PROPOSALS FOR REPLACEMENT OF THE SBT AND PERSONAL PROPERTY TAX RELIEF

Executive Summary

The Michigan Chamber of Commerce supports replacement of the Single Business Tax (SBT), and a 50% personal property tax credit, through a combination of a Business Income Tax and a Business License Tax.

These proposals were developed based on four guiding principles; that a tax be (1) broad-based with a low rate; (2) result in a net tax reduction; (3) be simple to administer and easy to comply with; and (4) be similar to other states. The Michigan Chamber retained Ernst & Young – a nationally recognized firm with extensive experience in modeling tax systems in over 30 states to aid in the development of these proposals.

This combination, low-rate tax system provides a method to reflect both a company's business activity and its ability to pay. Furthermore, Ernst & Young's economic stimulus model indicates a strong overall economic stimulus to Michigan's economy from the combination tax and the personal property tax credit system, resulting in job growth, higher wages for workers and lower prices for consumers.

The proposal for replacement of the SBT and for providing job providers with personal property tax relief (Option 1) includes the following parameters (more details on Option 1 are attached):

- Business Income Tax: rate = 3.05%
- Business License Tax rate: general rate = .48%
  wholesale/retail rate = .24%
  - Business License Tax, paid on *excess* above $350,000 threshold
  - $150 minimum tax (applies to any business with employees. Does not apply to sole proprietors who have no employees.)
  - $2 million cap per return on (gross receipts) license tax
- $500 million net tax reduction
- 50% personal property tax credit for all industries

The Michigan Chamber also supports a plan that would simply replace part of the SBT revenue with no other property tax relief included (Option 2) if the Legislature chooses to solely address the SBT. This would include the following parameters (more details for Option 2 are attached):

- Business Income Tax: rate = 1.85%
- Business License Tax rate: general rate = .24%
  wholesale/retail rate = .18%
  - Business License Tax, paid on *excess* above $350,000 threshold
  - $150 minimum tax (applies to any business with employees. Does not apply to sole proprietors who have no employees.)
  - $2 million cap per return on (gross receipts) license tax
- $500 million net tax reduction

Why this approach to replacement of the Single Business Tax makes sense for Michigan:

Generally speaking, the best tax systems are those that are broad-based with a low rate.

The Business Income Tax and the Business License Tax (BIT/BLT) are both broad-based and low-rate taxes. Both Option 1 and Option 2 would result in a net tax reduction overall for the business community. The attached tables show the tax impact on different segments of business. Each tax approach is relatively straightforward and would be a significant improvement over the complexity of the Single Business Tax.

Many states have two complimentary state-level business taxes; these often include an income-based tax system or a gross receipts tax system. Therefore, there are well-tested statutes and well-developed rules from other states to use as models.

Most individuals and businesses are familiar with paying tax based on income. Tax based on ability to pay is a generally understood and accepted method of taxation. An income tax can use federal income tax calculations as a starting point for computation of a new Michigan tax.

A Business License Tax would allow Michigan to assess all companies that do business in Michigan. This includes companies with primary operations based in Michigan and out-of-state companies with a sales force here.

Michigan's business personal property tax places a heavy burden on Michigan's job providers and capital investment in Michigan. This tax is a disincentive to investment in equipment, machinery, and furnishings in Michigan, is costly, and is an administrative burden to comply with and to administer. During debate about the merits of Michigan's Single Business Tax, some businesses indicated that personal property taxes are as problematic as the SBT.

Option 1 uses the combination of the (BIT/BLT) to replace the SBT and provides all industries with a 50% personal property tax credit (applied against the BIT/BLT) to offset personal property taxes paid at the local level. The proposal accommodates the credit by implementing higher tax rates via the business income tax and business "license" tax.

Option 1 and Option 2 would both result in increased economic activity for Michigan. However, the economic stimulus model by Ernst & Young indicates that Option 1, which would include personal property tax relief, creates a stronger economic stimulus for Michigan and therefore is the preferred approach.

For questions about this proposal please contact Tricia Kinley, or Rich Studley, at (517) 371-2100.

Details and Specifics

Business Income Tax Outline:

- Single low rate based on apportioned, adjusted federal taxable income.

(please note the rate changes for the personal property tax model.)

- Use Michigan RAB 98-1 with PL 86-272 (Physical Presence with 86-272, Agency/Representational Nexus – Not Attributional nexus.)

- Start with Line 30 of Federal Return with add-back of federal NOLs. No loss carryback, 20-year carryforward of apportioned state NOLs.

- SBT business loss carryovers would be allowed.

- Subtraction for:

  Foreign Dividends
  Sub-Part F Income
  Section 78 Dividend Gross-Up

- Unitary Filing – Mandatory and use UDITPA or other state's well developed unitary rules

  (i) unitary is "waters edge" and
  (ii) corporations may elect to file on a Federal consolidated return basis and avoid imposition of "mandatory unitary filing" for the consolidated group.

