

Legislative Analysis



SENATE SBT REPLACEMENT

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Senate Bill 94 (Substitute S-8)

Senate Bill 95 (Substitute S-4)

Senate Bill 96 (Substitute S-1)

Sponsor: Sen. Nancy Cassis

House Committee: Tax Policy

Senate Committee: Finance

Complete to 5-9-07

A SUMMARY OF SENATE BILLS 94–96 AS PASSED BY THE SENATE 5-3-07

The bills would create a new tax business tax system to replace the Single Business Tax, which expires on December 31, 2007. Highlights of the bills include:

- **Senate Bill 94 (S-8)**
 - A tax of 0.54% on gross receipts less purchases from other firms.
 - Automatic rate reduction if the amount of revenue from gross receipts tax under SB 94 and business income tax under SB 95 exceeds \$1.56 million by more than the change in inflation plus 1%.
 - Retaining the current SBT filing threshold of \$350,000 in gross receipts, but eliminating the "cliff effect" for businesses with gross receipts in excess of \$350,000 by phasing in tax liability for businesses with gross receipts between \$350,000 and \$650,000.
 - Allowing firms with gross receipts between \$350,000 and \$15 million to elect to pay the gross receipts tax under SB 94 or the business income tax under SB 95.
 - Phasing in tax liability for firms with gross receipts between \$15 million and \$50 million.
 - Allowing taxpayers to apply any unused carryforward from the SBT against the 2007 tax liability.
 - Retaining a number of credits from the SBT including venture capital investment, alternate energy, Michigan Economic Growth Authority, renaissance zones, brownfield development, and historic preservation.
 - Creating a new "entrepreneurial credit" for firms with up to \$25 million in gross receipts that create jobs and invest in the state.
 - Creating a credit of 25% of industrial and commercial personal property taxes on recently acquired property.
 - Creating a credit of 20% of utility property taxes for telephone companies and 5% for other utility property taxpayers.
 - A credit for compensation paid for research and development and management employees.
 - A credit for capital expenditures at Michigan International Speedway.

- A credit for restaurants that impose a smoking ban.
 - Apportionment based solely on the sales factor.
 - Market-based sourcing of sales.
 - Generally retaining the current tax rate and structure for insurance companies.
 - Subjecting depository financial institutions to a separate tax on "net capital," rather than the gross receipts tax and in lieu of the business income tax.
 - Requiring unitary filing for corporate groups.
 - Depositing proceeds into the General Fund.
 - Repealing the act on January 1, 2018.
- **Senate Bill 95 (S-4)**
 - A tax of 1.5% on business income.
 - Retaining the current SBT filing threshold of \$350,000 in gross receipts.
 - Allowing firms with gross receipts between \$350,000 and \$15 million to elect to pay the gross receipts tax under SB 94 or the business income tax under SB 95.
 - Apportionment based solely on the sales factor.
 - Market-based sourcing of sales.
 - Requiring unitary filing for corporate groups.
 - Depositing proceeds into the General Fund.
 - **Senate Bill 96 (S-1)**
 - Exempting new industrial personal property from property taxation.

Senate Bill 94 (S-8): Business and Economic Stimulus Tax

Taxpayers

A taxpayer would be an individual, firm, bank, financial organization, depository financial institution, limited partnership, limited liability partnership, co-partnership, partnership, joint venture, association, corporation, subchapter S corporation, limited liability company, receiver, estate, trust, or any other group or combination of groups acting as a unit.

The bill (Section 13), like the SBT, provides that firms with gross receipts of \$350,000 or less would not be required to file a return and would have no tax liability. Firms with gross receipts between \$350,000 and \$15 million would have the option to calculate their tax under SB 94 using gross receipts or under SB 95 using business income. The \$15 million threshold would be adjusted annually for inflation using the Detroit consumer price index. An election would have to be made every three years (provided the firm continues to be eligible to make an election).

Tax Rate and Base

The bill imposes a tax of 0.54% on the gross receipts less purchases from other firms. Gross Receipts generally means the entire amount received by the taxpayer from any activity whether in intrastate, interstate, or foreign commerce carried on for direct or indirect gain, benefit, or advantage to the taxpayer or to others, with a number of exclusions. Purchases from other firms include inventory and depreciable assets acquired in the tax year.

