

The Michigan Single Business Tax

1998-99



Michigan Department of Treasury
Office of Revenue and Tax Analysis
July 2002

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EXECUTIVE SUMMARY

- The Single Business Tax (SBT) is a modified value-added tax (VAT). A pure VAT's tax base taxes the value a firm adds to its products. Unlike a pure VAT, the SBT provides several exemptions from and deductions to value added. In addition, the SBT also offers numerous credits, which a pure VAT does not. The SBT's tax base is apportioned based on the share of a firm's sales, wages, and property in Michigan.
- FY 2001 Single Business Tax (SBT) revenues totaled \$2,224 million, down 11.6 percent from FY 2000. FY 2001 SBT revenues equaled 0.76 percent of Michigan personal income and accounted for 9.9 percent of State taxes and 25.6 percent of General Fund/General Purpose tax revenue.
- The SBT is considerably more stable than a corporate income tax. Annual changes in business income that would be subject to a corporate income tax have ranged between a 68.5 percent decline and a 211.8 percent increase. In contrast, annual SBT revenues have varied much less widely, ranging between a 14.0 percent decline and a 21.0 percent increase.
- Tax year 1998-99 is the latest year for which nearly all SBT returns are cleared.
- Larger firms pay the majority of the SBT. Firms with a 1998-99 SBT liability greater than \$10,000 accounted for only 24.7 percent of firms with an SBT liability but 91.2 percent of total SBT revenues. Conversely, firms with an SBT liability less than \$1,000 comprised 44.1 percent of all filers but only 0.47 percent of total revenues.
- Among major industrial classifications, manufacturing firms accounted for the largest share of 1998-99 SBT revenue (39.1 percent), followed by the services sector (19.4 percent).
- The capital acquisition deduction (CAD) reduced the overall 1998-99 Michigan tax base by 5.9 percent. The business loss deduction (claimed CADs not used in prior years and carried forward), reduced Michigan tax base by 3.5 percent.
- Firms for which compensation accounts for a disproportionately large share of their tax base may claim an excess compensation deduction. The excess compensation reduction reduced 1998-99 SBT tax liability by \$305.8 million. The gross receipts reduction method assures that no firm's tax base exceeds half of their adjusted gross receipts. The gross receipts reduction method reduced firms' SBT liability by \$250.1 million.
- The small business/alternate tax credit is the SBT's largest tax credit. In 1998-99, firms claiming the credit reduced their SBT liability by \$90.5 million.
- The Unincorporated/S Corporation credit reduced 1998-99 SBT liability by \$69.2 million.
- Corporations paid 74.0 percent of the 1998-99 SBT liability. S Corporations paid 15.6 percent.

- In 1998-99, the overall effective SBT tax rate equaled 1.5 percent. Across all major industrial classes, the effective SBT tax rate tends to rise as company size increases.
- In 1998-99, SBT liability equaled 2.2 percent of apportioned compensation and 0.4 percent of apportioned gross receipts.
- To raise the same revenue as the SBT, a 14.3 percent corporate income tax would need to be levied. The rate is so high because SBT replaced not only a corporate income tax but also six other taxes including a property tax on inventories and a corporate franchise fee. In addition, unlike the SBT, a corporate income tax is levied only on corporations. On the other hand, the corporate income tax's nexus standard is narrower than the SBT's.
- In FY 2000, Michigan ranked fourth both in state corporation taxes per person and as a percentage of personal income. When implemented the SBT replaced six other taxes besides a corporate income tax including a corporate franchise tax and a local property tax on inventories. If the SBT were reduced by 30 percent, the portion of the tax imposed to replace the local property tax, Michigan's ranking falls to 11th and 14th respectively.

CHAPTER 1

INTRODUCTION

In 1975, the Michigan legislature approved Public Act 228, radically changing the state's business tax environment. Titled the Single Business Tax (SBT) Act, Public Act 228 replaced profit-based taxation with value-added taxation. More specifically, the SBT replaced seven taxes: the state corporate income tax (the largest revenue generator, then levied at 7.8 percent); the financial institutions income tax; the corporate franchise fee; the savings and loan association fee; the domestic insurance company privilege fee; the local government property tax on inventories; and the intangibles tax on business. The fact that one tax replaced so many others gave impetus to the name *Single Business Tax*.

The Michigan SBT is unique because it is the only currently levied value-added tax (VAT) in the United States.¹ Compared to taxes levied on profits, value-added taxation is a completely different approach to raising tax revenue because it uses the value firms add to products as the tax base. The value a firm adds to a product is the sales price less the cost of materials used in production. This value added should act as a proxy for a firm's activity within a specified jurisdiction, such as a state. In turn, business activity provides a good measure of the government services a firm consumes over the tax year. For this reason, VATs are said to be levied on a "services consumed" or "benefits received" principle rather than an "ability to pay" (profits) principle.