- *Joyce* nexus standard applied to unitary groups, e.g., one member having nexus in a state does not create nexus for any other member of the unitary group in that state

- Assure C corporation members of a consolidated group, which are using a consolidated reporting methodology, whether or not members of a unitary group, are required to eliminate intercompany interest income/expense and intangible income/expense

- Corporations filing a consolidated or unitary return would also be allowed to eliminate intercompany sales to or from other members of the same consolidated or unitary group, ala IRC Regulation 1.1502-13.

- Use modified Federal affiliated group definition

- Partnerships and LLCs taxed as partnerships will be taxed at the partnership level with a subtraction for partners of partnership income for business income tax. No inclusion of partnership apportionment factors in the partner's apportionment factors for Business Income Tax, unless they are members of a unitary group, where they are owned directly or indirectly more than 50% by the other members of the unitary group.

- S corporations will be taxed at the S corporation level, but will not be includible in a C corporation's consolidated, unitary group tax return

- Apportionment to be based on 100% sales factor with no throwback

- Sourcing:

    Destination - based for sales of goods
    Destination - based on where the benefit of services are received
    Destination – based for intangibles

    - Financial Institutions (as currently defined in SBT)– Sourced based on MTC rules and RAB 2002-14

Use special apportionment rules for certain industry groups e.g. financial institutions, transportation companies, insurance companies. Follow current apportionment rules used for SBT for these groups.

Definitions need to be developed to determine which businesses qualify for unique industry treatment, e.g. a “financial institution might use the SBT definition of a bank or an entity that meets the 90/90 test. Incorporate current SBT definitions.

- Insurance companies subject to same structure as current SBT treatment.

Provide Transition Rules for discretionary credits already previously granted:

- MEGA credits
- Brownfield credits
- Renaissance Zones

Allow credits to be taken against income tax base

Assume there will be no credits as part of this new tax other than loss carryforwards and other credits described above" [MEGA, Bfield, RenZone].

- Retain current exemptions (i.e. non-profit)

Michigan Business License Tax Outline:

1. Low General Tax Rate

2. Low Alternate Wholesale/Retail Rate

3. Create a minimum tax of $150 dollars to be paid by business with gross receipts (GR) of less than $350,000. ($150 applies to any business with employees. It does not apply to sole proprietors who have no employees.)

4. GR tax paid on the *excess* GR above $350,000

5. $2 million cap (per return) on GR tax

6. Tax would be at affiliated group/consolidated/unitary level. To avoid the affects of pyramiding, consolidated, inter-company sales should be eliminated. If filing in Michigan, allow all to eliminate inter-company sales. Members of the affiliated/consolidate or unitary group would be determined by whether an entity was under common control, e.g., owned directly or indirectly more than 50% by the same interests.

7. Need alternative systems and/or special apportionment rules for insurance companies, transportation companies, banks, etc.

    - Insurance companies subject same structure as current SBT treatment.

8. Create special apportionment criteria for consumer excise taxes (like gasoline.)

9. Assume taxpayers will continue to file returns on their normal calendar or fiscal year basis.

10. Phase-in first year to avoid double taxation, keeping states fiscal year ending September 30 in mind.

11. Annual returns, with quarterly estimated taxes.

12. Create a comprehensive Michigan definition of gross receipts and related sourcing rules, for example:

    - *Sales of tangible personal property* – destination basis
    - *Sales of real property* – state where property is located
    - *Sales of services* – either where services are performed, based on cost of performance (MTC rules) or where benefit of services is received, e.g., customer's location (same as income tax)
    - Sales of intangibles – (Royalties sourced to where they are used)
    - Financial Institutions – Sourced based on MTC rules and RAB 2002-14

Gross Receipts should be defined, similar to the **sales factor** definition under MCL 208.7 (1)

- Provide a subtraction for:

  Foreign Dividends
  Sub-Part F Income
  Section 78 Dividend Gross-Up

13. Tax should be calculated based on taxpayer's Federal income tax method of accounting, e.g., cash, accrual, etc.

Nexus Rules:

- Same as RAB 1998-1

Special Industry Taxes, Possible Alternatives:

For gross receipts taxes, Financial Institutions would be taxed like everyone else, but an interest expense deduction from gross receipts, thus their gross receipts would be:

Gross receipts (primarily interest income) less an interest expense deduction for Financial Institution compensation

- Transportation Companies: Apportion gross receipts on some sort of mileage-based formula.

Provide Transition Rules for discretionary credits already previously granted:

- MEGA credits
- Brownfield credits
- Renaissance Zones

- Retain current exemptions (i.e. non-profit)

Assume there will be no credits as part of this new tax other than loss carryforwards and other credits described above" [MEGA, Bfield, RenZone].