The bill also provides that if the combined revenue from the gross receipts tax under SB 94 and the business income tax under SB 95 exceeds \$1.56 million (annually adjusted for the percentage change in the Detroit Consumer Price Index plus 1%), the rate for the following year would be lowered to generate revenue in the coming fiscal year of \$1.56 million (annually adjusted for the percentage change in the Detroit Consumer Price Index plus 1%).

The tax base for financial organizations would be gross receipts less the cost of any funds or interest expenses. Financial organizations would be any association, joint stock company, or corporation (other than a depository financial institution) at least 90% of whose gross receipts consist of dividends or interest or other charges resulting from the use of money or credit.

The tax base for foreign persons (outside of the U.S.) would generally mean gross receipts of business activity in the U.S. less purchases from other firms, irrespective of whether the foreign person is subject to taxation under the federal Internal Revenue Code.

The bill includes separate calculations for insurance companies and depository financial institutions (described below) and continues a separate calculation, from the SBT, for firms whose business activities consist of transportation services and transportation of oil and gas by pipeline as well as financial organizations.

Retained Credits

The bill (Section 20) provides that any unused carryforward from a credit under the SBT Act would be carried over to the gross receipts tax in the 2007 tax year. Any remaining unused carryforward could not be carried forward to offset tax liability in future years. Additionally, the bill retains a number of credits currently provided for in the SBT Act:

- Venture capital investment (Section 21/SBT MCL 208.37e).
- Alternate energy (Section 22/SBT MCL 208.39e).
- Michigan Economic Growth Authority (Section 23/SBT MCL 208.37c and 208.37d).
- Renaissance zones (Section 24/SBT MCL 208.39b).
- Brownfield development (Section 25/SBT MCL 208.38g).
- Charitable contributions (Section 35/SBT MCL 208.38).
- Historic preservation (Section 36/SBT MCL 208.39c).
- Community foundations (Section 37/SBT MCL 208.38c).

- Apprenticeships (Section 38/SBT MCL 208.38e).
- Donated automobiles (Section 39/SBT MCL 208.37g).

Personal Property Tax Credit (Section 28)

The bill creates a credit against the tax equal to 25% of personal property taxes paid on industrial or commercial property acquired within the past five years. Under the bills, "property taxes" would mean taxes paid under the General Property Tax Act, but would not include taxes under the Plant Rehabilitation and Industrial Development Act, the Obsolete Property Rehabilitation Act, the Technology Park Development Act, the Commercial Rehabilitation Act, or the amounts of payments under a contract with a local tax collecting unit to reimburse local units for property taxes that would otherwise be collected under the General Property Tax Act. (The SBT currently provides a credit equal to 15% of property taxes paid, including those taxes under the General Property Tax Act and those acts listed above.) The credit would not be refundable, but could be carried forward for up to 10 years.

Utility Property Tax Credits (Sections 28 and 30)

The bill provides two credits for utility property taxes levied under 1905 PA 282. A 20% credit would be available to telephone companies under Section 28. (This credit, combined with the 25% industrial personal property tax credit, would be nonrefundable, but could be carried forward for 10 years.)

The second credit (Section 30) would be equal to 5% of utility property taxes imposed under 1905 PA 282.

Michigan Entrepreneurial Credit (Section 29)

The bill creates a credit equal to 100% of the tax liability to firms that, in the prior tax year, (1) have less than \$25 million in gross receipts (adjusted annually for inflation); (2) create or transfer 20 new jobs in the state; and (3) have \$1.25 million in capital investment in the state. The "new" jobs would have to be jobs that did not exist in the prior year, represent an overall increase in full-time jobs from the prior year, and could not be transferred jobs where the employee worked in the state for the taxpayer, a related entity, or an entity with which the taxpayer files a consolidated return. The credit could not be claimed more than five times in five consecutive years. If the taxpayer relocates outside of the state within five years after claiming the credit and is no longer subject to the tax, all of the credits would have to be repaid and would be subject to collection by the Department of Treasury under the provisions of the Revenue Act.

Smoking Ban Credit (Section 31)

The bill creates a new tax credit equal to 10% of tax liability for restaurants that impose a smoking ban for the entire tax year.

