



## Michigan Report

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Volume #46, Report #220, Article #01 --Wednesday, November 7, 2007

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### SERVICE TAX PROPOSAL COULD CALL FOR LARGER SURCHARGE

The first-year surcharge to replace the sales tax on services on the Michigan Business Tax would be 32.9 percent under a draft that is to be taken up in the House on Thursday, a far higher rate than the range that has been under discussion since the Michigan Manufacturers Association first launched the plan as a way to replace the much reviled sales tax on services, Gongwer News Service has learned.

The first glimpses of the details of the replacement came hours after the Senate voted to repeal the service tax and the House Tax Policy Committee approved a bill to delay the implementation of the tax - due to go into effect December 1 - under December 20, but stripping a tie-bar to the repeal bill. The committee plans to take up a single bill repealing the tax and imposing the MBT surcharge Thursday, though whether that makes it to the full House for a vote later that day is not yet settled.

Meanwhile, Senate Majority Leader Mike Bishop (R-Rochester) said the Senate could be brought back into session the week of Thanksgiving to vote on a replacement for the services tax.

He also said he was designating a number of Senate members to negotiate with House members on a bipartisan replacement proposal. Named to negotiate on behalf of Senate Republicans were Sen. Nancy Cassis (R-Novi), Sen. Tom George (R-Kalamazoo), Sen. Jud Gilbert (R-Port Huron) and Sen. Mark Jansen (R-Gaines Twp.).

The developments occurred on a day when the Senate voted on a largely party-line vote to repeal the tax.

The proposed MBT surcharge rate drops to 27.3 percent after the first year, and complies with Governor Jennifer Granholm's demand that it not be temporary. It would carry a \$2 million limit on taxes paid by any one company, an element that helped drive the rate higher.

Earlier in the day, House Tax Policy Chair Rep. Steve Bieda (D-Warren) said the surcharge would be in the 20-25 percent range. "We're trying to keep it limited," he said, adding that without the \$2 million cap, the tax liability "gets a little dangerous" for some companies.

Initial reaction in some quarters to the 32.9 percent rate was one of alarm.

Matt Marsden, spokesperson for Mr. Bishop, said, "At that percentage, that's replacing a bad tax with a bad tax."

And Tricia Kinley, vice president of tax policy for the Michigan Chamber of Commerce which has been opposed to any replacement of the service tax but was willing to recognize the political reality of replacement of significant revenues, said, "That's going to be a little hard to stomach."

Both Ms. Kinley and Mr. Marsden also emphasized the importance of making the surcharge temporary.

Ms. Granholm has said the replacement tax must cover all the revenue that would be raised by the services tax (some \$615 million the first year and over \$700 million in a full fiscal year) and that it be permanent.

Chuck Hadden, MMA vice president of government affairs, said the "rate is what it is right now" but discussions are still underway on issues that could affect the rate. The \$2 million cap per company and the number of businesses who wind up paying the tax are factors that pushed the rate higher than was initially discussed, he said.

The provisions are in draft 1, and he said a draft 3 that modifies some other provisions will be the bill that the Tax Policy will work on Thursday.

Key features are that the surcharge is calculated before taking into account any credits, that insurance companies are exempt because they pay a higher premiums tax already, that a small business tax credit would reduce the alternative profits tax to a rate equal to 1.8 percent, provide refunds if the tax produces more revenue than projected to all businesses which paid the tax (rather than the current language in law giving refunds only for two years, and keeping half of the excess revenue for the state's rainy day fund).

Mr. Bieda said he would continue to sit down with businesses in crafting a replacement solution, adding, "We're trying to avoid the unintended consequences we had with the service tax."

He said the Legislature should work through the planned two-week break that is to begin after Thursday's session to resolve the problems with the service tax and help companies avert the costs of complying with the tax. He said that is one reason to extend the expiration date.

Scott Schrager of the Department of Treasury said the administration has reservations even about doing that, saying he is having a hard time grasping the concept of delaying the effective date of a tax that under a separate bill would be repealed 20 days earlier. He quoted with approval the view of Senate Finance Chair Nancy Cassis (R-Novi) who said keeping the clock running for required action by November 30 is the way to make sure the tax gets repealed.

