of the year prior to the tax year. Previously, the deadline was January 1.

1990 PA 255 [SB 429]

Revised the manner in which insurers are taxed under the SBT by modifying the calculation of credits for payments to various insurance associations and placement facilities for tax years 1989 and 1990; making insurers' tax year the calendar year; requiring insurers' annual returns to be filed by March 1; providing that insurers do not have an automatic extension to file annual returns; and allowing insurers' SBT returns to be made public.

1990 PA 257 [SB 962]

Allowed a small business to use negative adjusted business income from any of the five preceding tax years to determine whether the business qualifies for the small business credit in a tax year. In order to qualify for the credit, a business' adjusted business income minus the "loss adjustment" may not exceed \$475,000. "Loss adjustment" is the amount by which adjusted business income was less than zero in any of the five preceding years.

1991 PA 77 [SB 69]

Subjected the capital acquisition deduction (CAD) to the formula by which firms apportion their tax bases to Michigan and revised that formula.

Increased the gross receipts filing threshold from \$40,000 to \$60,000 in 1991 and \$100,000 beginning in 1992.

Required creation of a separate fund if the voters repealed the CAD by December 31, 1992.

1991 PA 128 [SB 202]

Specified how the capital acquisition deduction (CAD) was to be calculated for the 1991 tax year. Deleted language stating, that the apportioned CAD created by 1991 PA 77 would not be in effect for the 1991 tax year if a court ruled that an unapportioned CAD was allowed for the 1990 tax year.

1991 PA 169 [HB 5074]

Provided that an automobile dealership did not have to include in its tax base payments or credits for floor plan interest, effective for tax years 1985 to 1989.

Appendix B

Changes to the Single Business Tax*

1991 PA 170 [SB 299]

Extended the tax credit available to contributors to community foundations, but specified that the credit applies to contributions to the endowment fund of a community foundation. Allowed a taxpayer to also claim a credit for contributions to a shelter for homeless persons, food kitchen, food bank, or other entity that provides such services to the indigent, if the contribution is deductible for the donor under the Internal Revenue Code. Raised to \$6 million (from \$3 million) the cap on the aggregate amount that may be claimed for the years the credit is in effect, under both the Single Business Tax Act and the Income Tax Act.

1992 PA 69 [SB 511]

Required that at least half of the revenue sharing payments to cities, villages, and townships from SBT collections be made before November 1, rather than before October 1 as previously required.

1992 PA 98 [HB 4412]

Revised and expanded the small business credit against the SBT, by raising to \$10 million (from \$7.5 million) the ceiling on gross receipts, raising to \$9 million (from \$6.5 million) the point at which a firm must begin to reduce its credit, and providing that the credit was the greater of the amount by which the tax exceeds 3 percent (rather than 4 percent) of adjusted business income or a percentage reduction in tax liability.

1992 PA 159 [SB 1031]

Required that the amount available from SBT collections for distribution to cities, villages, and townships to replace intangibles tax payments be reduced by \$11,775,000 for fiscal year 1993.

1992 PA 170 [SB 771]

Increased from \$130 million to \$162.5 million the amount of an insurer's disability insurance premium that is exempt from taxation. Increased the threshold at which an insurer's gross premiums begin to reduce the exemption. For all tax years, specified that the exemption applies to premiums written in Michigan.

1993 PA 105 [HB 4857]

Excluded from the SBT base film rental payment made by a theater owner to a film distributor and royalties or other charges paid or incurred by radio or television broadcasters for program matter or signals that they broadcast.

1993 PA 168 [SB 695]

Reduced revenue sharing payments from the SBT to cities, villages, and townships by \$6,863,000 for fiscal year 1994.

Provided that a city, village, or township is not eligible for revenue sharing payments unless it requires sealed competitive bidding for any contract of \$20,000 or more, except a contract for professional services or emergency repairs exempted pursuant to a written policy of the local unit.

Appendix B

Changes to the Single Business Tax*

1993 PA 267 [HB 4827]

Extended, without a cap on total credits, the credit for contributions to homeless shelters, food kitchens, food banks, and similar organizations.