The purpose of this report is to provide the reader with a concise illustration of how the SBT works. Chapter 1 begins with a general overview of value-added taxation and the SBT. Tax base and liability summary statistics for the 1998-99 tax year are included. Chapter 2 discusses value-added taxation in greater detail and works through a simple example to illustrate the value-added concept. It compares the Michigan SBT (a modified VAT) to a pure VAT, and provides a history of the Michigan SBT. Chapter 3 contains an analysis of 1998-99 tax year data and provides statistical analysis of tax base components, deductions, and credits using industry, tax liability, and Michigan tax base (MTB or value-added in Michigan) breakdowns. Chapter 3 also moves the reader step-by-step through the SBT to allow for the clearest presentation of how liability is determined and who is affected. Chapter 4 concludes with an analysis of effective tax rates. Effective tax rates are derived for both MTB and business sector classes. In addition, Chapter 4 calculates SBT payments as a percentage of apportioned gross receipts and labor costs to allow for a comparison of this tax cost to other business costs, and compares the Michigan SBT with a corporate income tax.

¹New Hampshire imposes both a corporate income tax (Business Profits Tax) and a Business Enterprise Tax, which is a 0.75 percent tax on compensation, interest, and dividends paid. In FY 2001, the Business Profits Tax generated \$179.6 million and the Business Enterprise Tax, \$122.2 million. The impact of both taxes may be similar to a value-added tax, but they are not value-added taxes.

General Advantages of Value-Added Taxation

The base of a pure VAT is comprised of payments made by the firm to the factors it employs: wages paid to labor and profits, interest, and rent paid to the owners of capital (plus depreciation to reflect the consumption of capital used in the production process and any taxes levied on factor payments). There are two main advantages that a pure VAT (one with no deductions, exemptions, or credits) has compared to other forms of business taxation. First, a pure VAT taxes the measure of the entire economic activity of a firm independent of its legal structure. Most business taxes involve profit, asset, or net worth measures that are dependent on the organization's legal structure. Second, a pure VAT does not distort market activity (i.e., is neutral), thus it has no effect on the production decisions of the firm. A pure VAT does not alter the relative price of capital or labor for businesses because it is a flat tax on all business costs (labor and capital) and does not influence a firm's choice between capital and labor or the location site. A one percent tax imposed on all value-added (business activity) would increase the cost of using labor, capital, and all intermediate and final goods by one percent (assuming a perfect market economy and no other taxes). Thus, tax rates can also be adjusted without changing the relative economic position of any taxpayer. Small rate changes, however, can have dramatic effects on revenues due to the VAT's very broad base (for example, when the SBT rate was reduced from 2.35 to 2.30 percent in 1995, the estimated cut in taxes was \$49.2 million for FY 1996).

In contrast, the major taxes the SBT replaced (the corporate income tax, franchise tax, inventory tax, and business intangibles tax) were all taxes on capital. They also contained numerous incentives and penalties which distorted prices determined by the marketplace. Legislators sought to offset these distortionary effects by adding more exemptions and deductions. However, doing so increased tax complexity and worsened pre-existing inefficiencies. In addition, these taxes also discriminated against certain types of firms. For example, the profits tax was levied only on corporations and thus favored unincorporated firms and closely-held firms where profits were paid out as wages to owner-managers. The neutrality of the SBT has been reduced over the past 25 years as a result of legislative modifications which have narrowed or altered the pure VAT base (see Exhibit 9, page 21).

Disadvantages of Value-Added Taxation

There are several disadvantages to a VAT. First, value-added taxes are not well understood or accepted in the United States. Although Michigan has levied a VAT for 43 of the past 50 years, no other state has adopted a VAT. Second, most countries levy a VAT instead of a retail sales tax. In those countries, the VAT is an add-on to the price of goods and services sold. Michigan, like most states, already levies a sales tax. The SBT is a tax on businesses, not consumers, and could not be itemized on a customer's bill. Third, the additive method of calculating the tax base invites criticism of the tax as being primarily a tax on labor costs and makes the tax susceptible to constant efforts to remove items from the tax base (see page 14). Fourth, being unique to the United States, there was no established case law for the SBT, and it has been subject to constant litigation.

History of Value-Added Taxation in Michigan

The SBT is not the first VAT levied in Michigan. From 1953-1967, Michigan levied the Business Activity Tax (BAT) which was another form of VAT.² In 1967, the BAT was repealed in favor of a profit-based tax. Two factors explain this shift in tax policy. First, Michigan had also enacted a personal income tax in 1967. Corporate income taxation was reasoned to be a good complement to the personal income tax, a rationale strongly supported by organized labor. Second, smaller firms and the service industry (comprised mainly of smaller firms) opposed the BAT because it was not based on an ability to pay, but rather on resources used. As a result, some firms had a tax liability even in years when they realized a loss.

