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DIVIDED HOUSE PASSES M.B.T. SURCHARGE BILL

Instead of paying the maligned services tax, businesses would instead tack a surcharge onto their Michigan Business Tax liability under legislation that passed contentiously late Thursday. But House Speaker Andy Dillon (D-Redford Twp.) said after the vote he's leaving the door open to possible changes in the bill headed up by a proposal Rep. Brian Calley (R-Portland) is working on dealing with adjusting the gross receipts and business income rates in the MBT.

But without those changes yet in the HB 5408, the measure passed on a 58-48 vote with Rep. Ed Gaffney (R-Grosse Pointe Farms) and Rep. Tory Rocca (R-Sterling Heights) joining Democrats in approval (Rep. Martin Griffin (D-Jackson) and Rep. Aldo Vagnozzi (D-Farmington Hills) were absent from voting).

The emotions of the day ran wild, with business groups saying their support behind the surcharge was simply choosing between the lesser of two evils, and Republicans erupting in outrage when their amendment to the bill that would have just repealed the service tax was not considered on the floor.

House Minority Leader Craig DeRoche (R-Novi) told reporters Democrats broke House rules and the Constitution by not recognizing Republicans had enough signatures of support to their amendment for it to be considered. At that point several lawmakers from both parties surrounded the press table and argued back and forth about who was being obstructionists to the process.

"What you saw was a dangerous cocktail of arrogance and incompetence," Mr. DeRoche said. "In the pursuit of tax increases Democrats know no bounds."

Tax Policy Chair Rep. Steve Bieda (D-Warren) said the bottom line is divisiveness doesn't help the process and he plans on seeking a solution that brings both parties and chambers together.

During session Democrats traveled that bumpy road with Republicans twice, after accidentally moving to reconsider the vote when the bill first passed 57-47 and having to run past the Republican amendment for a second time to get the bill voted on officially and sent over to the Senate.

That whole process drew shouts from Republican members and when House Minority Floor Leader Dave Hildenbrand (R-Lowell) finally got recognized, his point of order was ruled out of order because he asked that members be allowed to speak to the bill.

Mr. Dillon said afterward he's had no real help or solutions from House Republicans the entire year, and that it's been easier for him to take advantage of Democrats being in the majority - essentially calling the shots on what does or does not happen during session.

Mr. Dillon said it was important for the chamber to act this week on a service tax replacement because of the pressure from the business community to get things done before the tax goes into effect December 1. Several members of that community coming forward with legitimate solutions in

accomplishing that goal, he said.

Mr. Calley said unlike the MBT, which rewards businesses for investment and jobs in Michigan, the services tax simply hurts the "home team," because services are taxed only when they are consumed here. But he also thinks a surcharge is just another step for businesses in an already complicated compliance structure and so looking at adjusting the rates that comprise the MBT is a better route.

If the rates were adjusted to meet the revenue neutral demand from the governor in taking away the service tax, the gross receipts rate have to go from 0.8 percent to 1.05 percent and the business income rate would rise from 4.84 percent to 6.34 percent, Mr. Calley said of the rough estimates.

He said credits for investment and compensation could also be increased to continue to reward businesses for doing work in Michigan, but he recognizes there is a balance in still bringing in the same revenue as the service tax would.

Mr. Calley also said he wants to put triggers to rollback the rates such as how the state's economy is performing or studying the unitary filings to reset the rates. Mr. Calley was confident his proposal could be worked out with all parties in time for the December 1 deadline.

Mr. Dillon said he had spoke to Senate Majority Leader Mike Bishop (R-Rochester) earlier Thursday, and they are forming a joint workgroup to deal with the service tax replacement over the month. He also said Mr. Bishop indicated to him tying the replacement to the MBT could work for him.

But Mr. DeRoche criticized Democrats lauding the surcharge as having support of the business community, saying, "It's like they are playing 'Survivor: Michigan' with the economy, with some businesses in the state voting 60,000 smaller businesses off the peninsula."

Mr. DeRoche noted the letter business groups supporting the surcharge sent to Mr. Dillon included, "We take this support for replacement reluctantly, but believe it is in the best interest of the State of Michigan and our state's overall business climate. We say reluctantly because we do not think increasing the state tax burden on business is good policy at this point in the state's economic cycle."

Mr. DeRoche said in the past there were are budget cuts some Democrats have voted for, such as cutting Wayne County Community Mental Health, making welfare reforms and taking away Medicaid for 19 and 20-year-olds, that should be done instead of asking businesses to pay more in taxes and pitting groups against each other. He said if there is no more service tax the budget agreement is broken, the budget targets no longer exist, and the budget should be reopened and cuts negotiated.

As HB 5408 heads over to the Senate it includes a 32.9 percent surcharge on the MBT taken after businesses calculate their liability for the gross receipts and business income and before the investment credits are applied. The surcharge would roll back to 27.3 percent after calendar year 2008 and the surcharge does not apply to insurance companies who pay a premiums tax under the MBT.

