

Michigan's Single Business Tax A Personal Journey

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Outline

- **Adopted in 1975 – why?**
- **Changes over time**
- **Who pays the SBT?**
- **Reflections**

SBT – Why was it Adopted?

- **Dominant industry**
- **Tax and spend cycle**
- **Previous history with VAT: 1950's**
- **Immediate budget crisis:
One time benefit**
- **Stars were aligned**

Goals for Business Taxes

- **Simplicity**
- **Fair: In reality and perception**
- **Broad-based**
- **Low rate**
- **Sufficiency: Make fight worth it**

(Simple, fair, minimize economic distortion and raise enough money)

Taxes Repealed

States Levying (2002)	Type of Tax	Share of MI Revenue at Time of Repeal
44	Corporate Income Tax	39%
14	Financial Institutions Income Tax	2.3%
18	Corporate Franchise Fee	20.8%
5	Savings & Loan Association Fee	4.5%
2	Domestic Insurance Co. Privilege	
2	Intangibles in Business	
15	Local Property Tax on Inventory	33.4%
	Total Profit-Based Taxes	41.7%

1975 Tax Reform Goals

- **Stability**

Michigan Corporate Income Tax Percent

1972 +62%

1973 +28%

1974 - 25%

1975 - 23%

(Constant 2001 dollar)

- **Simplicity: Replace 7 taxes with 1**

Tax Reform Goals (Cont.)

- **Equity across types of businesses (C-Corp, Partnerships, Sole)**
- **Avoid penalizing the efficient (high profit)**
 - **Increasing the corporate income tax was a real alternative**
- **Eliminate short-term budget deficit without a permanent tax increase (overlap old annual/new quarterly)**
- **Based on “Benefits-received” principle rather than “ability-to-pay”**

Changes in the SBT

- **Enacted 1975**
- **Changes prior to enactment**
 - **Gross receipts: 50%**
 - **Excess compensation: 65% of tax base**
 - **Gross receipts filing threshold**
 - **Credit for phone companies: 5%**

Initial SBT

Tax Base

- Compensation
- Profits
- Depreciation
- Interest paid

Tax Rate – 2.35%

Gross Receipts

- Maximum Tax Base cannot exceed 50% of gross receipts
- Maximum tax equals 1.175% times gross receipts

Changes in the SBT

- Rate reduced 2.35% to 1.9%
- Filing threshold increased from: \$34,000 to \$350,000
- Reduce the excess compensation from 65% to 63%
- Apportionment Formula

