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**BILL ANALYSIS**

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Senate Bill 633 (Substitute S-1 as reported)
Sponsor: Senator Nancy Cassis
Committee: Finance

Date Completed: 7-18-05

RATIONALE

Michigan's single business tax (SBT) is unique in that it is the country's only currently levied value-added tax. The tax is assessed at a present rate of 1.9% of a business's adjusted tax base, which essentially consists of compensation paid to labor, capital, business income (profit), and various additions and subtractions. Since the SBT does not rely solely on profits to determine a business's tax base, the tax originally was viewed as a more stable source of revenue than traditional business taxes, such as the corporate income tax. The SBT Act is scheduled to be repealed after December 31, 2009.

Studies by some business groups have shown that businesses pay higher taxes under Michigan's SBT than they would under business tax systems used in other states. For example, the Tax Foundation's State Business Tax Climate Index ranks Michigan's business tax climate nationally as the "36th best overall" ("Michigan 'Index Analysis': Elimination of Michigan SBT", 5-23-05). Reportedly, many business owners also find the one-of-a-kind tax confusing. Several business groups contend that the SBT has played a major role in Michigan's current economic difficulties because businesses are either leaving or choosing not to locate in the State in order to avoid the tax. Some people believe that businesses would be more likely to locate or expand in Michigan if the SBT were phased out.

CONTENT

The bill would amend the Single Business Tax Act to reduce the SBT rate from 1.9% to 1.8% during 2007 and reduce the rate by

0.1 percentage point on January 1, 2008, and each subsequent January 1. The bill would repeal Enacting Section 1 of Public Act 531 of 2002, which repeals the SBT Act for tax years that begin after December 31, 2009. The bill also would repeal Enacting Section 3 of Public Act 115 of 1999, which repeals the SBT Act when the current rate reductions bring it to zero percent.

Under the Act, beginning in 1999, and each January 1 after 1999, the SBT rate must be reduced by 0.1 percentage point on the January 1 following the end of the State fiscal year for which the State reports an ending balance of \$250,000,000 in the Countercyclical Budget and Economic Stabilization Fund.

Under the bill, the rate would be 1.8% beginning January 1, 2007, and before January 1, 2008. The rate would have to be reduced by 0.1 percentage point on January 1, 2008, and on each following January 1.

MCL 208.31

BACKGROUND

The SBT was created by Public Act 228 of 1975 and replaced seven other business taxes: the corporate income tax, corporate franchise tax, personal property tax on inventories, business intangibles tax, financial institutions tax, insurance company privilege fee, and savings and loan company privilege tax. The SBT is considered value-added because it imposes tax on value added to products at each step of production and distribution; that is, it attempts to measure a firm's business activity, and tax

that activity, rather than simply tax a firm's profits or receipts as is common in other states. The SBT rate originally was 2.35% of a business's tax base, but was lowered to 2.3% by Public Act 247 of 1994.

Public Act 115 of 1999 initiated a gradual phase-out of the SBT. Under the Act, the tax rate is to be lowered by 0.1 percentage point annually if the ending balance of the Countercyclical Budget and Economic Stabilization Fund exceeds \$250 million for the prior fiscal year. This provision reduced the rate from 2.3% to its current rate of 1.9%, but the tax has been frozen at that rate since January 1, 2002, when the Fund's year-end balance for the 2001-2002 fiscal year dipped below \$250 million.

Public Act 531 of 2002 will repeal the SBT Act for tax years beginning after December 31, 2009, regardless of the tax rate at that time.

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 bill would provide much needed tax relief for Michigan businesses by cutting the SBT rate annually beginning in 2007. The rate cut would send a strong message to Michigan's business community that the State is serious about getting rid of the SBT and that it is working to become more business friendly. Since most states have a corporate income tax, the bill would result in a decided tax advantage for businesses moving to Michigan, which would have neither a corporate income tax nor the SBT after the rate fell to 0% in 2025. Until that time, firms would be able to count on a reduced rate each year.

The improved business climate that would result from the phase-out of the SBT would strengthen the State's economy and stimulate job creation. This would help bring down Michigan's unemployment rate, which is among the highest in the nation.

