Senate Fiscal Agency
P. O. Box 30036
Lansing, Michigan 48909-7536

BILL ANALYSIS

Telephone: (517) 373-5383
Fax: (517) 373-1986
TDD: (517) 373-0543

House Bill 5743 (as passed by the Senate)
Sponsor: Representative Leon Drolet
House Committee: Tax Policy
Senate Committee: Finance

Date Completed: 3-30-06

RATIONALE

Michigan's single business tax (SBT) is unique in that it is the country's only currently levied value-added tax. The SBT 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 businesses taxes, such as the corporate income tax. The SBT Act is scheduled to be repealed after December 31, 2009.

Studies by some 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 2006 State Business Tax Climate Index ranked Michigan's business tax climate in 49th place nationally. Also, many business owners reportedly find the one-of-a-kind tax confusing. Several business groups and others 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 repealing the SBT before the end of 2009, and requiring that any replacement tax be more business-friendly, would provide relief to existing Michigan firms, as well as send a message to companies considering moving to Michigan or expanding their facilities that the State is serious about improving its business tax environment.

CONTENT

The bill would repeal the Single Business Tax Act effective for tax years beginning after December 31, 2007; require the Legislature to replace the SBT with a tax or taxes that were more conducive to job creation, investment, and economic growth; and prohibit the Legislature from replacing the lost revenue with an increase in certain taxes. Additionally, the bill would require the Governor's Council of Economic Advisors to develop a plan to replace all or a portion of revenue lost by the repeal of the SBT.

Specifically, the Legislature could not replace revenue not collected due to the bill's repeal of the SBT Act with an increase in the rate or base of any of the following:

-- The State income tax imposed under the Income Tax Act.
-- The sales tax imposed under the General Sales Tax Act.
-- The use tax imposed under the Use Tax Act.
-- Taxes collected on residential real property that was not leased or rented for more than 50% of any calendar year and on principal residences.
-- Any other tax whose economic incidence is on individuals.

Before January 1, 2007, the Governor's Council of Economic Advisors would have to develop a plan to replace all or a portion of the revenue not collected related to the bill's repeal of the SBT Act. Before January 1, 2007, the Council would have to report the plan to the Governor, the Senate Majority Leader, the Speaker of the House of

Representatives, and the Senate and House standing committees that dealt with tax and finance matters.

The bill also would repeal Enacting Section 1 of Public Act 531 of 2002 and Enacting Section 3 of Public Act 115 of 1999. Enacting Section 1 of Public Act 531 of 2002 repeals the SBT Act effective for tax years that begin after December 31, 2009. Enacting Section 3 of Public Act 115 of 1999 repeals the SBT Act on the January 1 of the year in which the rate is reduced to 0%, and states that the SBT Act is not effective for tax years that begin on or after that date.

(Public Act 115 of 1999 amended the SBT Act to provide that beginning January 1, 1999, the tax rate will be reduced by .1% each January 1 if the Comprehensive Annual Financial Report for a State fiscal year (published pursuant to the Management and Budget Act) reports an ending balance of more than $250 million in the Countercyclical Budget and Economic Stabilization Fund for that fiscal year. Under the Act, the SBT rate has been reduced from 2.3% in 1999 to its current rate of 1.9%.)

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 SBT is onerous and unfair, and the calculation of the tax base penalizes companies for creating jobs and offering health care. In addition to paying the SBT, Michigan businesses pay substantial amounts of real property taxes (which were not cut as much for businesses as for individuals when Proposal A was approved by the voters in 1993) and personal property taxes (which generally apply only to businesses). By ridding the State of the SBT, the bill would lead to a more equitable tax structure. Speeding up the tax's repeal by two years also would assure businesses that Michigan is improving its business tax climate. Further, the bill would provide certainty to businesses considering moving to or expanding in Michigan that whatever tax replaced the SBT would be more conducive to job creation, investment, and economic growth. This would help bring down Michigan's unemployment rate, which is among the highest in the nation.

The State will have to consider a new business tax to replace the revenue lost due to the repeal of the SBT in 2009. By moving up the time frame, the bill would create a sense of urgency to find a replacement tax that would be fairer to businesses. The sooner a new business tax was in place, the sooner the State could begin recruiting firms that have avoided locating in Michigan due to the SBT.

In addition to creating an economic stimulus, 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 have difficulty comparing it with the business taxes levied elsewhere when looking at possible locations. This can lead them to seek out other locations in states with more traditional tax systems, where tax liability and possible tax savings are usually more easily determined.

Opposing Argument

It would be irresponsible to repeal a tax that brings in an estimated $2.0 billion annually, or about 25% of the State's General Fund/General Purpose budget, without any plan for replacing the revenue, especially when the State is facing budget shortfalls. The SBT should be repealed when a replacement tax has been established to ensure that its elimination does not hurt funding for crucial State services. Michigan already is facing a tight budget in fiscal year 2006-07 and eliminating the SBT could lead to continued cuts in health care, education, prisons, and road construction after 2007.

Opposing Argument

There is little evidence that businesses choose a location based on a state's tax rate. For example, eight of the 10 states with the fastest-growing workforces tax businesses at a higher rate than Michigan does (when state and local business taxes are expressed as a percentage of private gross state product). Instead of basing its decision on taxes, a business is more likely to choose the state that has an educated, skilled workforce and provides its employees with the best quality of life. According to the Tax Foundation's 2006 State Business Tax Climate Index Rankings, Michigan's "overall" rank was 26th. It is unlikely that repealing the SBT would encourage many new businesses to locate in Michigan because any potential tax benefits would be outweighed by reductions in State services necessitated by repeal of the SBT.

Opposing Argument

Small businesses in Michigan would bear the brunt of replacing the lost SBT revenue. The bill contains language that would prohibit increases in the sales, income, use, and residential property taxes, and other taxes affecting individuals, to replace the lost revenue, and discussions about job retention have tended to focus on large manufacturers. Although small businesses are essential to economic growth and diversity, there is nothing in the bill to protect them.

Opposing Argument

Prohibiting the Legislature from increasing the State income, sales, use, residential real estate, and other taxes to replace lost SBT revenue would violate the Michigan Constitution. Under the Article IV, Section 25 of the Constitution, "No law shall be revised, altered or amended by reference to its title only. The section or sections of the act altered or amended shall be re-enacted and published at length." The bill would attempt to amend the various tax laws by reference.

Opposing Argument

Critics of the SBT claim that it drives businesses away from Michigan by being unnecessarily complex; however, this complexity stems from years of piecemeal attempts to take the SBT's value-added structure and mold it into a tax on corporate profits. As originally passed, the SBT was a fair, stable, and progressive tax that provided a more stable source of revenue than other forms of business taxes. Instead of being eliminated, perhaps the SBT should be re-enacted in its original form, which was fair and far less complicated.

Response: The SBT is an antiquated tax. It was enacted over 30 years ago when the commerce and economic activity of the State were dramatically different than they are today. The SBT was designed to level off the peaks and valleys of State revenue; it was not designed with any consideration for economic growth and certainly not drafted for the State's present economy.

Legislative Analyst: J.P. Finet

FISCAL IMPACT

This bill would reduce single business tax revenue by an estimated $1.3 billion in FY 2007-08 and would eliminate all single business tax revenue in subsequent fiscal years, which would total about $2.0 billion in FY 2008-09. All of this reduction in revenue would affect the General Fund/General Purpose budget.

Fiscal Analyst: Jay Wortley