R&D and Management Employees Compensation Credit (Section 32)

The bill would create a nonrefundable credit available to firms that employ at least 450 research and development or 450 qualified management staff employees. The amount of the credit would be calculated for each R&D or management employee whose wages subject to federal Medicare withholding taxes exceed the average wage subject to federal Medicare withholding taxes for non-R&D or non-management employees.¹ For each employee, the credit would be equal to the difference in the wages of R&D or management employees and of other employees (up to \$200,000), multiplied by 0.1. The total credit would be the aggregate amount calculated for each employee. In sum, the credit calculated for individual employees would be:

$$\begin{array}{r} \text{(R\&D/Mgmt employee wages} \\ \text{subject to federal Medicare taxes)} \end{array} - \begin{array}{r} \text{Average Non-R\&D/Non-Mgmt employee} \\ \text{wages subject to federal Medicare taxes)} \end{array} \times 0.1$$

Michigan International Speedway Credit (Section 34)

The bill creates a credit for the 2008-2017 tax years for capital expenditures made at the Michigan International Speedway. The credit would not be refundable, and unused credits could not be carried forward to offset tax liability in future years. The amount of the credit would be capped at an amount still to be agreed to. (The bill caps the credit at \$1, apparently using that figure as a placeholder until a final number is agreed to.)

Nexus of Out-of-State Firms (Section 15)

The bill notes that out-of-state firms would have nexus with the state if they engage in any of the following activities:

- Have at least one employee who is a Michigan resident conducting business in the state.
- Owns, rents, leases, maintains or has the right to use tangible personal property or real property temporarily or permanently located within the state.
- Has employees who own, rent, lease, maintain, or use an office within the state.
- Has agents, representatives, independent contractors, brokers, or others acting on its behalf who own, rent, lease, maintain, or use an office that enables the firm to establish and maintain a market in the state.
- Has goods delivered to Michigan in vehicles that the firm owns, rents, leases, maintains, or uses, or has goods delivered by a third-party,
- Regularly and systematically conducts business activity in the state through employees, agents, representatives, independent contractors, and others acting on its behalf, irrespective of whether these individuals reside in the state.

¹ Unlike federal Social Security taxes, which are imposed at a rate of 6.2% on wages up to \$97,500 beginning in 2007, there is no limit on wages subject to federal Medicare taxes (the withholding rate is 1.45%). However, there are federal rules in place specifying when certain types of compensation (stock-based compensation, nonqualified deferred compensation, etc) are subject to Social Security and Medicare withholding taxes. Also, contributions to a 401(k), while reducing a taxpayer's taxable income, are subject to social security and Medicare taxes.

Nexus is a sufficient connection between the state and taxpayer that brings that taxpayer within the state's taxing jurisdiction. A firm without nexus is not subject to taxation. In general, the bill retains the current nexus standards used for the SBT as provided for in the Department of Treasury's Revenue Administrative Bulletin 1998-1.

Apportionment

The bill would apportion the tax based solely on the sales factor, which would be a fraction where the numerator is total sales in Michigan and the denominator is total sales everywhere. For a foreign firm, the sales denominator of the sales factor would be sales occurring in the U.S. For a member of a unitary business group, the numerator would be sales in Michigan and the denominator would be the total sales of the unitary business group everywhere, although sales between members of the group would be excluded in determining the sales factor. The bill would retain a provision (MCL 208.54) permitting spun-off corporations (Delphi and Visteon) to exclude from Michigan and total sales, for the purpose of calculating the sales tax factor, sales made to its immediately preceding former parent corporation. The bill retains a provision providing that apportionment "fairly" represent the extent of a taxpayer's business activity in Michigan.

Sourcing

The bill would "source" sales of tangible personal property to the state if the property is shipped or delivered to any purchaser within the state irrespective of the fee on board point or other conditions of sale. Also, Michigan sales would also include receipts from the sale, lease, rental, or licensing of real property or tangible personal property located in the state. Sales of goods and other tangible personal property would be sourced to Michigan if the receipts are derived from customers within the state. Receipts from the performance of services would be sourced to Michigan if the recipient receives all of the benefit in the state.

Generally, under the SBT Act, for the purpose of calculating the sales apportionment factor, the sales of services and intangible personal property (i.e. sales other than sales of tangible personal property) are sourced to Michigan if a greater proportion of business activity, based on the cost of performance, occurs within Michigan than outside of Michigan.² The bill, instead, uses a "market-based" method of sourcing sales to Michigan, in which sales are sourced on where the purchaser is located or where the good or service is used.

