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BILL ANALYSIS

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Senate Bill 342 (Substitute S-1 as reported)
Sponsor: Senator William Van Regenmorter
Committee: Finance

Date Completed: 3-17-95

RATIONALE

The Single Business Tax (SBT) Act imposes a tax on business based upon a measure of a firm's activity in Michigan. A business that conducts all of its activities in Michigan must include all of those activities in its tax base. While a large majority of SBT payers are firms that operate only in Michigan, a large portion of total SBT revenue is paid by a small number of "multistate" firms; that is, businesses located outside the State that do business in the State, or businesses headquartered in Michigan that do business here and elsewhere.

The Act requires a multistate firm doing business in Michigan, whether or not headquartered here, to "apportion" its tax base by determining how much of its business activity is attributable to Michigan. This is accomplished by using a three-factor formula that requires the firm to calculate the ratio of its property, payroll, and sales in Michigan to its entire property, payroll, and sales, and apply this ratio to its nationwide (or worldwide) tax base, resulting in its apportioned tax base. The property, payroll, and sales factors of the apportionment factor are weighted; that is, the Act requires the use of 25% of the property factor, 25% of the payroll factor, and 50% of the sales factor. The apportionment formula is determined in the following manner:

$$.25 \times \frac{\text{Property in MI}}{\text{All Property}} + .25 \times \frac{\text{Payroll in MI}}{\text{All Payroll}} + .50 \times \frac{\text{Sales in MI}}{\text{All Sales}}$$

It has been argued that the structure of the apportionment formula favors multistate companies located outside Michigan over multistate companies located in Michigan, in effect giving outside companies a competitive advantage. For example, a Michigan-based company with significant property and payroll in Michigan must include those under the apportionment formula, while an outside company that sells products here but has no physical presence in Michigan can exclude property and payroll from the calculation. If the two companies have similar sales factors, the outside company enjoys a tax advantage under the SBT. Some people feel that this works as a disincentive for multistate companies to invest in Michigan. It has been suggested that the payroll and property factors be eliminated, and that apportionment be based solely on sales.

CONTENT

The bill would amend the Single Business Tax Act to alter the calculation of the SBT for multistate firms, by increasing the sales factor to 100% and eliminating the property and payroll factors after 1998.

Currently, under the Act, the tax base of a taxpayer is apportioned to Michigan by using 25% of property, 25% of payroll, and 50% of sales. The bill would change the apportionment formula in the following way: A taxpayer's tax base would have to be apportioned to the State by multiplying the tax base by the sum of 20% of the property factor, 20% of the payroll factor, and 60% of the sales factor, for tax year 1995; by the sum of 15% property, 15% payroll, and 70% sales, for 1996; by the sum of 10% property, 10% payroll, and 80% sales, for 1997; and by the sum of 5% property, 5% payroll, and 90% sales for 1998. After 1998, all of the tax base would have to be apportioned to the State by multiplying the tax base by the sales factor.

MCL 208.45

ARGUMENTS

(Please note: The arguments contained in this analysis originate from sources outside the Senate Fiscal Agency. The Senate Fiscal Agency neither supports nor opposes legislation.)

Supporting Argument
Currently, by including payroll and property in the SBT apportionment formula, multistate firms headquartered in Michigan find themselves at a competitive disadvantage relative to multistate businesses located outside the State. For instance, a Michigan-based business with sales here and in other states or countries will tend to have a greater percentage of its total business activity reflected in Michigan-based property and payroll than will an outside business with sales in Michigan. A Michigan-based business must include the payroll, property, and sales factors in determining its apportioned tax base, while an outside business with little or no physical presence in Michigan will have little or no in-State payroll and property to include in its calculation. Thus, the calculation of the business activity apportioned to Michigan under the SBT falls more heavily on the Michigan- based business than on the outside firm. This has led to many negative ramifications for Michigan-based multistate businesses.

In effect, the current tax structure provides a disincentive for multistate firms to maintain or increase their physical presence in Michigan, since if they only sell products here rather than produce or store them, they can avoid including payroll and property in their tax bases. The bill, by basing the apportionment formula on a 100% sales factor, would level the playing field for Michigan-based firms; that is, multistate firms would be taxed on the same single factor regardless of the point of manufacturing. This would make the tax climate in Michigan much more attractive to job providers because they would no longer be penalized under the tax for locating here. Further, removing payroll and property from the apportionment calculation would significantly reduce the taxes of some firms, thus rewarding those business that already have significant in-State property and payroll.

