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SFA



BILL ANALYSIS

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Senate Bill 1380 (as reported without amendment)
Sponsor: Senator Bill Schuette
Committee: Finance

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RATIONALE

The volume of goods, services, and income from investment that flows between the United States and Canada constitutes the largest bilateral exchange in the world, according to information from the Canadian Embassy's Department of Foreign Affairs and International Trade in Washington, D.C. Among the states, Michigan is Canada's leading trade partner, with more than half of the State's exports purchased by Canada. An enormous amount of the goods transported between Michigan and Canada moves by truck. Apparently, amendments to the Single Business Tax (SBT) Act made by Public Act 115 of 1999 may have negative tax consequences for Canadian motor carriers.

On a national level, a treaty between the United States and Canada exempts from taxation by either country business profits that are not directly attributable to a permanent establishment; that is, a Canadian firm that does business in the United States is not taxed by the Federal government on its profits, except for profits derived from a permanent establishment in the United States (if the firm has one). The same exemption is granted by Canada for U.S. firms doing business in Canada. This means, then, that the business profits of a Canadian trucking company derived from shipping between the countries are exempt from U.S. Federal tax, unless the firm has a permanent facility in the United States; and the profits of a Michigan trucking company are exempt from Canadian taxes, unless the Michigan firm has a permanent facility in Canada.

The SBT is levied on the adjusted tax base of a taxpayer with business activity in the state; the "tax base" is business income before allocation or apportionment; and "business income" is Federal taxable income. Thus, until the enactment of Public Act 115, a Canadian trucking firm with no permanent facility in the United States paid no SBT, because it had no "business income" for purposes of the tax.

Public Act 115 of 1999 made several major changes to the SBT, including reducing the tax by .1% each year until it is eliminated, and replacing the capital acquisition deduction with an investment tax credit. Public Act 115 also added Section 19 to the SBT Act

to prescribe the application of the tax to foreign companies. Among other things, Section 19 provides that the tax base of a foreign person includes the sum of business income and adjustments that are related to United States business activity, "whether or not the foreign person is subject to tax under the Internal Revenue Code". Thus, evidently, Canadian trucking firms doing business in Michigan are now subject to the SBT for business activity in this State, whether or not they have a permanent establishment in Michigan and are exempt from Federal tax on their business profits. It has been suggested that Canadian truckers should be exempted from the SBT under certain circumstances, so they can avoid paying a tax that they had not been subject to before the enactment of Public Act 115.

CONTENT

The bill would amend the SBT Act to exempt a person from the tax if the person met all of the following criteria:

- The person was a foreign person. (The Act defines "foreign person" as an individual who is not a U.S. resident, or a person formed under the laws of a foreign country or a political subdivision of a foreign country, whether or not subject to Federal taxation.)
- The person would be subject to apportionment under Section 57 of the Act if not for the proposed exemption. (Section 57 provides for the taxation of a taxpayer whose business activity consists of transportation services, apportioned based upon revenue miles of the taxpayer in Michigan versus revenue miles of the taxpayer everywhere else. A revenue mile is the transportation for consideration of one net ton in weight or one passenger the distance of one mile.)
- The person's business activity in Michigan was limited to the transportation and loading or unloading of goods that were delivered by a truck.
- The person did not have a "permanent establishment" in Michigan.

A "permanent establishment" would be a fixed place of business through which the business of a foreign person was wholly or partly carried on, including a place of management, a branch, an office, or a factory.

The bill would apply to tax years beginning after 1999.

Proposed MCL 208.35b

ARGUMENTS

(Please note: The arguments contained in this analysis originate from sources outside the Senate Fiscal Agency. The Senate Fiscal Agency neither supports nor opposes legislation.)

Supporting Argument

The trade that passes between the United States and Canada, particularly between Michigan and Ontario represents the world's largest trading partnership. This trade relationship supports thousands of jobs in both countries. It also generates enormous truck traffic between Michigan and Ontario, mostly for transporting products related to auto manufacturing. Until recently, Canadian trucking firms that shuttled goods between Michigan and Canada were not subject to the State's SBT, except on profits and business activity generated at a permanent facility in Michigan. A change in the State SBT, however, now makes Canadian truckers subject to the SBT for business activity in Michigan, whether or not they have a permanent facility in the State. This means, then, that a Michigan trucking firm with no permanent facility in Canada has no tax liability on its business profits generated there, while a Canadian trucking firm doing business in Michigan is taxed on its business activities in the State. This upsets the competitive balance between Michigan and Canadian trucking firms, and might cause Ontario or other provinces to adopt retaliatory tax policies aimed at Michigan trucking firms. By eliminating the inequitable tax treatment that now exists, the bill would return the truckers of both countries to an equal footing and prevent such action.

Opposing Argument

Some question whether Canadian truckers, who have substantial business activity in the State and who use Michigan roads and facilities, should be exempt from Michigan taxes.

Response: It must be remembered that Canadian trucks do pay taxes in Michigan. Canadian trucking companies belong to the International Fuel Tax Agreement which apportions diesel fuel taxes to various states and provinces, regardless of where the fuel was purchased, based upon the number of miles each truck drives in an individual state or province.

FISCAL IMPACT

The bill would reduce State General Fund revenues by an unknown amount. Over the 1993-1996 period, SBT receipts from firms in the transportation sector comprised 1.9% of SBT revenues. The share of SBT revenues that would be attributable to firms covered by the bill is unknown, although the share is likely to be minimal. The Revenue Consensus Estimate for SBT revenues is \$2.2 billion in both fiscal year (FY) 1999-2000 and FY 2000-01. If the firms covered by the bill were to contribute 2% of SBT revenues from all firms in the transportation sector, the bill would reduce General Fund revenues by approximately \$800,000.

The bill would have no fiscal impact on local units.

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This analysis was prepared by nonpartisan Senate staff for use by the Senate in its deliberations and does not constitute an official statement of legislative intent.