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Senate Bill 1274 (as enrolled)
Sponsor: Senator Cameron S. Brown
Senate Committee: Economic Development, Small Business and Regulatory Reform
House Committee: Commerce

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RATIONALE

Some people believe that Michigan's single business tax (SBT) creates a disincentive for the State's small businesses to hire new employees, leading employers to make do with fewer workers or to leave the State in search of lower taxes. The disincentive is believed to result from the fact that, under the "value added" method of computing a company's SBT liability, employee compensation and insurance benefits are used in determining the company's tax base, with its tax liability being a percentage of the base minus deductions. Therefore, when a business hires a new employee, its tax liability may increase, regardless of whether the business experiences increased revenue. It has been suggested that one way to compensate businesses for the added tax burden they may face when hiring a new employee, and to stimulate additional hiring in the State, would be to give businesses an SBT credit for employees hired to fill new positions.

CONTENT

The bill would amend the Single Business Tax Act to allow employers with gross receipts for a tax year of \$10 million or less to claim a credit against the SBT equal to the following percentages of compensation paid by the taxpayer to employees who performed "created jobs" (in high technology or manufacturing) in Michigan for that tax year:

- If the taxpayer made capital investment in the State of less than \$150,000 in the tax year, 0.5%.
- If the taxpayer made capital investment in the State of \$150,000 or more, but less than \$750,000, 1.5%.

- If the taxpayer made capital investment in the State of \$750,000 or more in the tax year, 2.0%.

The credit would be allowed for tax years beginning after December 31, 2004, and before January 1, 2006.

For purposes of determining the credit, compensation paid to employees performing created jobs would be determined according to a formula based on the difference between the average compensation paid per full-time employee in the tax year beginning in 2004 and the average compensation paid per full-time employee in the tax year beginning in 2005, for employees performing high-technology activity or manufacturing jobs, not to exceed \$85,000 per job. For purposes of determining compensation paid to employees, the taxpayer would not be allowed to include compensation paid to a parent, sibling, child, stepchild, adopted child, or stepparent of an active shareholder or officer, a shareholder of an S corporation, a partner of a partnership, a member of a limited liability company, or an individual who was a sole proprietor.

The capital investment threshold would have to be met at the principal place of employment of any employee of the taxpayer who performed a created job. Leased employees would be considered employees of the entity whose employment operations were managed by a professional employer organization.

"Created jobs" would mean jobs meeting all of the following criteria:

- The jobs were high-technology activity or manufacturing jobs.
- The jobs did not exist in Michigan in the immediately preceding tax year.
- The jobs represented an overall increase in full-time equivalent jobs of the taxpayer in Michigan for the tax year from the total number of such jobs of the taxpayer in the State in the preceding tax year.
- The jobs were not one into which an employee transferred if he or she worked in the State for the taxpayer, an affiliate of the taxpayer, or an entity with which the taxpayer filed a consolidated SBT return, in another job before beginning the created job.
- The jobs were not qualified new jobs used to calculate a credit under Section 37c or 37d of the Act (which provide for credits certified by the Michigan Economic Growth Authority).

In addition, the benefits for the employee in a created job would have to include coverage under health and welfare and noninsured benefit plans, including prescription coverage, primary health care coverage, and hospitalization that was not limited to emergency room services or subject to dollar limits, deductibles, and coinsurance provisions that were not less favorable than those for physical illness generally.

If the credit allowed under the bill for the tax year and any unused carryforward of the credit exceeded the taxpayer's SBT liability for the tax year, the excess could not be refunded, but could be carried forward as an offset to the SBT liability in subsequent tax years for 10 years, or until the excess credit was used up, whichever occurred first.

A member of an affiliated group as defined in the SBT Act, a controlled group of corporations as defined in Section 1563 of the Internal Revenue Code and further described in 26 CFR 1.414 (b)-1 and 1.414(c)-1 to 1.414(c)-5, or an entity under common control as defined by the Internal Revenue Code, would have to determine gross receipts on a consolidated basis for the purposes of the bill.

"High-technology activity" would mean that term as defined in the Michigan Economic Growth Authority Act (i.e., advanced computing, advanced materials,

biotechnology, electronic device technology, medical technology, and advanced vehicles technology (as those terms are further defined in the Act); engineering or laboratory testing related to product development; technology that assists in the assessment or prevention of threats or damage to human health or the environment; product research and development; and tool and die manufacturing). "Manufacturing jobs" would mean jobs for a company that has a classification under the North American Industrial Classification System as sector 33, subsector 321 or subsector 322.