Unitary Business Groups

The bill (Section 75) would treat members of the same unitary business group as one taxpayer for the purposes of an original return, and would require unitary business groups to file a combined return that includes each U.S. person included in the group. For the purposes of calculating the sales factor, sales between members of the group would not

² The "cost of performance" means those costs directly related to the activity performed for a client determined in a manner consistent with the taxpayer's method of accounting for federal income tax purposes. The cost of performance is determined separately for each sale.

be included. The bill (Section 15) provides that a member of a group (or a consolidated taxpayer group) would not have nexus with the state based solely on the in-state nexus of another member of the group.

Under the bill, a unitary business group would be a group of persons related through common ownership whose business activities are integrated with, are dependent upon, and contribute to each other. It would not include a member where at least 80 percent of the member's business activity occurs outside of the U.S.

Insurance Companies (Chapter 5)

Under current law, insurance companies are liable for the SBT or the so-called retaliatory tax (if applicable) levied under the Insurance Code, whichever is greater.³ The SBT Act (MCL 208.22a) provides that the tax base and adjusted tax base of an insurance company is 25 percent of the company's adjusted receipts, subject to any apportionment. Adjusted receipts generally include, among other items, gross direct premiums, rental and royalty receipts, and receipts from business activity other than the business of insurance. In addition, insurance companies are subject to a "surcharge" under MCL 208.22b equal to 1.26 times the company's tax liability before application of certain credits. The total tax of an insurance company under the SBT calculates out to be 1.0735 percent of the company's adjusted receipts, less certain industry-specific credits and other credits.

The bill, in general, would treat insurance companies in the same manner as currently provided under the SBT Act. The bill would impose a tax on insurance companies equal to 1.0735 percent of "adjusted receipts" (using the same definition as included in the SBT Act). The bill retains certain exclusions from the tax base (including the first \$130 million in disability insurance premiums) and several industry-specific credits.

The bill also retains a provision from the SBT that the tax is in lieu of all other privilege or franchise fees or taxes imposed by any other law, *except* taxes on real and personal property.

Depository Financial Institutions (Chapter 6)

The bill creates a separate calculation for depository financial institutions (banks) that would be in lieu of both the gross receipts tax imposed under the bill and the business income tax imposed under SB 95. Banks with business activity and nexus would be subject to a franchise tax of 0.225% of the average "net capital" over last five years (or fewer years, if the bank has not been in existence for five years). Net capital would include capital stock paid in, surplus, undivided profits and capital reserves, net unrealized holding gains or losses on available for sale securities and cumulative foreign currency translation adjustments and a deduction for a portion of U.S. and Michigan obligations.

³ Under the Insurance Code's retaliatory tax, MCL 500.576a, when an insurer's state of incorporation imposes a larger aggregate tax burden on a Michigan insurer doing business in that state than Michigan imposes on a company from that state doing business in Michigan, the foreign insurer must pay Michigan a tax equal to the difference in aggregate tax burdens.

Exemptions

Generally, the bill would retain exemptions from the SBT Act (MCL 208.35) for the following: (1) the U.S. government, the state, other states, and political subdivisions; (2) charitable and educational institutions exempt from federal income taxes; (3) nonprofit cooperative housing associations; (4) the production of agricultural goods; (5) farmers' cooperatives; (6) activities under the Agricultural Commodities Marketing Act; (7) services provided by an attorney-in fact; and (8) multiple employer welfare arrangements providing dental benefits.

Miscellaneous Provisions

Chapter 7 of the bill generally includes a number of provisions from Chapter 4 of the SBT Act, concerning (1) estimated returns, (2) annual returns, (3) furnishing copies of federal returns, (4) information returns, and (5) administration and rules.

Revenue Disposition (Section 78)

The bill provides that revenue from the tax would be deposited in the General Fund.

Effective Dates (Section 91)

The bill would take effect January 1, 2008, and would be repealed January 1, 2018.

Senate Bill 95 (S-4): Business Income Tax

Taxpayers

As in SB 94, a taxpayer would be an individual, firm, bank, financial organization, depository financial institution, limited partnership, limited liability partnership, co-partnership, partnership, joint venture, association, corporation, subchapter S corporation, limited liability company, receiver, estate, trust, or any other group or combination of groups acting as a unit with business activity in the state. To be subject to taxation under the bill, a person would have to have nexus with the state consistent with federal Public Law 86-272 (15 USC 281 to 384).⁴

Businesses with gross receipts of less than \$350,000 would not be required to file a return and would have no tax liability under the bill. If a business with gross receipts between \$350,000 and \$15 million elects under SB 94 to pay the gross receipts tax, it would be exempt from the business income tax. (The \$15 million threshold would be adjusted annually for inflation using the Detroit consumer price index. An election would have to