In addition to creating an economic stimulus by ridding the State of the SBT, the bill would encourage firms to locate in Michigan by repealing a confusing tax that is little-understood by business owners from outside

the State. Since Michigan is the only state with this type of tax, companies find it difficult to compare it with business taxes levied in other states when looking at possible locations. This can lead them to seek out locations in states with more traditional tax systems, where tax liability and possible tax savings are usually more easily determined.

Opposing Argument

Some people believe that restructuring the SBT to make it friendlier to manufacturing (which critics of the SBT often claim is hurt the most by the tax) would be a better solution than doing away with the tax outright. Currently, the SBT brings in about 25% of the State's General Fund/General Purpose revenue or, roughly \$1.9 billion for fiscal year 2005-06. Michigan already is facing a tight budget in 2006 and cutting the SBT could lead to continued cuts in health care, education, prisons, and road construction in order to avoid a significant deficit. A restructuring of the tax could provide relief for manufacturers without decreasing State SBT revenue.

Response: The SBT needs to be eliminated, not restructured. A revenue-neutral restructuring of the SBT would require that some industries pay an increased SBT levy to offset the reduced tax paid by others. The State should not be picking winners and losers when it comes to taxation and should reduce the SBT on all taxpayers equally. Additionally, restructuring would primarily benefit manufacturing, which is cutting jobs in Michigan, while hurting growing industries like insurance and financial planning. Continued cuts in State spending and the increased tax revenue generated by expanding businesses should offset the revenue lost by eliminating the SBT.

Opposing Argument

Under the bill, the SBT no longer would be repealed after December 31, 2009, as scheduled, but would continue to be collected until the year 2025. The prolonging of the SBT phase-out could be viewed as a major tax increase for businesses that are not expecting to pay the tax after 2009. If the bill aims to improve the State's economic climate by ridding Michigan of the SBT, the repeal should be moved up, not delayed 15 years.

Response: The bill would represent a tax increase only if a business does not

expect another tax to replace the SBT when it is repealed. Currently, the SBT generates about a quarter of the State's General Fund/General Purpose revenue. Even if the State were to continue making significant budget cuts over the next four years, there is no way it could sustain that type of revenue loss without implementing a tax to replace at least some of the revenue that will be lost from the repeal of the SBT. It is unrealistic to assume that, in 2009, the tax will be repealed entirely without some sort of replacement tax being enacted.

\$1.6 billion in FY 2010-11. All of these estimated changes in single business tax revenue would affect the General Purpose portion of the General Fund.

Fiscal Analyst: Jay Wortley

Opposing Argument

Businesses do not decide to locate in a particular state based solely on its business tax. A number of studies have shown that firms consider a variety of factors when choosing a location and a state's business tax rate is rarely the top criterion. Quality of life issues, on the other hand, are usually high on the list of reasons a company chooses to locate in a particular state. If the State had to make significant cuts to education, roads, and law enforcement to compensate for the loss of SBT revenue, it is unlikely that companies would continue ranking Michigan highly on quality of life issues.

Legislative Analyst: J.P. Finet

FISCAL IMPACT

The bill would lower the single business tax rate from the current level of 1.9% to 1.8% in 2007, 1.7% in 2008, and 1.6% in 2009. These tax rate reductions would reduce single business tax revenue by an estimated \$79 million in FY 2006-07, \$189 million in FY 2007-08, and \$306 million in FY 2008-09. Also, under current law, the single business tax is scheduled to be repealed effective for tax years that begin after 2009. The bill would eliminate this repeal; instead, the tax rate would continue to be reduced by 0.1 percentage point each calendar year until it would fall to zero in 2025. As a result, after 2010, this bill would generate large increases in SBT revenue compared with current law. For example, under current law, the tax rate will fall to zero beginning in 2010, but under the bill it would decline from 1.6% in 2009 to 1.5% in 2010 and 1.4% in 2011. As a result, compared with current law, the bill would generate an estimated \$970 million increase in single business tax revenue in FY 2009-10 and

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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.