Opposing Argument
The bill chooses winners and losers; some firms would benefit greatly while others would experience a tax increase. A Michigan-based company with significant property and payroll in-State relative to its sales would be helped greatly by the change to a 100% sales factor, while a company with significant sales in Michigan but little physical presence would experience a substantial tax increase. While it is easy to say that we should embrace a tax structure that favors in-State companies, should this be done at the expense of out-of-State companies? The issue of favoring in-State companies must be looked at in context. Though the current SBT apportionment formula appears to favor an outside firm over an in-State firm if those firms have similar sales levels, it must be remembered that the out-of-State firm is paying taxes in its home state, and anywhere else it has sales or presence. Thus, while the tax burden imposed under the SBT may be greater for the Michigan-based company, the total tax burden imposed on the outside firm may be as great or greater, and not reflect any advantage at all. Further, though the Michigan-based firm may have a heavier SBT burden, it also uses and enjoys the benefits of the State's services and infrastructure. The bill could have a significant negative impact on an out-of-State firm with substantial Michigan sales, and thus increase costs for its distributors and customers.

Opposing Argument
The bill would have a major impact on SBT revenues. The State has cut taxes, including business taxes, several times in recent years. The SBT has been changed in several ways to favor small business; for instance, the gross receipts filing threshold has been raised and the alternative tax rate has been reduced. If the State experiences an economic downturn in the future and finds itself short of revenue, the change proposed by the bill would exacerbate the revenue problem. If such a situation developed, and the State needed to raise funds, it would be unacceptable to reverse the gains that small businesses have made, while letting big multistate businesses enjoy the changes in the apportionment formula.

Response: The revenue implications would not be as severe as expressed. First, the bill would phase-in the change to a 100% sales factor over a period of five years, so the State would have a chance to adjust to any reduced revenues. Further, the increased taxes on some out-of-State firms combined with a more aggressive attempt on the part of the State to make them pay the taxes they owe could greatly reduce any drop in SBT revenues caused by the bill.

Opposing Argument
The bill, by adopting a 100% sales apportionment formula, in effect would change the nature of the SBT, to the point that it would no longer resemble a value-added tax. If important elements involved in adding value to a product, payroll and property, were removed in favor of a fully weighted sales factor, then the tax would no longer reflect changes in value. In fact, under the bill a company could locate in Michigan and produce goods and,

if it sold its product only outside the State, not apportion any of its tax base to the State. Instead of adopting this idea, the State should repeal the SBT in its entirety. Since its inception, the tax has been a detriment to business in the State and a disincentive for employers to locate here.

Legislative Analyst: G. Towne

FISCAL IMPACT

This bill would reduce Single Business Tax revenue by an estimated $35 million in FY 1994-95 and $81 million in FY 1995-96. By FY 1999-2000, when the switch to a 100% sales apportionment factor would be fully phased in, the loss in revenue would be an estimated $250 million. These losses in SBT revenue would affect the GF/GP budget and revenue sharing. In FY 1994-95, the loss in revenue would be borne entirely by the GF/GP budget and in FY 1995-96, GF/GP revenue would be reduced by an estimated $80 million and revenue sharing payments to local governments would be reduced by $1 million. In FY 1999-2000, GF/GP revenue would be reduced by an estimated $215 million and revenue sharing payments would be cut by $35 million.

Presently, a business that operates in other states in addition to Michigan, first calculates its SBT tax base by determining its gross tax base, which reflects its total business activity both in and out of Michigan. This gross tax base is then apportioned to Michigan using an apportionment factor. This apportionment factor is made up of the weighted average of the following three separate factors: 1) sales factor (Michigan sales/total sales); 2) payroll factor (Michigan payroll/total payroll), and; 3) property factor (value of property in Michigan/value of all property). The sales factor has a 50% weight and the property and payroll factors each have a 25% weight. This bill would change the apportionment factor from this weighted three-factor formula, to a single factor based on sales. This proposed change would affect multistate businesses only because businesses that operate only in Michigan do not apportion their tax base and therefore are not affected by a change in the apportionment method. Multistate businesses account for about 5% of all SBT returns and 50% of total SBT payments. This change to a 100% sales apportionment factor would tend to benefit those multistate businesses that are based in Michigan, or at least have a major physical presence in Michigan, but sell their products all over the country or world. Businesses that would tend to incur a tax increase would be those companies based outside of Michigan, but with sales in Michigan. In other words, any multistate business whose sales factor is less than the average of its payroll and property factors, would realize a tax reduction under this bill. Conversely, any multistate business whose sales factor is greater than the average of its payroll and property factors would realize a tax increase.

Fiscal Analyst: J. Wortley

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