All companies would be capped at a \$2 million surcharge liability, though banks would get a 23.4 percent surcharge after 2008 and have no cap apply to them.

Small businesses would still maintain their alternative tax rate at 1.8 percent.

Scott Schrage said 55,000-60,000 businesses would be affected by the surcharge. About 150,000 small businesses would not be affected, with 40,000 benefiting from the small business alternative profit treatment.

Comparisons are difficult on winners and losers because it involves comparison a tax which has not gone into effect and which has no history to a surcharge on another new tax. "It's a little rocky," he

said.

In general, the major beneficiaries are in-state multi-state companies, with manufacturers being the industrial segment most benefiting. Also utilities, telecommunications and the construction industry would see a benefit. If the cap was eliminated, the surcharge could be reduced 10 percent. The cap benefits 27 businesses and 10 unitary groups for a savings of about \$75 million, Mr. Schrager said.

Mr. Schrager said the surcharge essentially equates to a 1.06 percent gross receipts rate and a 6.5 percent business income rate, but after 2008 that would decrease.

But during the Tax Policy Committee, Rep. John Pastor (R-Livonia) stated, "We're still raising their rate by 32 percent no matter what you say."

The service tax is expected to generate \$614 million in its first year - a number some business groups argue is extremely low and could be upward of \$1 billion instead - and the MBT surcharge would bring in \$56.3 million short of that. However, in fiscal year 2009, the surcharge would generate an estimated \$56 million over the service tax.

The surcharge would be permanent, a fixture Chuck Hadden with the Michigan Manufacturers Association doesn't like, but is making do with the political realities of getting the governor to sign the bill. Also, the MBT would rebate taxpayers if it goes above the estimated revenue, while under current law the additional money would be split evenly between the taxpayers and the Budget Stabilization Fund.

"We will be back with reforms, we will be back with revenue increases and we will be back with structural reforms," Mr. Hadden said.

Several groups oppose the surcharge, including the National Federation of Independent Businesses, with Michigan Director Charlie Owens saying half of his members will be adversely affected and half will not. But Rep. Tim Melton (D-Auburn Hills) questioned if the split on the surcharge was 50-50, why the NFIB wasn't neutral to the bill.

Mr. Owens said the argument for needing a new tax or else schools will not be good or people will be cut off health care is wrong.

"We can pursue tax policy that gives Michigan a vibrant economic function," he said.

Among those asking for repeal but opposing the solution in addition to NFIB were Peter Jaskowski of Transcanada, Home Builders, Michigan Association of Independent Agents, Michigan Restaurant Association and Michigan Association of Realtors.

Brad Ward of the Realtors sparked a sharp exchange with Rep. Paul Condino (D-Southfield) when he urged legislators "not to make the same mistake" with the replacement revenue as it did when adopting the service tax without sufficient public review.

Mr. Condino, laying the responsibility for the service tax with the Senate due to its refusal to consider higher income taxes, said legislators are under the gun to respond to business demands to repeal the tax so they can avoid millions of dollars in compliance costs. "How are we not behind the eight-ball? Tell me how we are not doing the right thing," he said of the push to work through the day on a solution.

Mr. Ward said he was not seeking a protracted process, but given the impact of the proposed surcharge, he said his association needs time to "take a good look at this. We're not opposed to revenue replacement but it should be more broadly based than under the current bill."

Tricia Kinley with the Michigan Chamber of Commerce said her group opposes the surcharge as written, arguing it should be temporary with a specific sunset in place and the revenue generated only limited to the business-to-business portion of the service tax.

"A 33 percent rate is unreasonable and untenable to many businesses," she said.

Chris Fisher with the Associated Builders and Contractors said the state has to be more aggressive in seeking efficiencies, but the group would not oppose increasing the sales tax half a percent or increasing the income tax instead of finding revenue through a surcharge.

Mr. Melton argued most businesses, even with the surcharge, are better off than they were a year ago under the Single Business Tax.

Jared Rodriguez with the Grand Rapids Chamber of Commerce said the choice between the service tax and surcharge was like playing Russian roulette and "We've got a gun to our head and a maul to the foot might look better."

Complying with the surcharge will be much easier on members, he said, adding while the realities are what they are, the Chamber also supports structural reforms and perhaps looking at an income tax increase instead.

Sarah Hubbard of the Detroit Regional Chamber said it was important to act quickly because businesses continue to spend money to prepare for compliance with the service tax. "They aren't sitting around waiting for you," she said.

Several insurance groups, the Big Three automakers, bankers and telecommunications also threw their support behind the surcharge.

After the vote, the Ax the Tax Coalition released a statement saying, "Just one month ago, when job providers from around the state met to talk about an effort to repeal the sales tax on services, hope that the Legislature would fix this problem was slim. Today, after a tremendous amount of work by business owners and operators to communicate with their legislators and gather petition signatures, the repeal of the service tax is one step closer to reality. While there are many opinions on if and how this tax should be replaced, there is one single and now successful opinion that the services tax must go."

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