
Business Tax Changes & the Effect on Industries

Prepared for
SBT Replacement Tax Seminar

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Outline

- I. Introduction
 - II. Three Questions
 - III. Replacement Business Taxes
 - IV. Effect on Industries
 - V. Items to Consider When Evaluating Replacement Taxes
 - VI. Conclusions
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I. Introduction

Anderson Economic Group, LLC

- Economic consulting firm specializing in business valuation, public finance, tax, and economic and fiscal impact analysis
- Clients include corporations, nonprofits, state governments, and local governments throughout the United States
- Offices in East Lansing, MI and Chicago, IL

Patrick L. Anderson

- Founder and CEO of Anderson Economic Group
 - Author of *Business Economics & Finance* (CRC Press, 2004)
 - Author of 2006 SBT Repeal Law for Michigan
 - Co-author of 2006 50-State Business Tax Benchmarking Study (with Caroline Sallee)
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II. Three Questions

1. Will the replacement tax raise more, less, or the same amount of revenue as the SBT?
 - SBT repeal law called for “less costly” tax
 - AEG 50 State Tax Benchmarking study shows Michigan “business” taxes higher than top 10 states

 2. Will the replacement tax be a tax on “businesses” or “individuals”?
 - Most plans affect only “businesses”
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II. Three Questions (cont.)

3. What form will a “business” tax take?
 - Let’s review the options.....

III. Replacement Business Tax Proposals

1. Gross Receipts + Business Income
 - Michigan Chamber of Commerce Plans

 2. Gross Receipts Tax Only
 - Grand Rapids Area Chamber of Commerce
 - Detroit Regional Chamber of Commerce

 3. Gross Receipts + Income + Assets Tax
 - Governor Granholm's MBT

 4. Subtractive VAT
 - Gary Wolfram

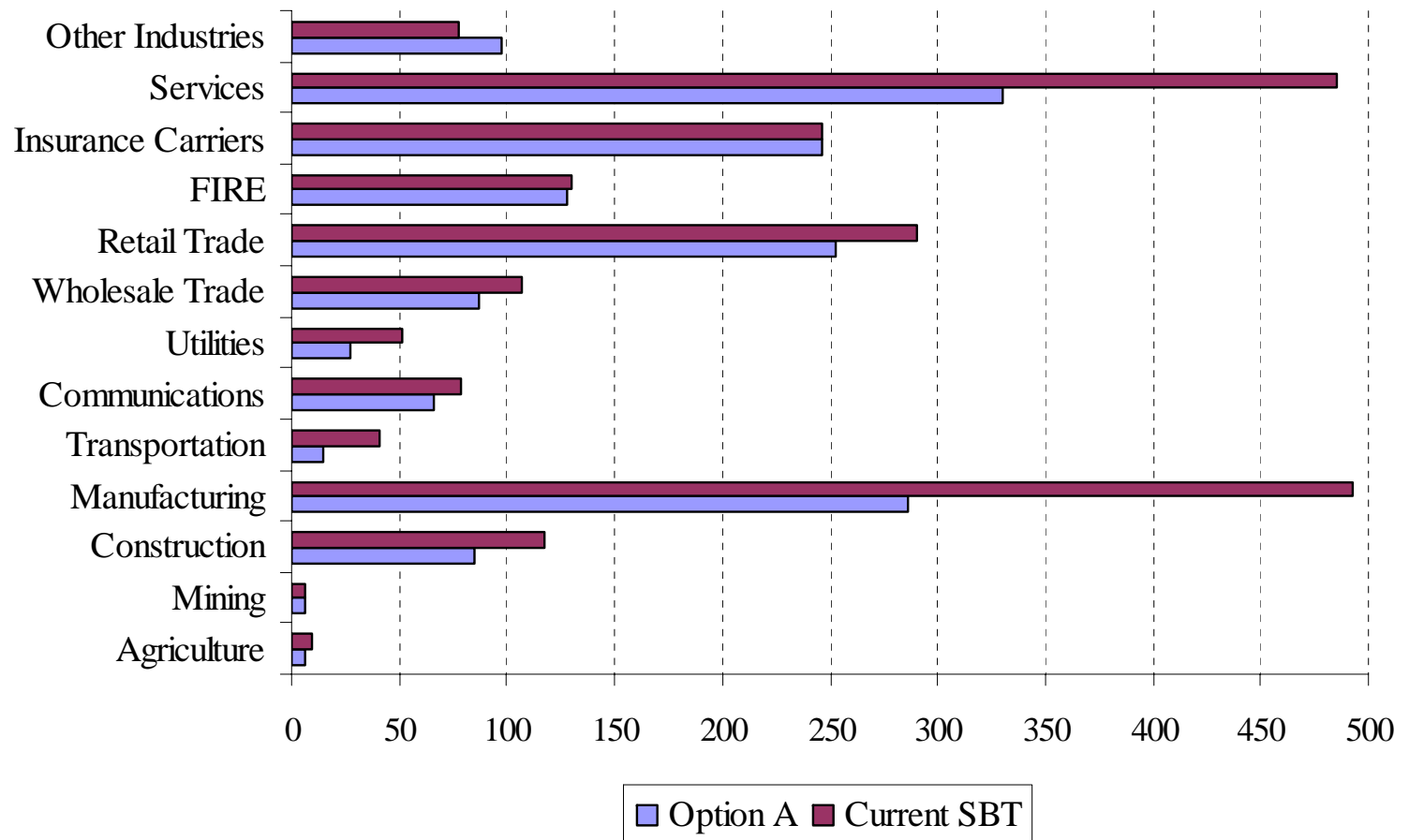
 5. Sales Tax on Services
 - "Fair" Tax
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IV. Effect on Industries