Eight years later, the State of Michigan returned to a VAT with the passage of Public Act 228 of 1975. Two events led to this short experiment with profits-based taxation. First, during the 1970s Michigan was heavily dependent on the durable goods industry, an industry characterized by highly cyclical profits. Cyclical profits created unstable business tax collections and caused revenues to plummet during economic downturns when they were needed most (see the following table).

Corporate Income Tax Collections (millions)

<u>Fiscal Year</u>	<u>Corporate Income Tax</u>	<u>Percent Change</u>
1968	\$38.5	
1969	210.4	446.5 %
1970	188.0	-10.6
1971	151.2	-19.6
1972	259.0	71.3
1973	357.8	38.1
1974	299.5	-16.3
1975	235.7	-21.3

Source: Annual Report, various years, Michigan Department of Treasury.

Second, the State of Michigan was suffering from a short-term fiscal crisis in 1975 resulting from tax cuts enacted in 1973-74 and a recession-plagued economy.³ As a result, state tax revenues declined and nondiscretionary spending (on education, welfare, and other social

²The original rate of the BAT was 0.4 percent, although public utilities were taxed at a lower rate of 0.1 percent. By 1967, the rate had increased to 0.75 and 0.2 percent, respectively. Financial institutions and insurers were exempt from the BAT. Like the SBT, the BAT also included many reductions and credits.

³From 1970-76, unemployment in Michigan averaged 8.1 percent compared to a national unemployment rate average of 6.1 percent.

programs) increased. By 1975, the State of Michigan was faced with a \$200 million (7.9 percent of General Fund/General Purpose (GF/GP) revenue) budget shortfall.

Historically, business taxes had been increased to cover revenue shortfalls. Lawmakers recognized that this approach was a short-term solution and decided that a more permanent plan of action was necessary. Against this background, a proposal for the return to value-added taxation was put forward. At the time, five specific benefits were cited for the return to value-added taxation:

1. **More stable revenue**

Because labor compensation accounts for approximately 70 percent of the VAT base, the VAT base grows at nearly the same rate as personal income. Therefore, the SBT base (and hence revenue) is more stable, particularly when compared to a corporate income tax. Revenue stability had particular appeal to legislators who felt that a tax system with greater stability would reduce the need for tax increases and spending cuts during economic downturns. Businesses were encouraged to view enhanced revenue stability as a means to halt ever-increasing tax rates. It was argued that if recessionary budget shortfalls could be avoided, perhaps the need for future tax increases could be avoided as well.

2. **A VAT does not discriminate**

A VAT covers all forms of business and all business activities, not just corporate profits. Firms are not penalized for their choice of corporate business form or for being profitable.

3. **The SBT, as enacted, encouraged capital investment**

The SBT allowed firms an immediate deduction for capital expenses from the taxable base. It was reasoned that increased capital investment would create jobs and increase the demand for goods and services. In addition, a full capital deduction would benefit young firms that made large investments in new capital.

4. **Ease of administration**

The SBT consolidated the administration of seven pre-existing taxes into one office. Also, the State administers the tax; local units need not be involved.

5. **A one-time revenue increase of \$200 million to balance the budget**

This one-time revenue infusion resulted from an overlapping period of payments between the old and new tax regimes. However, excluding the initial year, the SBT rate was set to generate the same revenue as the taxes it replaced.

The revenue stability of the SBT cannot be overemphasized because these revenues comprise a significant portion of total state tax revenues. In FY 2001, SBT revenues (including insurance company retaliatory taxes) totaled \$2,224 million and accounted for 9.9 percent of total state tax revenues and 25.6 percent of GF/GP tax revenue. (See Exhibits 1 and 2, pages 6 and 7.) SBT annual revenue fluctuations ranged from -14.0 to 21.0 percent, registering positive growth in most years. On the other hand, if a Corporate Income Tax were still in effect in Michigan over the same period, annual revenues would have been substantially more volatile. Total taxable income growth varied widely, ranging from -68.5 percent to 211.8 percent, and declined over nearly half of the period (see Exhibit 27, page 55). In contrast, as a percentage of total state personal income, SBT tax revenues have been relatively stable and have declined in the past 20 years.

Data

Data for this report was compiled from tax returns filed for tax years ending in December 1998 through November 1999. The 1998-99 tax year represents the most recent year where over 99 percent of SBT returns had been audited and completely processed. As of Spring 2002, 160,277 firms had filed an SBT return for this period. For the purposes of this report, two categories of filers were eliminated from the analysis. The first category includes firms that had no liability and were not required to file because they were below the gross receipts filing threshold: there were 16,530 of these firms. The second category includes firms that had no liability and provided insufficient information to calculate a liability: there were 2,326 of these firms. Excluding these two categories of returns, aggregated statistics that appear in this report are based on the remaining 141,421 SBT filers.