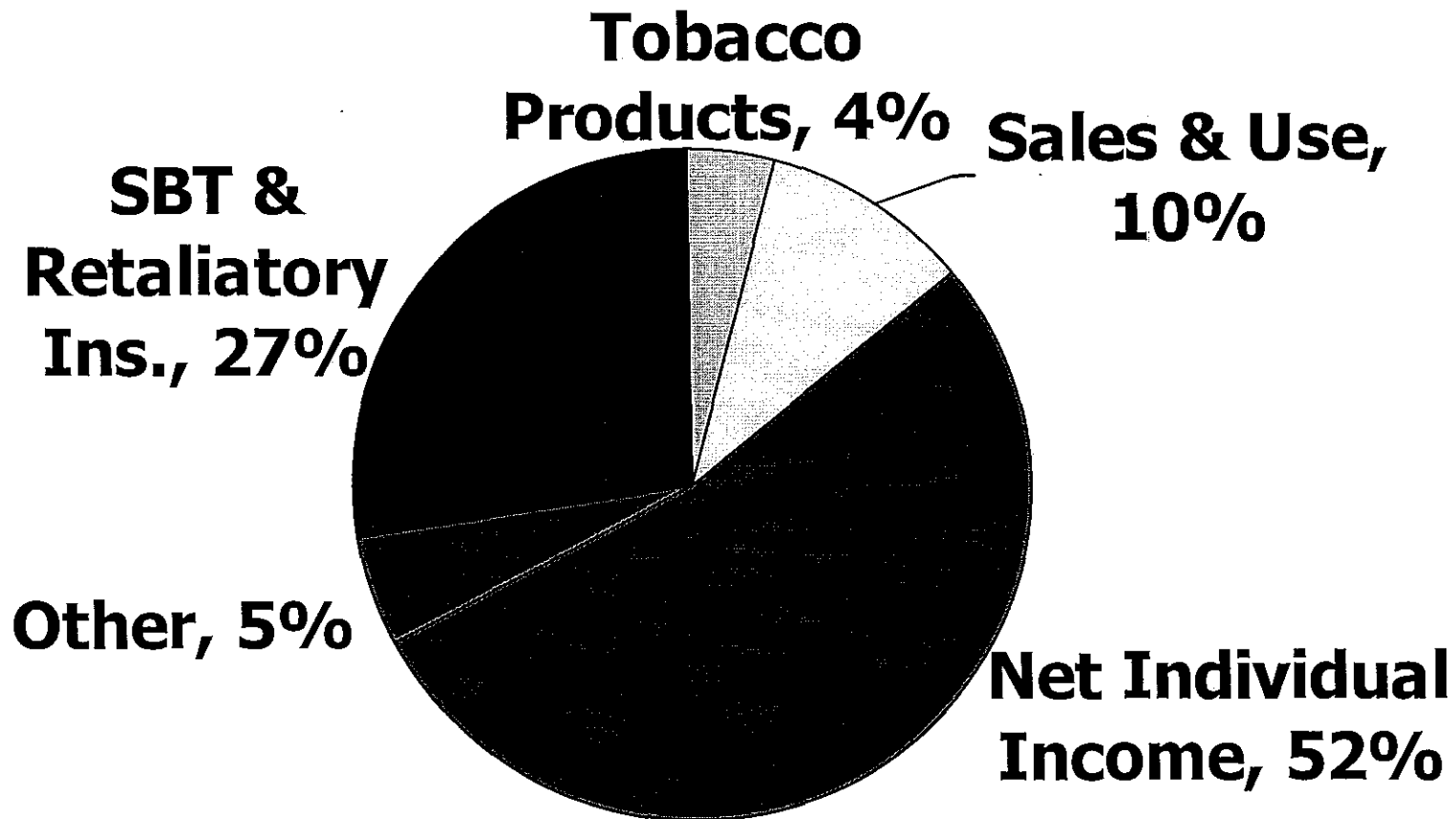
	Sales	Property	Payroll
Initial	33.3%	33.3	33.3%
Revised	90%	5%	5%



Changes in the SBT

- **Remove from compensation unemployment insurance, FICA, and workers' compensation**
- **Repeal Dec. 31, 2009**
- **Total changes \$932 Million in FY 2003 (Appendix A: lists 28 changes)**
- **SBT raises \$1.9 Billion**

SBT Provides 27% of GF-GP Revenue (FY 2003 Revenue Estimate)



Who Pays Michigan SBT

- **1/10 of 1% of all firms account for 27% of the revenue**
- **2% of all firms pay 60% of the tax**

Conversely

- **27% of all firms have NO SBT liability**
- **44% of all firms pay less than \$1,000 in tax and account for 1/2 of 1% of total revenue**

Who Pays SBT by Sector (1998-99)

Total Manufacturing Transportation Equipment (13.9%)	39.1%
Services	19.4%
Retail Trade	14%
Finance, Insurance, and Real Estate	5.5%
All Other	22%
Total	100%

Who Pays by Legal Organization (1998-99)

Individual	1.4%
S-Corp	15.6%
C-Corp	74%
Other PC LLC partnerships	9%
Total	100%

Reflections: SBT Advantages

- **More stable (See Tables B and C)**
- **Low rate vs. Broad-based
Minimizes the distortion of business
decision-making**
- **No rate increase since inception**
- **More neutral with respect to legal
organization**
- **With “additive approach” most federal
business tax charges don’t hurt
(accelerated depreciation: reduces
profits but increases depreciation)**



Reflections: SBT Disadvantages

- **Unpopular to pay taxes when business loses money**
- **Unpopular with professional businesses (Accountants, Doctors, Lawyers)**
- **Constant pressure to enact special provisions**
- **Perception: SBT is “small business tax”**

Courts and Legislation

U.S. Supreme Court (1991)	Trinova vs. Dept. of Treasury	Constitutional
Michigan Court of Claims (1989)	Caterpillar Corp vs. Dept. of Treasury	CAD unconstitutional increased revenue by \$500 Million
Michigan Court of Appeals (1991)	Caterpillar Corp vs. Dept. of Treasury	CAD unconstitutional reduced revenue by \$450 Million
Michigan Legislature (1991)	Used same 3-factor to apportion both taxes and CAD	Changed from 1/3 split to 40% sales tax 30% property tax, 30% payroll tax
Michigan Supreme Court (1992)	Caterpillar Corp vs. Dept of Treasury	Reversal the Court of Appeals

Courts and Legislation (Cont.)