"Related entity" would mean an entity that met any of the following criteria:

- More than 1% of it was owned by either another entity or an entity that owned more than 1% of another entity.
- It owned more than 1% of another entity.
- It marketed itself under a common name or trademark with any other entity or received payroll, human resources, administrative, or other similar services from a company that provided those services to another entity.

The terms "active shareholder" and "officer" would be defined as they are in Section 36 of the SBT Act. ("Active shareholder" means a shareholder who receives at least \$10,000 in compensation, director's fees, or dividends from the business, and who owns at least 5% of the outstanding stock. "Officer means an officer of a corporation other than an S corporation, including the chairperson of the board, president, vice-president, secretary, and treasurer.) "Capital investment" would mean an investment that may be used to calculate the credit for capital assets under Section 35a of the Act.

Proposed MCL 208.37f

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

Under the SBT Act as it currently stands, businesses that take on additional employees also take on additional tax

liabilities, under the standard method of filing. The proposed SBT exemption would mitigate the Act's punishment of businesses that hire employees to fill new high-technology or manufacturing jobs. It would serve to give some incentive to employers with gross receipts of \$10 million or less a year to hire new employees, by offering them an SBT credit for .5% to 2% of the compensation paid to newly hired high-tech or manufacturing employees who receive health care coverage or health insurance. This would encourage the businesses to build profitability by hiring new workers rather than attempting to increase the productivity of current employees. The proposed SBT tax credit would take some of the burdens and risks out of hiring additional employees for businesses that may be unsure of whether to increase their workforce. Adding jobs to the Michigan economy also would more than offset the loss in State revenue predicted from the credit because the new employees themselves would pay taxes such as the State income tax and sales tax.

Supporting Argument

This bill is similar to Senate Bill 1093, which was vetoed, but addresses concerns raised by Governor Granholm in her veto message. The Governor stated that Senate Bill 1093 would reduce business taxes for transfers among business affiliates, even when no net new jobs would be created. Under Senate Bill 1274, however, a "created job" could not be one into which an employee transferred if he or she worked in this State for the taxpayer, an affiliate of the taxpayer, or an entity with which the taxpayer filed a consolidated SBT return. Also, unlike the earlier proposal, this bill specifies the health care coverage that a created job would have to include. In addition, since it would specifically target newly created jobs in high-technology activity or manufacturing, Senate Bill 1274 is far less broad than the vetoed bill. Furthermore, the credit under Senate Bill 1274 could be claimed only for tax years beginning during 2005.

Opposing Argument

The proposed tax break would constitute a windfall for those companies that were going to hire regardless of the whether the new credit was implemented. Despite the recent downturn in statewide hiring, employers are continuing to hire when they need new workers. The bill would not provide a break

only to those companies that would decide to hire based on the new SBT credit. Also, employers' tax savings from the bill would not be significant enough to spur those businesses that have been reluctant to hire into taking on additional payroll.

Response: Even if a taxpayer would hire a new employee without the tax credit, the credit would be minimal unless the taxpayer made capital investment in the State of at least \$150,000. Thus, by creating the credit, the bill would help promote economic development. Furthermore, the bill would send a message that the State is serious about job creation.

Opposing Argument

Many of the companies that would receive the proposed tax break file using the "alternative tax rate" method, which does not take new payroll or benefits into account when determining a company's SBT liability. Therefore, these companies would receive the benefit of the credit despite the fact they do not pay additional SBT taxes on new hires. The alternative rate allows taxpayers to calculate their SBT based on income and is available to all businesses that have less than \$10 million in gross receipts and adjusted business income under \$475,000, and pay any individual officer or shareholder not more than \$115,000.

Legislative Analyst: J.P. Finet

FISCAL IMPACT

While this credit would be in effect only for the 2005 tax year, its fiscal impact would be spread over FY 2004-05 and FY 2005-06. It is estimated that the bill would reduce single business tax revenue by about \$3.3 million in FY 2004-05 and about \$6.7 million in FY 2005-06. All single business tax revenue goes into General Fund/General Purpose revenue, so this loss in revenue would affect the General Fund/General Purpose budget. The bill would have no direct impact on local governments.

Fiscal Analyst: Jay Wortley

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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.