Whenever possible, tables and graphs that appear in this report use data from the total population of cleared returns. However, in some instances it was necessary to omit certain firms from aggregated statistics. For example, firms that filed but had a tax base of zero (possibly because they used the gross receipts short method to file or filled out the simplified form) were excluded from the calculation of components of the MTB (see Exhibit 13, page 31) and effective tax rate calculations (see Exhibits 23 and 24, pages 50 and 51). In addition, a number of firms were omitted from calculation of SBT liability as a percent of gross receipts (see Exhibit 26, page 53), as they did not provide needed information. These instances were noted in the relevant tables and graphs.

Summary of 1998-99 SBT Liability

Exhibits 3 through 6 (on pages 8, 9, and 11) provide some general breakdowns of SBT liability by business sector, liability class, and MTB. The MTB refers to a firm's tax base, or value added, that is attributable to business activity within Michigan. For firms that conduct all business in Michigan, the MTB represents their *total* tax base before any credits or deductions are applied. Firms that are active in more than one state must use a formula to apportion a share of their business activity to Michigan (addressed in Section 1 of Chapter 3). The MTB for these firms represents their *apportioned* tax base before any credits or deductions are applied.

Exhibit 1
Single Business Tax Revenue History*

<u>Fiscal Year</u>	<u>SBT Revenue (Millions)</u>	<u>Percent Change From Prior Year</u>	<u>Percent of Total State Taxes **</u>	<u>Percent of State Personal Income ***</u>
1980	\$1,225	10.3 %	20.0 %	1.30 %
1981	1,053	-14.0	17.0	1.04
1982	1,047	-0.6	16.4	1.01
1983	1,143	9.2	15.6	1.06
1984	1,384	21.0	16.5	1.15
1985	1,495	8.1	16.7	1.14
1986	1,675	12.0	18.1	1.19
1987	1,638	-2.2	17.1	1.12
1988	1,873	14.3	18.2	1.20
1989	1,922	2.6	17.7	1.15
1990	1,877	-2.3	17.0	1.07
1991	1,750	-6.8	14.9	0.97
1992	1,863	6.5	15.2	0.99
1993	1,979	6.2	15.4	0.98
1994	2,230	12.7	14.8	1.04
1995	2,344	5.1	13.4	1.02
1996	2,393	2.1	12.9	1.01
1997	2,407	0.6	12.4	0.97
1998	2,492	3.5	12.1	0.96
1999	2,560	2.7	11.7	0.94
2000	2,517	-1.7	11.0	0.88
2001	2,224	-11.6	9.9	0.76

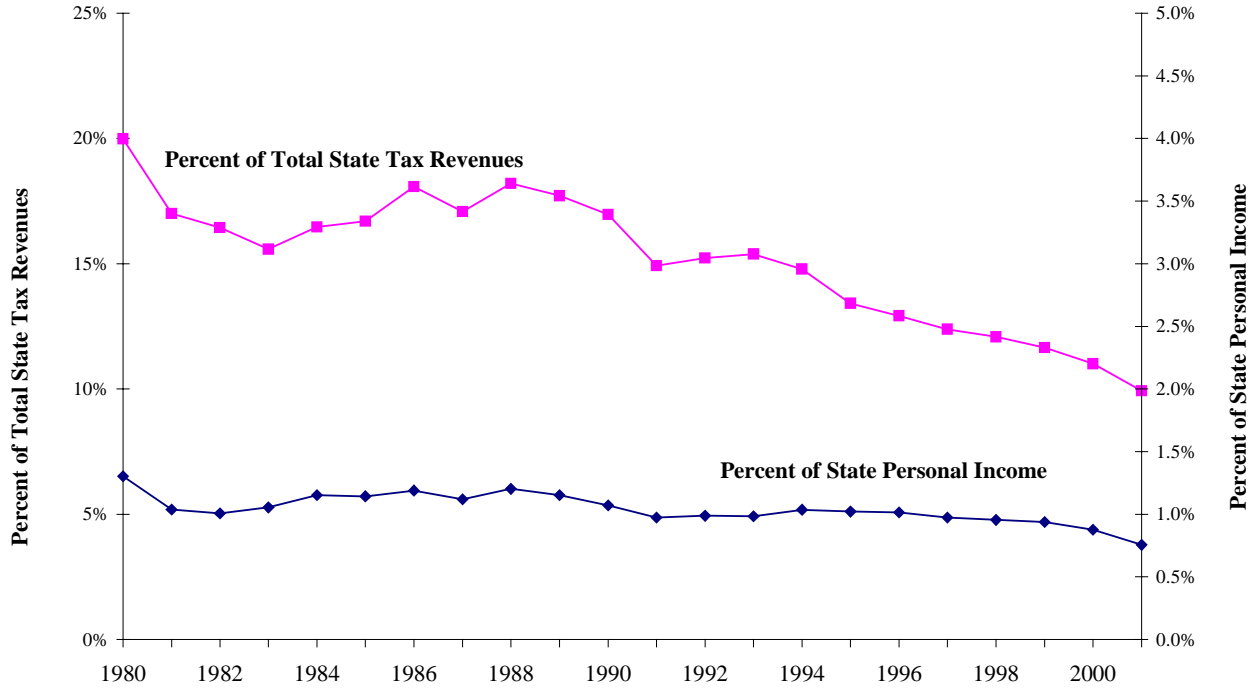
* Includes insurance company retaliatory taxes.