1. Any tax change will have varying effects on industries.
2. Because the SBT is no longer a neutral tax, any tax change will also vary by taxpayer within industry.

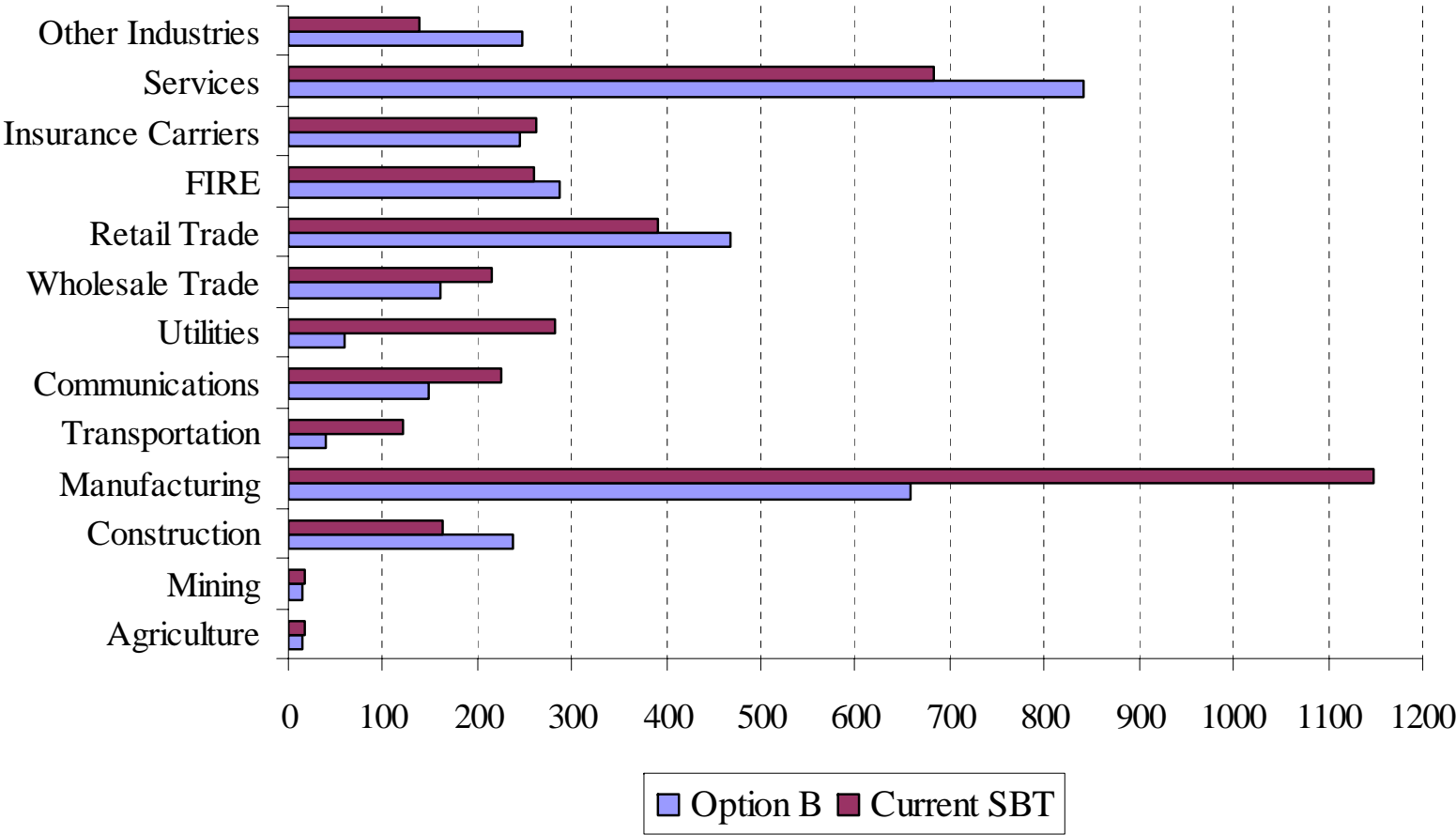
Let's look at the likely effects on “average” taxpayers within an industry...