⁴ Public Law 86-272, enacted in 1959, generally prohibits states from imposing a tax on the income of a corporation derived from interstate commerce if the only business activities within the state by or on behalf of the corporation are the solicitation of orders of tangible personal property where orders are sent outside of the state for acceptance or rejection and, if accepted, are filled by shipment or delivery from a point outside of the state. Additionally, PL 86-272 provides that independent contractors may engage in soliciting sales, making sales, and maintaining a sales office within a state without subjecting the corporation to taxation.

be made every three years, provided the firm continues to be eligible to make an election).

Tax Rate and Tax Base

The bill would impose a tax of 1.5% on the adjusted business income of taxpayers. Business income would generally mean that part of federal taxable income that is derived from business activity. Adjustments to business income, prior to apportionment and allocation, include (1) adding interest income and dividends derived from obligations or securities of other states, in the same amount excluded from federal taxable income, less related expenses not deducted in computing federal taxable income under Sections 265 and 291 of the federal Internal Revenue Code; (2) adding all taxes on income or measured by net income, to the extent deducted in calculating federal taxable income; (3) adding any carryback or carryover of a net operating loss, to the extent deducted in calculating federal taxable income; (4) deducting royalties and dividends received from persons other than U.S. persons; (5) adding the loss or subtracting the income attributable to another entity whose business activities are taxable under the bill or would be taxable were the entity located in Michigan; (6) add any interest, royalty, or other expense paid to a related person not included in a unitary business group for use of an intangible asset, to the extent deducted in calculating federal taxable income.

Adjustments to business income, after allocation and apportionment, would include an adjustment for any non-business income or loss allocated to the state and deducting any available business loss, including a business loss carryforward calculated under Section 23b(h) of the SBT Act.

The bill contains separate tax base calculations for financial organizations, firms whose business activities consist of transportation services, and transportation of oil and gas by pipeline.

Apportionment and Sourcing

The bill apportions the tax base solely on the sales factor. The bill continues a special calculation for spun-off corporations, as currently provided in the SBT Act and SB 94. The bill also contains specific "market-based" sourcing provisions for the following:

- Receipts from the rental or lease of real property.
- Receipts from the rental or lease of tangible personal property.
- Receipts from the rental or lease of mobile transportation property.
- Sales derived from securities brokerage services.
- Royalties and other income received from the use of, or privilege of using intangible personal property.
- Interest from loans secured by real property.
- Interest from loans not secured by real property.
- Receipts from the sale of loans.
- Receipts from credit card receivables.
- Loan servicing fees.

- Receipts from trading assets.

Miscellaneous Provisions

The bill generally includes several provisions carried over from Chapter 4 of the SBT Act concerning (1) estimated returns, (2) annual returns, (3) furnishing copies of federal returns, (4) information returns, and (5) administration and rules.

Unitary Business Groups

The bill treats unitary business groups in the same manner as provided in SB 94.

Revenue Disposition

The bill provides that revenue from the tax would be deposited in the General Fund.

Senate Bill 96 (S-1): Personal Property Tax Exemption

The bill would amend the General Property Tax Act to exempt from taxation, beginning December 31, 2007, industrial personal property that prior to December 31, 2007, was not subject to taxation or exempt from taxation under the act (that is, "new" industrial personal property.)

FISCAL IMPACT:

The bills provide that if the combined revenue from the gross receipts tax under SB 94 and the business income tax under SB 95 exceeds \$1.56 million (annually adjusted for the percentage change in the Detroit Consumer Price Index plus 1%), the rate for the following year would be lowered to generate revenue in the coming fiscal year of \$1.56 million (annually adjusted for the percentage change in the Detroit Consumer Price Index plus 1%). A fiscal review is in progress to determine whether that threshold will be met.

The exemption for new industrial personal property would reduce property tax revenue for local units of government by an estimated \$47 million. Additionally, the exemption would reduce revenue generated from the 18 mills levied for school operating purposes by an estimated \$30 million, which requires an increase in School Aid Fund expenditures, and would reduce revenue from the 6-mill State Education Tax by an additional \$10 million, for a total impact on the School Aid Fund of \$40 million.

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■ This analysis was prepared by nonpartisan House staff for use by House members in their deliberations, and does not constitute an official statement of legislative intent.