

SFA

BILL ANALYSIS

Senate Fiscal Agency

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Senate Bill 962 (Substitute S-1 as reported by the Committee of the Whole)
 Sponsor: Senator John J.H. Schwarz, M.D.
 Committee: Finance

RECEIVED**OCT 08 1990**

Date Completed: 5-25-90

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RATIONALE

Under the Single Business Tax (SBT) Act, small businesses can qualify for the small business credit according to the Act's requirements. A small business with an "adjusted business income" under \$475,000 (and gross receipts under \$7.25 million in 1990, or \$7.5 million in 1991 and thereafter) can choose either 1) to pay a tax of 4% on adjusted business income, or 2) to calculate its tax under the standard SBT provisions and use the small business credit. ("Adjusted business income" is the sum of business income; compensation and directors' fees of active shareholders; compensation and directors' fees of officers; and loss carryforwards and carrybacks.)

It has been pointed out that the Act's eligibility requirements for the credit may not be fair to firms that have large profits one year and large losses the next, compared to firms with steady revenue streams. A firm that has large losses in a year may actually end up with a negative adjusted business income (less than zero), thus easily qualifying for the credit that year. There is no provision, however, to carry forward that negative adjusted business income to the next year or succeeding years when the firm may make a profit (as is allowed on the Federal tax return); as a result, the firm might not qualify for the credit. Thus, over a period of years in which two firms may have comparable business incomes and Federal income tax liabilities, the firm with steady revenue may qualify for the credit each year while the firm with fluctuating revenue may only qualify in the years in which it had losses. It has been suggested that, for purposes of determining eligibility for the credit (but not in calculating the credit itself), a firm be allowed to carry forward any negative adjusted business income.

CONTENT

The bill would amend the Single Business Tax Act to allow a small business to use negative adjusted business income from any of the five preceding tax years to determine whether the business qualified for the small business credit in a tax year.

Under the bill, in order to qualify for the credit, a business' adjusted business income minus the "loss adjustment" could not exceed \$475,000. "Loss adjustment" would mean the amount by which adjusted business income was less than zero in any of the five preceding years. In determining a loss adjustment for a tax year, a taxpayer would not have to use more of its negative adjusted business income than the amount needed to qualify for the credit (in other words, reduce its eligibility income below \$475,000). A taxpayer could not reuse a negative adjusted business income amount it had used to determine a loss adjustment in a previous tax year, or use a negative adjusted business income amount from a year in which it did not qualify for the credit.

Currently, a small business is disqualified from claiming the credit if: 1) the small business is an individual, partnership, or a sub-chapter S corporation and the individual or any one partner or shareholder receives more than \$95,000 as a distributive share of the adjusted business income; or 2) the small business is a corporation (other than an S corporation) and the sum of the compensation and director's fees of a shareholder, plus business income and adjustments times the percentage of outstanding stock owned by the shareholder, exceeds \$95,000. The bill would allow the subtraction of loss adjustment in each calculation to determine whether an individual, partner in a partnership, shareholder in an S

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corporation, or shareholder in a corporation other than an S corporation, exceeded the threshold of \$95,000.
MCL 208.36

FISCAL IMPACT

The bill would lead to a small, indeterminate reduction in SBT revenues. Very few firms would be eligible to benefit from the proposed change.

ARGUMENTS

Supporting Argument

The bill simply would allow a firm with significant losses in a tax year to use those losses in a succeeding year in determining eligibility for the small business credit. Currently, if a firm has a large loss resulting in a negative adjusted business income, it will easily qualify to claim the small business credit; however, in succeeding years when it has a large profit it may be disqualified. This can put it at a competitive disadvantage with a firm of comparable size, earnings, and Federal tax liability, that has a steady revenue that allows it to claim the credit each year. By allowing a firm to use unused negative business income from a year to reduce positive income in a succeeding year, the bill would level the playing field and assist those firms that have large yearly fluctuations in revenue.

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