Tax Liability: Current Law & MI Chamber's Option A



Source: Michigan Chamber of Commerce, E&Y Estimates, 2006
 Analysis: Anderson Economic Group, LLC

Tax Liability: Current Law & MI Chamber's Option B



Source: Michigan Chamber of Commerce, E&Y Estimates, 2006
 Analysis: Anderson Economic Group, LLC

Observations

1. Manufacturers are harmed by the SBT - almost any reasonable tax change helps them.
 2. Service industries are most helped by low gross receipts tax rates. Services have relatively low personal property and plans that offset a higher GR rate with PPT relief do not benefit these industries.
 3. “FIRE” also affected by gross receipts taxes more than income or personal property taxes.
 4. Wide variation in liability among taxpayers in these industries.
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Governor's MBT Proposal

- Overall, good structure
 - Gross Receipts tax rate of 0.125% is competitive (Ohio's gross receipts tax rate is 0.26%)
 - Business income tax rate is low at 1.875%
 - Personal property tax relief is given to businesses that particularly need the relief
 - Improves the treatment of small businesses
 - Exempts businesses with gross receipts under \$350,000
 - Phases in tax liability for businesses with gross receipts between \$350,000 and \$700,000
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“Asset Tax” in the Governor’s MBT

- A tax on assets puts many businesses at risk for higher tax liabilities. Specifically:
 - Businesses with cash on their balance sheets
 - Businesses with accounts receivable
 - Banking industry is likely to be hit hard by this tax
 - The asset tax will produce several undesirable outcomes:
 - Businesses will likely spend more time and money in tax planning to avoid having assets in Michigan
 - Tax revenue from this tax is likely to be lower than originally estimated due to tax planning by firms
 - A tax on assets sends a signal to businesses that they do not want to hold investments and assets in Michigan
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V. Items to Consider When Evaluating Replacement Tax Plans

- A. Tax Base
 - What is being taxed?

- B. Rate
 - How much is being taxed?

- C. Who Pays
 - Are all businesses paying? Some?

Tax Base Examples

Consider two examples:

1. The tax base under different tax systems for a realtor (a provider of services).
2. The tax base under different tax systems for a grocer (a retailer of goods).

A1. Tax Base Example: Realtors

Question: What is the “Sale” for a Services Transaction?

Consider:

- \$100,000 home listed with realtor, sold for \$100,000 plus \$2000 in other costs, and \$500 in prepaid interest.
 - Buyer pays \$22,500 down and finances \$80,000.
 - Seller receives \$100,000 less Realtor commission of \$6,000.
 - Realtor incurs direct costs of \$1000, including listing costs.
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Possible Answers:
Sales tax base for real estate transaction

1. The \$100,000 purchase price, before any costs or commission.
 2. The \$100,000 price less the \$6,000 commission.
 3. The \$6000 for the commission.
 4. The \$6000 commission less the \$1000 costs.
 5. The \$6000 for the commission, the \$2000 in costs (except the government costs, of course), and the \$500 (plus unstated future) finance charges over the life of the mortgage.
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Defensible Tax Bases for Realtor Services —Using the Example

1. Pure Income Tax

Base: Business Income, based on IRS- reported income.