1993 PA 329 [HB 5109]

Would have increased the tax rate from 2.35 percent to 2.75 percent if Proposal A had been rejected. The act was part of a package to implement a new school financing plan tied to submission to the voters of Proposal A in a March 15, 1994 special election. (Proposal A was passed by the voters and raised the sales tax rate from 4 percent to 6 percent).

1994 PA 231 [HB 5566]

Extended the credit available for contributions to community foundations and to homeless shelters, food kitchens, and food banks, and similar entities providing food and shelter to the indigent.

1994 PA 245 [HB 5614]

Reduced the alternative tax rate for small businesses from 3 percent of adjusted business income to 2 percent.

1994 PA 246 [HB 5090]

Increased the filing threshold from \$100,000 to \$137,000 for 1994 and to \$250,000 for 1995 and subsequent tax years.

1994 PA 247 [SB 1145]

Reduced the SBT rate from 2.35 percent to 2.3 percent, effective October 1, 1994.

1994 PA 248 [HB 4958]

Increased payments from SBT revenue to local governments by 0.53 percent of gross collections before refunds for the 12-month period ending on the June 30 before the payment date.

1994 PA 249 [SB 145]

Required the Department of Treasury to annualize the SBT rate provided for by 1994 PA 247 as necessary and impose the applicable tax rate.

1994 PA 300 [SB 1132]

Reduced revenue sharing payments from the SBT by \$6,863,000 for fiscal year 1995.

1995 PA 1 [HB 4230]

Exempted payments under the Federal Insurance Contribution Act, the Railroad Retirement Act, and similar social insurance programs.

Appendix B

Changes to the Single Business Tax*

1995 PA 6 [SB 235]

Exempted payments to state and federal unemployment compensation funds and payments (including self-insurance payments) for workers' compensation insurance and Federal Liability Act insurance.

1995 PA 23 [SB 350]

Provided for tax credits for businesses as authorized by the Michigan Economic Growth Authority. Businesses may claim the credits based on qualified new jobs and on authorized business activity.

1995 PA 77 [SB 406]

Provided that the tax base and adjusted tax base of an insurance company is equal to 25 percent of the insurer's gross receipts, as apportioned under the act, excluding receipts on the sale of annuities and receipts on all reinsurance transactions.

1995 PA 80 [HB 4678]

Specified that when an individual member of an affiliated group or controlled group of corporations or an entity under common control has apportioned or allocated gross receipts less than \$100,000, it is not required to file a return or pay a tax.

1995 PA 135 [SB 498]

Reduced revenue sharing payments from the SBT to cities, villages, and townships by \$16 million for fiscal year 1996.

1995 PA 255 [SB 768]

Exempted certain partnership entities, if the activities of an entity are exclusively related to a charitable, educational, or other purpose or function that is the basis for any exemption (under the Internal Revenue Code) from federal income tax for the members of the partnerships, and if all of the partners or members of the entity are exempt from federal income tax under the code.

1995 PA 256 [HB 4931]

Specified that an insurance company that is a member of an affiliated group can allocate the assessments paid to the Michigan Life and Health Guarantee Authority (and used to determine its SBT liability) among the members of its affiliated group, if one of the group members has no employees and acquires goods and services from other affiliated group members. These provisions were effective for tax years 1993 to 1995 and applied to a single company (Jackson Nation Life Insurance Company).

1995 PA 282 [SB 342]

Altered the apportionment formula, increasing the sales factor and decreasing the payroll and property factors by setting them at 90 percent sales, 5 percent payroll, and 5 percent property in 1999 and thereafter. Changed the Capital Acquisition Deduction (CAD) to a Michigan-only CAD; that is, for 1997 and thereafter, a firm could deduct the cost of tangible assets, provided they are located in Michigan.

Appendix B

Changes to the Single Business Tax*

1995 PA 283 [HB 4605]

Changed the tax base apportionment factor for tax years 1997 and 1998 from a formula that weighted property 25 percent, payroll 25 percent, and sales 50 percent to a formula that weighted property 10 percent, payroll 10 percent, and sales 80 percent.

1995 PA 284 [HB 4358]

Raised the small business credit compensation limit from \$95,000 to \$115,000 and allowed partial credits in cases in which an officer or owner receives compensation between \$95,000 and \$115,000.