Take note of potential problems with pass through excise taxes on gasoline (and other pass through taxes) being included in the GR tax base.

Detailed Tax Simulation Results

Option 1 *License tax*: 0.48% general and 0.24% wholesale/retail rate (50% lower), $2m cap, $150 minimum, $350,000 exemption
Income tax: 3.05% *Property tax credit*: 50%

Entity Level Taxes:

	Current Law	Proposed Law			Change from SBT	
Industry	**SBT**	**License Tax**	**Income Tax**	**Total Tax**	**$Change**	**%Change**
Ag	$9	$9	$2	$11	$2	16.4%
Mining	$6	$9	$2	$10	$4	74.8%
Construction	$117	$145	$19	$164	$47	40.5%
Manufacturing	$493	$401	$84	$485	($8)	-1.7%
Non-Durable	$180	$129	$28	$157	($24)	-13.1%
Durable	$313	$272	$57	$329	$15	4.9%
Transportation	$41	$22	$5	$27	($14)	-33.9%
Communications	$79	$58	$52	$111	$32	41.1%
Utilities	$51	$29	$17	$46	($6)	-11.5%
Wholesale Trade	$107	$99	$15	$114	$7	6.3%
Retail Trade	$290	$243	$89	$332	$42	14.5%
FIRE (Excludes Insurance Carriers)	$130	$143	$67	$210	$80	61.5%
Insurance Carriers	$246	$246	$0	$246	$0	0.0%
Services	$485	$436	$161	$596	$112	23.0%
Other	$78	$117	$58	$175	$97	124.0%
Total	**$2,132**	**$1,956**	**$570**	**$2,526**	**$394**	**18.5%**

Entity Level Taxes with Personal Property Tax Credit:

	Current Law	Proposed Law				Change vs. Current Law	
Industry	**SBT+TPP Tax**	**License Tax**	**Income Tax**	**TPP Tax**	**Total Tax**	**$Change**	**%Change**
Ag	$17	$9	$2	$4	$15	($2)	-12.4%
Mining	$17	$9	$2	$6	$16	($1)	-6.5%
Construction	$163	$145	$19	$23	$187	$24	14.5%
Manufacturing	$1,147	$401	$84	$327	$812	($335)	-29.2%
Non-Durable	$333	$129	$28	$76	$233	($100)	-30.0%
Durable	$814	$272	$57	$250	$579	($235)	-28.9%
Transportation	$122	$22	$5	$40	$67	($54)	-44.5%
Communications	$226	$58	$52	$74	$184	($41)	-18.3%
Utilities	$281	$29	$17	$115	$160	($121)	-42.9%
Wholesale Trade	$216	$99	$15	$54	$168	($47)	-22.0%
Retail Trade	$391	$243	$89	$51	$382	($8)	-2.2%
FIRE (Excludes Insurance Carriers)	$259	$143	$67	$65	$274	$15	5.9%
Insurance Carriers	$262	$246	$0	$8	$254	($8)	-3.0%
Services	$684	$436	$161	$100	$696	$12	1.8%
Other	$138	$117	$58	$30	$204	$67	48.5%
Total	**$3,920**	**$1,956**	**$570**	**$894**	**$3,420**	**($500)**	**-12.8%**

Option 2 *License tax*: 0.24% general and 0.18% wholesale/retail rate (25% lower), $2m cap, $150 minimum, $350,000 exemption
Income tax rate: 1.85% *Property tax credit*: none

Entity Level Taxes:

Industry	Current Law SBT	Proposed Law			Change from SBT	
		License Tax	Income Tax	Total Tax	$Change	%Change
Ag	$9	$5	$1	$6	($4)	-37.6%
Mining	$6	$5	$1	$6	$0	1.5%
Construction	$117	$74	$11	$85	($31)	-26.9%
Manufacturing	$493	$234	$51	$286	($208)	-42.1%
Non-Durable	$180	$80	$17	$97	($84)	-46.4%
Durable	$313	$155	$34	$189	($124)	-39.7%
Transportation	$41	$12	$3	$15	($27)	-63.9%
Communications	$79	$34	$32	$66	($13)	-16.3%
Utilities	$51	$17	$10	$27	($24)	-46.7%
Wholesale Trade	$107	$78	$9	$87	($20)	-18.9%
Retail Trade	$290	$199	$54	$253	($36)	-12.5%
FIRE (Excludes Insurance Carriers)	$130	$87	$41	$128	($2)	-1.5%
Insurance Carriers	$246	$246	$0	$246	$0	0.0%
Services	$485	$232	$98	$330	($155)	-32.0%
Other	$78	$62	$35	$97	$19	24.9%
Total	**$2,132**	**$1,285**	**$346**	**$1,632**	**($500)**	**-23.5%**