** Does not include fees, permits or licenses.

*** Based on Bureau of Economic Analysis state personal income data, April 23, 2002 release.

Source: State of Michigan Comprehensive Annual Financial Reports and
Bureau of Economic Analysis. Calculations by the Office of Revenue and Tax Analysis.

Exhibit 2
SBT Revenues* as a Percent of Total State Tax Revenues
and as a Percent of State Personal Income



* Includes taxes paid by insurance companies.

Source: State of Michigan Comprehensive Annual Financial Report and Executive Budget.

For tax years ending between December 1998 and November 1999, 141,421 firms filed an SBT return. Of these firms, 102,880 had a positive tax liability totaling \$2.4 billion⁴ (not including insurance company taxes, see Exhibits 3 and 4, pages 8 and 9). Manufacturing firms paid the highest share of SBT revenue, contributing 39.1 percent of total revenue. The service industry contributed 19.4 percent of total revenues, while the retail trade industry provided approximately 14.0 percent of total SBT revenues.

Firms in the service industry comprised the largest sector of filers, accounting for 29.3 percent of all firms that filed in 1998-99. The retail trade sector was the next largest representing 24.3 percent of total firms; while the finance, insurance, and real estate sector accounted for 11.1 percent of all firms that filed. The manufacturing sector and construction sector each accounted for 10.2 percent of total firms.

⁴This figure is slightly different than the \$2.36 billion listed in the FY 1999 State of Michigan Comprehensive Annual Financial Report due to the difference in time frames between liabilities for a tax year and fiscal years in which payments are made.

Exhibit 3
Single Business Tax, 1998-99

<u>Business Sector</u>	<u>Number of Firms</u>	<u>Percent of Firms</u>	<u>Tax Liability</u>	<u>Percent of Liability</u>
Agriculture, Forestry, and Fishing	2,016	1.4 %	\$8,511,091	0.4 %
Mining	500	0.4	6,422,628	0.3
Construction	14,430	10.2	117,784,450	5.0
Manufacturing	14,436	10.2	924,413,544	39.1
Other Durable Manufacturers	5,098	3.6	182,661,011	7.7
Non-Durable Manufacturers	3,497	2.5	208,251,644	8.8
Primary Metals	543	0.4	48,382,640	2.0
Fabricated Metals	2,284	1.6	79,137,028	3.3
Machinery--Except Electrical	2,328	1.6	77,812,457	3.3
Transportation Equipment	686	0.5	328,168,764	13.9
Transportation	3,956	2.8	47,366,083	2.0
Communications and Utilities	1,426	1.0	166,482,764	7.0
Wholesale Trade	5,262	3.7	110,029,943	4.7
Retail Trade	34,428	24.3	332,019,018	14.0
Finance, Insurance, and Real Estate	15,699	11.1	129,293,255	5.5
Services	41,474	29.3	459,293,774	19.4
Not Elsewhere Classified/Misc.	<u>7,794</u>	<u>5.5</u>	<u>64,137,104</u>	<u>2.7</u>
All Businesses	141,421	100.0 %	\$2,365,753,654	100.0 %

Note: Liability figures represent tax years ending December 1998 or January through November 1999.

Source: Office of Revenue and Tax Analysis, Michigan Department of Treasury.