1995 PA 285 [SB 545]

Specified the basis upon which the small business credit, as increased by 1995 PA 284, must be reduced if compensation or fees to any officer or shareholder of a firm exceed \$95,000.

1996 PA 342 [HB 4853]

Amended the State Revenue Sharing Act to create a bipartisan revenue sharing task force within the legislative branch.

Revised certain distribution formulas and funding sources.

Repealed the provisions of the Single Business Tax Act related to revenue sharing.

1996 PA 347 [SB 880]

Allowed a film distributor to exclude from its tax base certain royalty payments, fees, and charges paid to a film producer. Prohibited a film producer, or film distributor and producer, from deducting from its tax base certain payments, fees, and charges received.

1996 PA 382 [SB 924]

Allowed taxpayers owning eligible property in Brownfield redevelopment zones to take a credit equal to 10 percent of the cost of investments in eligible property.

1996 PA 441 [HB 5190]

Allowed a business located in and conducting business activity in a renaissance zone to claim a credit equal to the tax liability attributable to business activity conducted in the zone.

1996 PA 470 [HB 4840]

Extended the deadline for SBT credits to be awarded by the Michigan Economic Growth Authority to December 31, 1999.

1996 PA 578 [HB 5990]

Specified that the tax base and adjusted tax base of an insurance company is 25 percent of the company's adjusted receipts.

Appendix B

Changes to the Single Business Tax*

1996 PA 593 [SB 872]

Allowed a taxpayer to claim a refundable credit against the tax for the expenses related to the training of an apprentice who is a state resident at least 16 years old but under 20 years, has not obtained a high school diploma, and meets certain other criteria.

1997 PA 124 [HB 4773]

Made clarifications with respect to the retail sale of certain agricultural goods and tax base determination for farmers' cooperative corporations.

1997 PA 190 [SB 705]

Eliminated the sunset on the tax credit for donations to community foundations.

1997 PA 191 [HB 4091]

Eliminated the sunset on the tax credit for donations to food banks and homeless shelters.

1998 PA 221 [HB 5580]

Amended the Revenue Act to provide for voluntary disclosure agreements.

1998 PA 225 [HB 4910]

Eliminated the "throwback rule" formerly used for apportionment purposes. Under this rule, shipments made from a place in Michigan for purchases made (but not taxable) in another state were considered to be sales made in Michigan.

1998 PA 240 [SB 116]

Provided that a farmer's cooperative corporation must exclude from its adjusted SBT base the revenue and expenses attributable to business transacted with farmers or farmers cooperative corporation patrons to whom net earnings are allocated in the form of patronage dividends as defined in the Internal Revenue Code.

1998 PA 493 [SB 872]

Extended the period for Canadian companies to enter into a voluntary disclosure agreement.

1998 PA 504 [HB 5795]

Reduced the sales ratio required to qualify for the alternate capital acquisition deduction extending an exception available to Meijer, Inc. to the K-Mart Corporation.

1998 PA 534 [SB 105]

Allowed a tax credit equal to 25 percent of the cost of restoration of an approved historical site.

1998 PA 539 [SB 1038]

Excluded from the tax base royalties paid for computer software under a license agreement.

Appendix B

Changes to the Single Business Tax*

1999 PA 100 [SB 573]

Extended the deadline for SBT credits to be awarded by the Michigan Economic Growth Authority to December 31, 2003.

1999 PA 115 [HB 4745]

Provided for the tax rate to decrease by 0.1 percent each year that the ending balance of the Budget Stabilization Fund exceeds \$250 million, beginning on January 1, 1999. Provided for the automatic repeal of the SBT when the tax rate reaches zero.

Replaced the capital acquisition deduction with an investment tax credit based on the amount a firm invests in tangible assets in Michigan. The amount of investment is to be multiplied by a percentage determined by dividing the current tax rate by 2.3 percent and multiplying the result by 0.85 percent.

1999 PA 184 [SB 717]

Eliminated the January 1, 2000, sunset date for the apprenticeship tax credit.

1999 PA 213 [SB 888]

Amended provisions of the historic restoration credit to alter the original sunset provision for the credit and make a number of technical and administrative changes.