But he declined to address what legislative options the administration would support to replace the revenues, referring to the governor's criteria that the replacement be revenue neutral, be bipartisan and not be temporary.

Mr. Bieda said he plans to move through his committee a single bill to repeal the service tax and provisions for replacement revenue, adding that the MBT surcharge is the frontrunner at this point. That avoids blowing a hole in the recently passed budget, and allows legislators with "one vote to either accept it or reject it. It's a little easier to work on a consensus with one bill than a number of bills."

Noting the support the surcharge had from several business interests, he said there is no similar consensus to raise some revenue from the income tax. And he said the Legislature always has the opportunity to address the surcharge again, even if it is not explicitly made temporary.

While he said the call on whether to take the bill (HB 5408) to a full House vote is one for the speaker, Mr. Bieda said, "There is a good chance that it could be done tomorrow."

A spokesperson for House Speaker Andy Dillon (D-Redford Twp.) said no decision has yet been made, adding that workgroups will continue to discuss the issue with leadership. What to replace the service tax with, the process to use and how to develop a consensus are all matters to be determined before going forward, Greg Bird said.

But he said Mr. Dillon does agree with the governor that the replacement tax needs to be permanent,

as is the service tax, because "it's pretty apparent through the projections we see that we're going to be experiencing revenue problems in the coming years."

The move to fully replace the revenue, and the backing of some segments of the business community of that concept, spurred impassioned opposition from Tax Policy committee member Rep. John Pastor (R-Livonia), who said to his colleagues, "You guys just don't get it."

He said it was "disheartening" to hear those business interests supporting the replacement tax idea, stressing again the need to cut spending first and enact more reforms as businesses have to do when facing downturns.

"They are looking at horrible, horrible death," he said of businesses looking for any alternative to what many called a job-killing service tax. "This is crazy. We need to live within our means."

Eric Henning, governmental affairs director for General Motors, said the automaker was looking at paying "tens and tens and tens of millions" more dollars under the services tax, preferring the MBT surcharge that would amount to only a few million.

"It was an ill-conceived tax," he said. GM officials said they were surprised the state would impose such a tax that affects only in-state businesses, and have already found compliance difficult because they do not have the definitions of affected services in their records. Rick Zablocki of GM said replacing all of the revenue with a surcharge is not the company's first choice, but said, "We had to look at what is politically palatable."

Kelli Murphy of Ford said an MBT surcharge is the most straightforward way to deal with the problem and protect revenue so the entire budget debate is not reopened.

Those two firms along with Chrysler, Kellogg's, Herman Miller, Steelcase, Alticor, Dow Chemical, EDS and the Insurance Institute of Michigan were among two dozen businesses and business groups signing a letter to legislators urging action before the Thanksgiving break to repeal the service tax - which they said is having a serious impact on business - and replace it with an MBT surcharge.

"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," the letter said. "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. However, we recognize that major cuts in the recently passed state budget are unlikely to be accomplished before the service tax would go into effect."

Mr. Hadden assesses the chances of House action on Thursday at 50-50, but also urged a quick recreation of the workgroup on the MBT to craft a bipartisan solution.

Ms. Kinley said of the MBT replacement, "We're open to this idea if it can be made temporary and reasonable. For a lot of people, 33 percent is not reasonable." She said the Chamber is still collecting feedback from its members, some of it for the idea and some against.

She said the surcharge will wind up hitting a lot of companies that are to pay higher taxes already under the MBT than they did under the single business tax.

The letter from businesses supporting the MBT surcharge said the surcharge should be reduced as quickly as possible, but did not call for a sunset date.

Mr. Hadden said the sunset argument is "an item I'm not winning. But I'm still going to be coming back to the Legislature with or without a sunset and hoping to have a buffet of ideas of ways to raise revenue, reform government, or cut (spending) to lower that surcharge."

Still opposing the replacing all of the service tax - some of which is paid by individuals - and certainly opposing it be done through the MBT, is a business coalition that includes the National Federation of Independent Business, Michigan Association of Home Builders, Michigan Grocers Association, Michigan Restaurant Association, Michigan Association of Independent Agents and Associated Builders and Contractors.

