House
Legislative
Analysis
Section

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SBT BASE; APPORTIONMENT

House Bill 4398 as introduced
First Analysis (4-2-87)

Sponsor: Rep. H. Lynn Jondahl
Committee: Taxation

THE APPARENT PROBLEM:

A firm's single business tax (SBT) liability is calculated by adding profits, labor costs, interest, royalties and certain other items. The base is then apportioned to Michigan by multiplying the tax base by the average of the firm's property, payroll and sales attributable to Michigan. Two firms with headquarters in other states that do business in Michigan used an alternative calculation of their Michigan SBT base, producing a lower tax liability, and their method was upheld by the Court of Appeals. Jones & Laughlin Steel and Wilson Foods computed their tax bases, excluding compensation, and apportioned this total using the law's "three factor formula." Then they added their actual compensation in Michigan. Because actual Michigan compensation was less than total compensation apportioned to Michigan, the court approved the alternative calculation, saying the three-factor average on the entire tax base resulted in an excessive amount of compensation attributed to Michigan.

The firms based their claim on Section 69 of the Single Business Tax Act, which allows taxpayers to petition the state revenue commissioner for an alternate method of apportioning the taxpayer's business activity in Michigan if the act's apportionment formula does not "fairly represent" the extent of that activity. The result of the court's decision in *Jones & Laughlin Steel Corporation* v. *Department of Treasury,* 145 Mich. App. 405 (1985), is that many out-of-state taxpayers are appealing their past taxes based on a separate allocation of compensation or other components of the tax base.

THE CONTENT OF THE BILL:

The bill would specify that the apportionment provisions of the act would be presumed to fairly represent the extent of a taxpayer's business activity in this state taken as a whole and without a separate examination of the specific components of the tax base, unless it could be demonstrated that the business activity attributed to the taxpayer in this state was out of all appropriate proportion to the actual business transacted in Michigan and led to a grossly distorted result.

A taxpayer's business activity would be presumed to be fairly represented by the three-factor formula if the apportioned tax base calculated using the three-factor formula exceeded either (1) the apportioned tax base calculated by multiplying total SBT base by the percentage of the firm's total sales attributable to Michigan, or (2) the apportioned tax base calculated by using the gross receipts reduction allowed in the act. (Note: The language in subsections 3 (A) and (B) apparently is in error; in order to have the intended effect, the bill would have to specify that a taxpayer's business activity would be presumed to be fairly represented by the three-factor formula if the apportioned tax base was less than, rather than exceeded, either of the two options specified.)

Further, the filing of a return or an amended return would not be considered a petition for determining whether the apportionment provisions of the act fairly represented the taxpayer's business activity in the state (MCL 208.69).

The second enacting section of the bill specifies that its provisions would be "curative," expressing the original intent of the legislature that the single business tax is an indivisible value-added tax and not a combination or series of several smaller taxes, and that relief from the act's three-factor formula should be granted only under extraordinary circumstances. Further, the enacting section states that the bill would clarify existing procedures and standards for granting relief.

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FISCAL IMPLICATIONS:

According to the House Taxation Committee staff, at least 118 out-of- state taxpayers have filed for refunds based on the *Jones* decision, representing a potential revenue loss of $57.6 million plus interest. In addition, the ongoing revenue loss possible if House Bill 4398 is not enacted amounts to $35 million annually (4-1-87).

ARGUMENTS:

For:

The bill would reverse the effect of the *Jones & Laughlin Steel Corporation* v. *Department of Treasury* decision, which created a potential windfall for out-of-state single business taxpayers at the expense of the state treasury and Michigan employers. To be consistent, the Department of Treasury would have to apply the alternative calculation to all taxpayers whose actual Michigan compensation differs substantially from their apportioned compensation. This would result in significantly higher tax liabilities for Michigan companies who employ large numbers of people in this state, while rewarding out-of-state companies who benefit from sales in Michigan but provide few jobs for Michigan residents. By focusing on separate components of the tax base, the court decision ignored the integrated nature of the single business tax; the SBT is derived from corporate income tax statutes where the specific components of a taxpayer's income cannot be separated out. Further, the terms and definitions used in the bill reflect the constitutional standards set by the U.S. Supreme Court for relief from formulary apportionment.

POSITIONS:

The Department of Treasury supports the bill (4-1-87).

The Michigan Manufacturers Association supports the bill (4-1-87).