Michigan Legislature (1993)		Apportionment: 50-25-25
Michigan Legislature (1995)		Apportionment: 80-10-10 CAD Mich. only & backup section added
Michigan Court of Claims (1999)	Jefferson-Smurfit vs. Dept. of Treasury	CAD unconstitutional
Michigan Legislature (1999)		CAD replaced with Investment Tax Credit & Phased out by Dec. 31, 2009
Michigan Court of Appeals (2001)		Reversed Court of Claims (important retroactivity)



Potential Changes

Revenue = A + B (Income)

- **Keep SBT and overweight profits**
- **Enact a small SBT and independent CIT**
- **Enact a gross receipts tax and a CIT**

*Michigan has a major political dilemma:
Any change will probably hit the large
number of firms which currently pay little
or no tax.*



Conclusions

- **Adopted in 1975 – why?**
- **Changes over time**
- **Who pays the SBT?**
- **Reflections**

Table A
Michigan SBT Recent Major Changes
(Millions)

Enacted	Change	Tax Cut (FY03)
PA 77 of 1991	Raise Filing Threshold (to \$100,000)	\$14.5
PA 77 of 1991 & 282, 283 1995	Apportionment Change	\$27.8
PA 98 of 1992	Lower Alternative Tax to 3% and Raise Gross Receipts Limit	\$24.1
PA 245 of 1994	Lower Alternative Tax to 2%	\$13.7
PA 246 of 1994	Raise Filing Threshold (to \$250,000)	\$41.2
PA 247 of 1994	Lower SBT Rate to 2.3%	\$65.8
PA 6 of 1995	Exempt UI, FICA, Worker's Comp. Payments	\$138.4
PA 23 of 1995	MEGA Credit	\$20.0
PA 284 of 1995	Small Business Credit Changes	\$24.7
PA 382 of 1996	Brownfield Tax Credit	\$2.5

Michigan SBT Recent Major Changes

(Cont.)

Enacted	Change	Tax Cut (FY03)
PA 441 of 1996	Exemptions for Renaissance Zones	\$1.5
PA 593 of 1996	Youth Apprenticeship Credit	\$0.1
PA 578 of 1996	Revise Definition tax base for insurance Companies	\$1.2
PA 240 of 1998	Agricultural Co-op Exemption	\$2.0
PA 221, 225 of 1998	Eliminate Throwback/Voluntary Disclosure	\$0.0
PA 534 of 1998	Historical Preservation Credit	\$0.0
PA 115 of 1999	Phase Out SBT, Replace CAD with ITC, Clarify Foreign Tax Base, Industrial Restructuring Provision	\$465.4
PA 44 of 2000	Change Investment Tax Credit	\$12.8

Michigan SBT Recent Changes

(Cont.)

Enacted	Change	Tax Cut (FY03)
PA 143 of 2000	Brownfield Credit (New)	\$40.7
PA 143 of 2000	MEGA Job Retention	\$12.8
PA 144 of 2000	MEGA High Tech	\$4.0
PA 477 of 2000	Change Gross Receipts Definition	\$3.1
PA 241 of 2001	Iron Ore Credit	\$1.4
PA 531 of 2002	Repeal SBT Entirely after 2009	---
	Raise Filing Threshold to \$350,000	\$13.7
PA 532 of 2002	NEXT Energy Credit	\$0.9
	Total	\$932.1

Projected FY 2003 SBT Revenue: \$1,896 million.