Charles Owens, executive director of NFIB, told the committee his members and business allies want a solution "that is equitable and well thought out. We do not support full replacement (of revenue)," he said. He said while using mostly budget cuts may not be possible politically, his group prefers a broader tax such as a higher sales tax rate or upping the income tax.

But the Michigan League for Human Services said a sales tax on services is part of what is needed to modernize Michigan's tax structure and ensure growth of revenues essential to support the growing demand for state programs. In written testimony, MLHS President Ann Marston said the portion of consumer spending on services has soared to 60 percent, compared to nearly all consumer spending dedicated to goods when the sales tax was first enacted in the 1930s.

**REPEAL VOTE:** The Senate voted 23-15 to approve SB 838, with Sen. Glenn Anderson (D-Westland) and Sen. Jim Barcia (D-Bay City) joining a solid Republican caucus in favor of the bill. Mr. Anderson was the only Democrat to oppose the tax when it was adopted on October 1.

When it passed the Senate the measure was tie-barred to SB 845 that delays the implementation of the tax from December 1 to December 20. That tie-bar was eliminated when SB 845 came from the House committee.

Senate Democrats tried and failed to put a new tie-bar on the bill, to HB 5408, which they said could be used as the vehicle to create a replacement tax.

Without a replacement tax at least in the sights of lawmakers voting to repeal the tax only was nothing more than a political gimmick, Democrats said.

The repeal would "blow a \$600 million hole into this budget," said Senate Minority Leader Mark Schauer (D-Battle Creek). Repealing the tax without a replacement at least in process is the same strategy used to repeal the Single Business Tax and that led to months of uncertainty until lawmakers and the administration were able to approve the Michigan Business Tax.

Sen. Mike Prusi (D-Ishpeming) said that unless a replacement tax was in place passing SB 838 was just an example of "gotcha."

"This is just about gotcha votes, so the media will say look at those heroic Republicans and here are the Democrats being obstructionists," he said. "When are we going to come to the conclusion that the problems of this state will require everybody to take part in the solutions?"

And Sen. Gretchen Whitmer (D-East Lansing) said that because testimony was abbreviated in Tuesday's Finance Committee meeting (to allow as many people as possible to testify) committee members did not get a chance to hear the full comments of the witnesses, many of whom said in their written testimony that they supported a fairer, more broadly-based tax.

But those comments caused Ms. Cassis to charge (over loud Democratic objections) that Ms. Whitmer was mischaracterizing the committee's meeting.

Real people, not lobbyists, spoke to the committee about the effect the tax would have on them, Ms. Cassis said, and it was clear that for the state to move forward, even towards a replacement, it must first take steps to eliminate "this ill-conceived" tax.

And Mr. Bishop said he was not confident that the House would begin to move a replacement proposal unless the Senate acted to repeal the tax. "Hopefully, this will prime the pump, so we can see some solutions," he said.

**ANTI-SERVICE TAX TESTIMONY:** The House Tax Policy Committee continued to hear other opposition to the service tax and warnings from businesses of its effect on the economy if not repealed. Jared Rodriguez, vice president for public policy for the Grand Rapids Chamber of Commerce, said the "confusion over the tax is just the tip of the iceberg" of problems over the tax. "Extending the sales tax to services is a step back. You can do better," he said.

Fred Schlemmer of Steelpro in Wayne, a warehousing firm for steel used by automakers, said the tax will mean a huge cost increase that threatens not only his warehouse operations but also the freight haulers that move the steel. It would also wipe out a cost advantage, he said, that helps attract business bound for Canada.

Other business leaders said the tax piles tax upon tax, would drive some businesses to other states, that it is random in its application, and perhaps most unsettling to many, lays the ground for further expansion to more services in the future.

Representatives of electric cooperatives said one large unintended consequence of including landscaping in the tax is that the tree trimming needed to ensure reliable transmission lines is now taxed. Tony Anderson of Cherryland Electric Cooperative said his utility trims the equivalent of lines stretching coast to coast every seven years at a cost of several million dollars. "I encourage you to look at other avenues such as cuts and the Michigan Business Tax," he said.

George Moroz of the Tourism Industry Coalition strongly opposed the heavier burden the tax will lay on a significant and growing sector of the Michigan economy. Any service tax the state might impose, he said, should be as broadly based as possible.

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