Exhibit 4
1998-99 Tax Liability Breakdown

<u>Liability Class</u>	<u>Number of Firms</u>	<u>Percent of Firms</u>	<u>Cumulative Percent</u>	<u>Tax Liability</u>	<u>Percent of Liability</u>	<u>Cumulative Percent</u>
\$1,000,000 - and over	179	0.13 %	0.13 %	\$787,415,792	33.28 %	33.28 %
\$500,000 - \$999,999	263	0.19	0.31	184,296,890	7.79	41.07
\$100,000 - \$499,999	2,750	1.94	2.26	537,157,628	22.71	63.78
\$50,000 - \$99,999	3,396	2.40	4.66	236,559,289	10.00	73.78
\$10,000 - \$49,999	18,792	13.29	17.95	413,219,657	17.47	91.25
\$5,000 - \$9,999	13,785	9.75	27.69	97,616,363	4.13	95.37
\$1,000 - \$4,999	39,939	28.24	55.94	98,487,088	4.16	99.53
\$500 - \$999	10,670	7.54	63.48	7,950,193	0.34	99.87
\$100 - \$499	9,868	6.98	70.46	2,900,124	0.12	99.99
\$50 - \$99	1,481	1.05	71.50	110,168	0.00	100.00
\$1 - \$49	1,757	1.24	72.75	40,462	0.00	100.00
\$0	<u>38,541</u>	<u>27.25</u>	100.00	<u>No Liability</u>	<u>0.00</u>	100.00
Total	141,421	100.00 %		\$2,365,753,654	100.00 %	

<u>Michigan Tax Base Class</u>	<u>Number of Firms</u>	<u>Percent of Firms</u>	<u>Cumulative Percent</u>	<u>Tax Liability</u>	<u>Percent of Liability</u>	<u>Cumulative Percent</u>
\$100,000,000 - and over	92	0.07 %	0.07 %	\$658,785,505	27.85 %	27.85 %
\$50,000,000 - \$99,999,999	129	0.09	0.16	140,451,466	5.94	33.78
\$10,000,000 - \$49,999,999	1,597	1.13	1.29	499,620,252	21.12	54.90
\$5,000,000 - \$9,999,999	2,311	1.63	2.92	249,735,200	10.56	65.46
\$2,000,000 - \$4,999,999	6,769	4.79	7.71	311,628,596	13.17	78.63
\$1,000,000 - \$1,999,999	9,768	6.91	14.61	189,535,488	8.01	86.64
\$500,000 - \$999,999	15,843	11.20	25.82	136,179,006	5.76	92.40
\$100,000 - \$499,999	56,239	39.77	65.58	141,381,742	5.98	98.38
\$50,000 - \$99,999	13,433	9.50	75.08	6,400,335	0.27	98.65
\$1 - \$49,999	13,415	9.49	84.57	1,553,940	0.07	98.71
\$0 or less	<u>21,825</u> *	<u>15.43</u>	100.00	<u>30,482,124</u>	<u>1.29</u>	100.00
Total	141,421	100.00 %		\$2,365,753,654	100.00 %	

* Includes gross receipts short-method filers who do not report their Michigan Tax Base (recorded as zero).

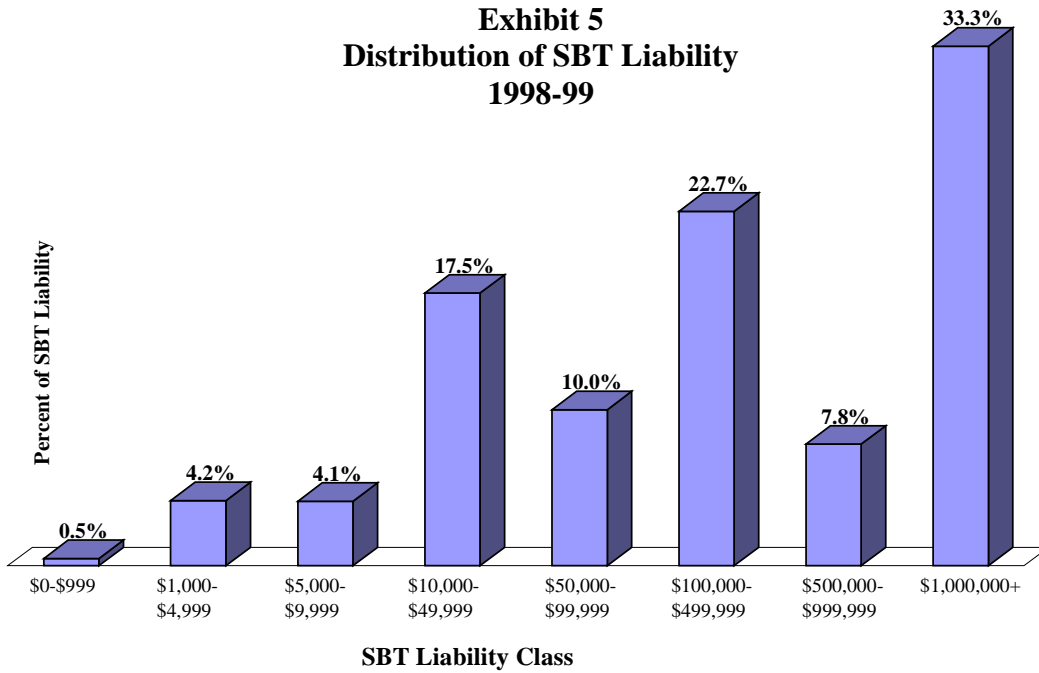
Source: Office of Revenue and Tax Analysis, Michigan Department of Treasury.

