SFA BILL ANALYSIS

Senate Fiscal Agency • Lansing, Michigan 48909 • (517) 373-5383

Senate Bill 878 (as enrolled)
Sponsor: Senator Norman D. Shinkle
Senate Committee: Finance
House Committee: Taxation

PUBLIC ACT 390 of 1988

Date Completed: 2-27-89

RATIONALE

In 1976, the single business tax (SBT) replaced a corporate profits tax and several other business taxes. Since its inception, there have been complaints about the value-added nature of the SBT, under which, in calculating its tax base, a business must add together its business income, wages, other compensation, interest paid, and depreciation. Small businesses have been particularly vocal in their criticism of the tax, claiming that its complicated formula often results in situations in which a firm ends up with a tax liability even though it lost money for the year. Others say that calculating SBT liability for a small business is so difficult that often a firm pays more to tax accountants than it owes in taxes. Still other small businesses claim that the structure of the tax is a disincentive to hiring new employees because adding employees tends to raise tax liability. In response to these complaints the Governor, in May of 1988, proposed replacing the SBT with a profits tax for small businesses. Others felt that small businesses could be helped by modifying the small business credit. Under the Act, businesses with gross receipts (with an adjustment for the capital acquisition deduction) less than $40,000 are exempt from SBT liability. Businesses with gross receipts over $40,000 but less than $6 million can claim a small business credit against the tax, as long as certain income levels are not exceeded. The credit can be claimed for up to 90% of a firm's tax liability. (For a description of the small business credit, see "CONTENT" below.) Some people feel that it could be advantageous for some small businesses to continue to pay taxes under the SBT provisions, and therefore have proposed that small businesses be given a choice of paying a profits tax or calculating and claiming a modified small business credit.

CONTENT

The bill would amend the Single Business Tax Act to allow a taxpayer with gross receipts under $7 million in 1989, who otherwise qualifies for the small business credit, to choose to pay a tax of 4% on "adjusted business income" rather than using the value-added method of taxation in the Act. As under current law, to qualify for the small business credit a taxpayer's adjusted business income could not exceed $475,000 for corporations and partnerships and more than $95,000 for individuals; and, a shareholder, officer, or partner could not have more than $95,000 in income from the business. While these limits would remain the same, the bill provides that the gross receipts limit would increase to $7.25 million in 1990 and $7.5 million after 1990. (Under the Act, "adjusted business income" is the sum of "business income"; loss carryforwards; compensation and directors fees of active shareholders; and compensation and directors fees of officers. "Business income" is Federal taxable income for a corporation; for other taxpayers it means that part of Federal taxable income derived from "business activity". "Business activity" is defined in the Act as a transfer or rental of real, personal, mixed, tangible, or intangible property, or the performance of services (but not services of an employee to an employer, services as a director of a corporation, or a casual transaction).)

Currently, under the Act, the small business credit cannot exceed 90% of a taxpayer's SBT liability. The bill provides that, for the 1988 tax year and beyond, the credit could not exceed 100% of tax liability.

Currently, a taxpayer with gross receipts (plus adjustments for the capital acquisition deduction as provided in the Act) less than $40,000 is exempt from the tax. The bill would raise the limit to $41,000 for tax year 1989; $42,000 for 1990; $43,000 for 1991; $44,000 for 1992; and $45,000 for 1993 and thereafter.

MCL 208.35 and 208.36

FISCAL IMPACT

The bill would result in a reduction of General Fund/General Purpose SBT revenues of $8 million to $12 million per year.

ARGUMENTS

Supporting Argument

The value-added nature of the SBT and its complicated computations have long been criticized by businesses, especially small businesses, as unfair and discouraging. As reported during discussions on the bill, some 4,000 businesses that were liable for the SBT last year either had no profit or lost money. This is an absurd situation and certainly works against the growth and development of the business climate, which the State has consistently maintained as one of its top goals. How can new businesses be attracted to the State when they know that there is a chance that they will pay business taxes whether or not they make a profit? Further, the tax is so complicated that most small businesses, without the expertise to discern the best tax strategy or the resources to hire full-time employees to work strictly on business taxes, must hire tax specialists to calculate the tax. This is frustrating to small business owners, particularly when a business discovers that it made no money but owes taxes, or, when it owes more in fees to the tax specialist than it owes in taxes.

The bill, by allowing small businesses that are eligible for the small business credit simply to pay a 4% tax on adjusted business income, would eliminate or alleviate many of the complaints expressed about the tax. It would make computation of the tax much simpler for many taxpayers, and assure that businesses that didn't make a profit paid no taxes on losses. This would make small businesses more competitive, and ensure that businesses in their start-up years had a greater chance of success; that is, it would let firms reach a stage of profitability before they had to pay the SBT. Many small businesses claim that the current tax policy discourages the hiring of new employees because additional wages have the effect of reducing the small business credit. The bill would correct this problem, and thus ensure that the State's tax structure did not have a negative impact on the State's greatest producer of new jobs.

Opposing Argument

The SBT is not based on profitability, nor is it a tax on the positive income generated by a business: it is a measure of the amount of services and resources a business uses and it taxes the benefits received. While some say that it is unfair to tax a business that makes no profit or loses money, there are ways in which a business can reduce its profits or make it look as if it lost money. Is it fair for one business to conduct itself this way, and not pay taxes, while another business operates without avoiding profitability and thus pays taxes? The SBT ultimately is fair because it is based on taxing a business' level of activity.

One of the main reasons the tax was developed and successfully adopted is that it stabilized business tax revenue. A State business tax based solely on profits, particularly in a boom and bust state like Michigan, can fluctuate wildly. The bill would challenge the integrity of the SBT because, by allowing a significant portion of the taxpayers to base their taxes on profits, it would make the level of tax revenue far less predictable. Further, taxing small businesses on a profits tax, and large businesses on the SBT, is unfair tax policy; some of those businesses may be competing with each other, but they would be taxed in different ways.

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