2000 PA 44 [SB 1040]

Increased the investment tax credit for firms with adjusted gross receipts of \$5 million or less.

2000 PA 143 [SB 269]

Extended the availability of brownfield tax credits through December 31, 2002 and revised provisions regarding eligibility, maximum amount, and approval process for the credits. Also provided for expanded eligibility criteria for tax credits certified by the Michigan Economic Growth Authority.

2000 PA 373 [SB 1380]

Provided for alternative calculation methods to determine compensation by a “foreign person” that does not have a permanent establishment in the United States and who business activity consists of the transportation of persons or property for other by motor vehicle.

2000 PA 429 [SB 1345]

Expanded the definition of “qualified new job” for the purpose of claiming a tax credit as certified by the Michigan Economic Growth Authority, provided for the repayment of a credit if 51% or more of the jobs are removed from the state, and added new provisions regarding insurance companies and the community foundation tax credit.

2000 PA 477 [SB 1300]

Revised the definition of “gross receipts” to exclude money collected by advertising agencies for certain purposes.

Appendix B

Changes to the Single Business Tax*

2001 PA 224 [SB 490]

Provided for an exemption of the portion of the SBT tax base attributable to a multiple employer welfare arrangement that provides dental benefits.

2001 PA 229 [HB 5474]

Revised the definition of “sale” or sales to include royalties, fees or other payments or consideration not deducted from the tax base except for royalties paid to a franchiser as consideration for the use outside of this state of trade names, trademarks, or similar intangible property.

2001 PA 230 [SB 486]

Revised the treatment of certain royalties to include in the tax base of a franchiser, but not in the tax base of the franchisee.

2001 PA 249 [SB 516]

Provided for a credit for the consumption of qualified low-grade hematite in an industrial or manufacturing process.

2001 PA 278 [SB 775]

Provided for a one-year exemption from the tax base of certain foreign corporations (organized outside the United States) the portion of its tax base attributable to the international operation of aircraft.

2002 PA 442 [SB 1278]

Made technical changes that allowed foreign companies to calculate a reasonable approximation of business income and adjustments for SBT purposes.

2002 PA 531 [SB 1322]

Provided for a non-refundable energy credit, an increase in the SBT gross receipts filing threshold from \$250,000 to \$350,000, and the repeal of the SBT act beginning after 2009.

2002 PA 588 [HB 6073]

Provided a credit that allowed a firm to claim a credit against the tax for qualified research expenses related to the firm's pharmaceutical-based business activity.

2002 PA 603 [HB 5403]

Adjusted the tax base to determine the amount of compensation attributable to professional employer organizations.

2002 PA 606 [SB 1422]

Excluded certain items from the definition of gross receipts when calculating a firm's tax base.

Appendix B

Changes to the Single Business Tax*

2002 PA 622 [SB 1500]

■ Made technical changes for firms operating in renaissance zones to provide for NextEnergy credits.

2002 PA 726 [HB 6501]

■ Extended the sunset for Brownfield redevelopment credits from 2002 to 2007.

*All acts amended the Single Business Tax Act of 1975, M.C.L. 208.1 et seq., unless otherwise noted.
Source: House Fiscal Agency compilation from various sources

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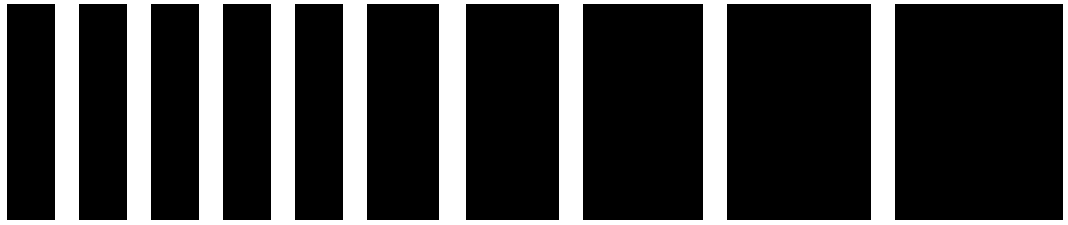
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November 2003



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