(answer no. 4; plus answer no. 2 for the property owner)

Note: could be in addition to tax already paid on pass-through income.

2. Sales Tax on “Service”

Base: Commission income only; no sales tax paid on listing fees resulting in sale.

(answer no. 3 or 4)

Defensible Tax Bases for Realtor services—Using the Example

3. Gross Receipts Tax
Base: Commission; gross receipts tax also paid on listing fees and other non-government charges.
(answer no. 5—for multiple entities)

 4. Value Added Tax
Base: Commission less listing costs and other non-payroll costs.
(answer no. 4)

 5. Transaction Tax (“Fair Tax”)
Base: the whole *shabang*; sale price, commission, all other charges.
(answer no. 1 and 5)
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A2. Tax Base Example: Grocers

Question: What is the tax base for retailers under different tax systems?

Answer:

Sales tax:	sale price
Gross receipts:	revenue from sales
Business income:	profit
Value-added:	difference between gross receipts and cost of goods sold

A2. Tax Base Example: Grocers (cont.)

			<u>Sales Tax</u>	<u>Gross Receipts Tax</u>	<u>Value- Added Tax</u>	<u>Income Tax</u>
Income Statement						
Net Taxable Sales to Consumers	\$ 1,200.0		\$ 1,200.0			
plus: sales-tax-exempt sales to consumers	\$ 4,300.0					
plus: Net Sales to Producers	\$ 100.0					
equals: Total Operating Revenue		\$ 5,600.0		\$ 5,600.0		
less: COGS		\$ 4,150.0				
equals: Value Added		\$ 1,450.0			\$ 1,450.0	
less: Operating Expenses		\$ 1,300.0				
less: Net Capital Expense		\$ 100.0				
plus: Other Income or Loss (including interest)		\$ 40.0				
equals: Pre-Income-Tax Profits		\$ 90.0				\$ 90.0
<i>memo: pre-tax profit margin</i>	2%					
Base of tax			\$ 1,200.0	\$ 5,600.0	\$ 1,450.0	\$ 90.0

B. The Higher the Rate...

...the More Distortional the Tax!

- **Gross Receipts**
 - 0.125% in Governor's Plan
 - 0.24%, 0.33%, 0.48%, 0.70% depending on the option in Chamber of Commerce Plan
 - Ohio's gross receipts rate of 0.26%
 - No more than 0.75% in GRC plan

 - **Business Income**
 - 0.125% in Governor's Plan
 - 1.85%, 2.45%, 3.05%, or 4.24% depending on the option in Chamber of Commerce Plan
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C. Who Pays?

- **Governor's MBT**
 - Businesses w/ receipts under \$350,000 are not subject to taxation
 - Phases in tax liability for businesses w/ receipts between \$350,000 - \$700,000
- **MI Chamber Plans**
 - \$150 minimum tax for any business with employees
 - Maximum tax of \$2 million

C. Who Pays?

- Detroit Regional Chamber
 - Businesses w/ receipts under \$350,000 pay no tax
 - Maximum tax of \$1 million
- Grand Rapids Chamber
 - Businesses w/ receipts under \$350,000 pay a tax of \$150

“Maximum” tax is subject to both political and constitutional attacks.

VI. Conclusions

1. Many tax plans being introduced will be better than the current law for most Michigan businesses.
 - Current SBT is unfair, expensive, and punitive for major manufacturers.
 - There are a number of low-rate, broad-based tax plans that would be better for the Michigan economy.

 2. Effect of tax plans will vary by industry, and by taxpayer within industry.
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VI. Conclusions (cont.)

3. A combination of gross receipts plus profits tax, with some PPT relief, is one approach gaining currency.
 4. Governor's plan adds an "asset tax" that would severely affect some taxpayers and would encourage aggressive tax planning.
 5. Key questions include:
 - Will the replacement tax raise more, less, or the same amount of revenue as the SBT?
 - Will the replacement tax be a tax on "business"?
 - What form will a "business" tax take?
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