Nearly 30 percent of all filers (27.3 percent) had no liability in 1998-99 (see Exhibit 4, page 9). Almost half of the firms (44.1 percent) that filed had liability of less than \$1,000. These firms accounted for only 0.47 percent of total revenues. In contrast, 179 firms (0.13 percent of total filers) accounted for 33.3 percent of total revenues. Firms with liabilities greater than \$10,000 supplied 91.2 percent of total SBT revenues while comprising only 17.9 percent of the total number of firms that filed and 24.7 percent of firms with a positive liability.

The bottom half of Exhibit 4 presents a similar breakdown based on the MTB or value added in Michigan. As noted, the MTB represents a firm's apportioned tax base before any credits, deductions, reductions, or exemptions. As shown by Exhibit 4, large and very large firms (firms with an MTB greater than \$10 million) comprised 54.9 percent of total SBT revenues, yet represented only 1.3 percent of total filers. Medium-sized firms (firms with an MTB between \$500,000 and \$10 million) contributed 37.5 percent of total revenues, while comprising 24.5 percent of total filers. Small firms (firms with an MTB less than \$500,000) or firms that had a negative MTB accounted for only 7.6 percent of total revenues, but represented about 74.2 percent of all filers. Gross receipts short-method filers are not required to report their MTB. Firms that do not report their MTB are listed as having an MTB of zero.

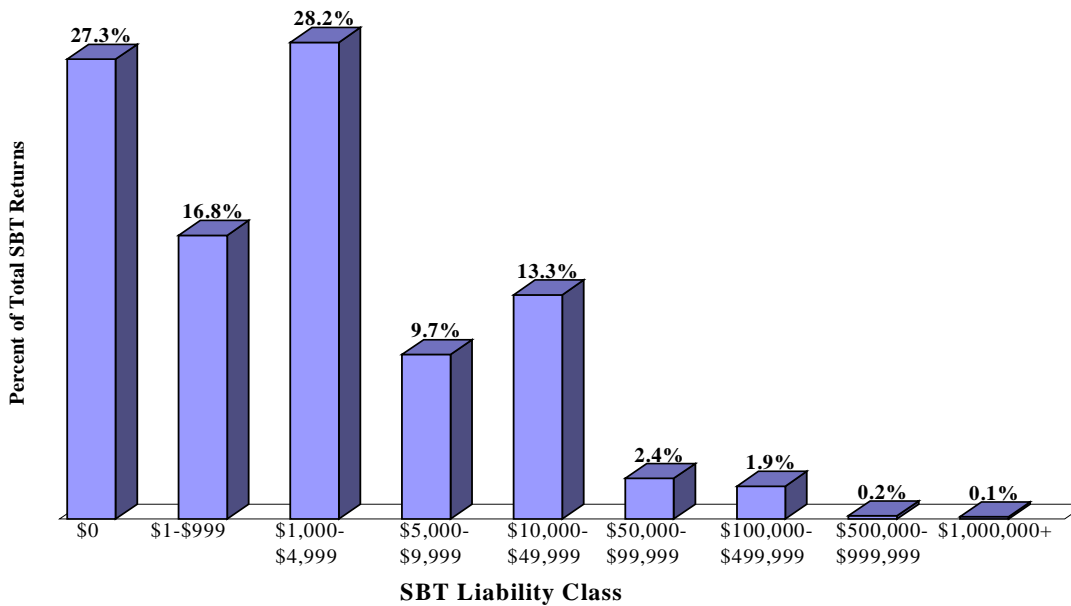
These figures indicate that larger firms are providing the great majority of SBT revenues (see Exhibits 5 and 6, page 11). Chapter 4 discusses effective tax rates and will present evidence regarding the progressivity of the SBT.

**Exhibit 5
Distribution of SBT Liability
1998-99**



Note: Includes all firms filing SBT returns using forms C-8000 and C-8044. Figures may not sum to 100% due to rounding.
Source: Office of Revenue and Tax Analysis, Michigan Department of Treasury.

**Exhibit 6
Distribution of Firms Filing an SBT Return
1998-99**



Note: Includes all firms filing SBT returns using forms C-8000, and C-8044. Figures may not sum to 100% due to rounding.
Source: Office of Revenue and Tax Analysis, Michigan Department of Treasury.

CHAPTER 2

VALUE-ADDED TAXATION

This chapter discusses briefly the calculation of the VAT base and compares a pure VAT to Michigan's SBT. Chapter 3 focuses on the differences between the SBT and a pure VAT (i.e., credits, deductions, and reductions), while Chapter 4 focuses on the progressivity of the SBT resultant from those differences, and compares the SBT with a corporate income tax.