Table B

SBT Revenue History (Actual) (Billions)

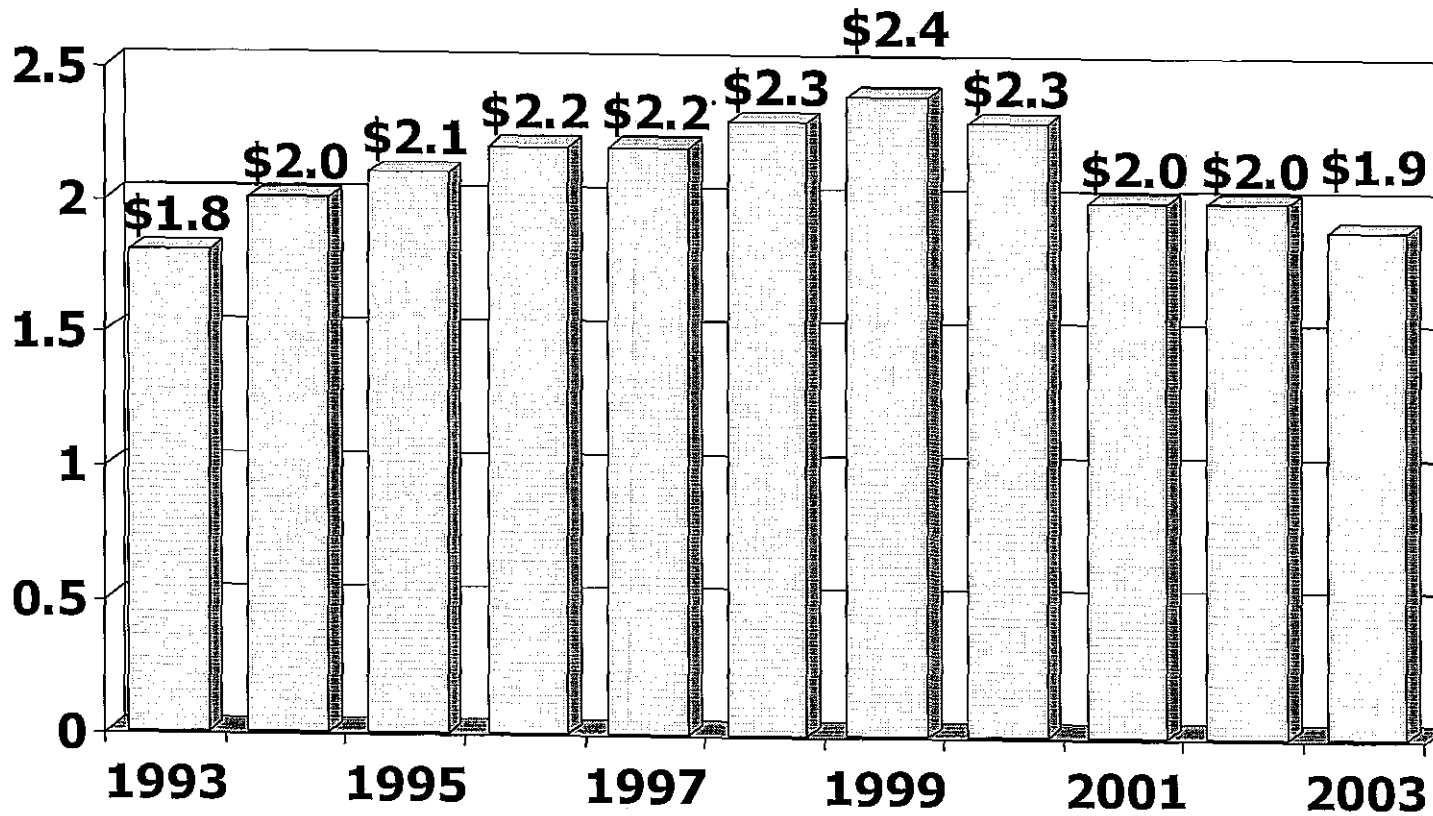
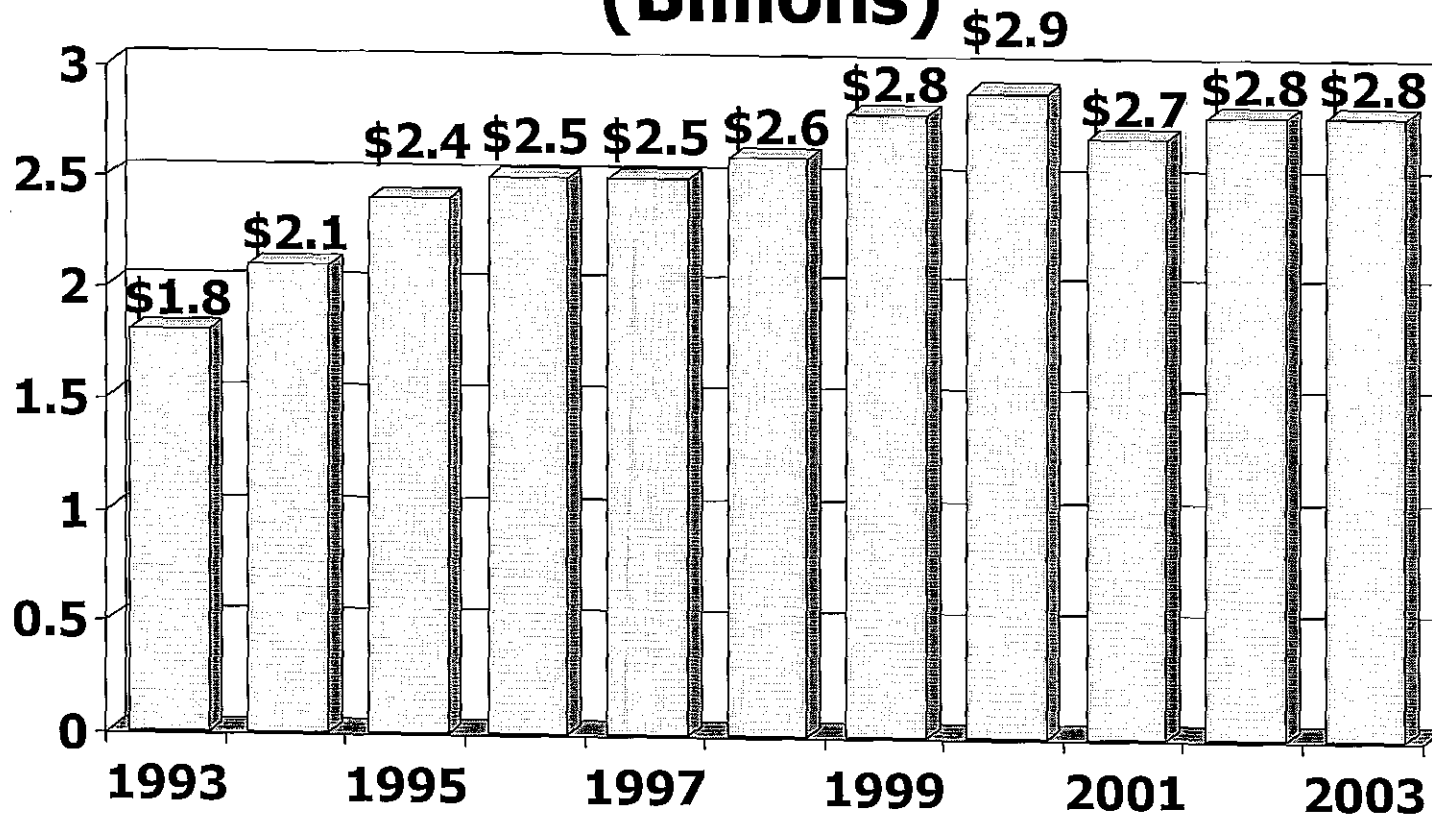


Table C

SBT Revenue Plus Post 1991 Tax Cuts (Billions)



Common Arguments Against the SBT

- **Not based on ability to pay**
- **It taxes labor**
- **The low rate would be easy to increase**
- **Taxes would shift from**
 - **Large to small**
 - **Manufacturing to services**
- **It was too complex**

Answers to Common Argument

- **Several of the repealed taxes were not based on income: The benefit principle is still valid**
- **Labor is a major component of value added but not disproportionately taxed**
- **The low rate was never incremental**
- **Complexity was more a perception than a reality; however, complexity did grow over time with the numerous changes**