There are three types of VATs: consumption, gross product, and income. The tax base of all three VATs can be calculated using one of two methods: a subtraction method or an addition method. However, it is noted at this time that, regardless of the type of VAT or method used to calculate the base, the tax is still levied on a resources-used principle.

The Value-Added Tax Base

Whether a VAT is levied on a consumption, income, or gross product basis depends upon the treatment of capital purchases. Purchases of capital goods can be treated in one of three ways: (1) inclusion in the tax base with no deductions, (2) inclusion in the tax base with allowances for depreciation, or (3) complete removal from the tax base. The inclusion of capital purchases in the tax base turns a VAT into a gross product VAT. If depreciation is permitted, then the VAT becomes an income-type VAT. If capital purchases are removed completely from the tax base, then the tax becomes a consumption-type VAT. Capital purchases are not consumption because they are not immediately consumed when they are purchased. Rather, capital goods contribute to the production of other consumption goods over their productive lifetime.

Until 1997, the Michigan SBT was a consumption-type VAT for all firms because it allowed the full deduction of capital purchases from the tax base. The tax base equals total income less purchases of capital goods, which equals total consumption.

For tax years beginning in 1997-1999, the Michigan SBT no longer allowed the full deduction of capital purchases from the tax base for multistate firms. For tax years beginning after 1999, Public Act 115 of 1999 replaced the capital purchase deduction with a Michigan investment tax credit (ITC) and Public Act 44 of 2000 enacted graduated ITC credit rates based on firms' adjusted gross receipts (AGR). As a result, for tax years beginning after 1999, the Michigan SBT will remain a consumption-type VAT only for firms with AGR of \$1 million or less.⁵

⁵For tax years beginning after 1999, Public Act 115 of 1999 replaced the capital acquisition deduction with a 0.85 percent Michigan ITC. Public Act 44 of 2000 increased the ITC credit rate for firms with AGR of \$5 million or less. For firms with AGR of \$1 million or less, the ITC rate is 2.3 percent; for firms with AGR between \$1 and \$2.5 million, 1.5 percent; and between \$2.5 and \$5 million, 1.0 percent. The credit rate will be reduced proportionally as the SBT rate is cut. (For more information see the footnote on page 42.)

In addition to the different types of VATs, there are two calculation methods which can be used to derive the VAT base. The VAT base represents the value a firm adds to a product through the production process. In other words, the base is the difference between a product's sales price and the cost of materials used to make that product. This base can be derived either by adding together the individual components of the tax base (addition method) or by subtracting the cost of materials from a firm's total revenue (subtraction method). Both methods arrive at the same tax base and, hence, same tax liability.

A simple example illustrates the calculation of the VAT base using both the addition and subtraction methods.

Value-Added Tax Example

Business: Bakery

Value Added: Any payment made to a factor of production (including depreciation) used in the production process

Costs: Labor (Wages, Compensation, Pensions)
 Materials (Flour, Sugar, Utilities)
 Depreciation of Capital (Building, Machines)
 Interest Paid on Loans

$$\textit{Profits} = \textit{Total Revenue (Sales)} - \textit{Total Costs}$$

Rearranging this equation shows that total revenue equals profits plus total costs:

$$\textit{Total Revenue} = \textit{Profits} + \textit{Total Costs}$$

Substituting for total costs yields:

$$\textit{Total Revenue} = \textit{Profits} + \textit{Labor Costs} + \textit{Cost of Materials} + \textit{Depreciation} + \textit{Interest Paid}$$

The value added is the difference between a firm's total revenue (sales) and the cost of materials used to make the final product:

$$\textit{Value Added} = \textit{Total Revenue} - \textit{Cost of Materials}$$

Substituting for total revenue yields:

$$\textit{Value Added} = \textit{Profits} + \textit{Labor Costs} + \textit{Cost of Materials} + \textit{Depreciation} + \textit{Interest Paid} - \textit{Cost of Materials}$$

or

$$\text{Value Added} = \text{Profits} + \text{Labor Costs} + \text{Depreciation} + \text{Interest Paid}$$

When a consumption-type VAT is used and capital purchases are excluded from the tax base, the value added becomes:

$$\text{Value Added} = \text{Profits} + \text{Labor Costs} + \text{Depreciation} + \text{Interest Paid} - \text{Capital}$$

The equation below demonstrates that the same VAT base can be derived by using the subtraction or addition method. These two calculations are equivalent; they will always yield the same tax base because this identity must hold:

Subtraction Method

Addition Method

$$\text{Total Revenues} - \text{Cost of Materials} = \text{Profits} + \text{Labor Costs} + \text{Depreciation} + \text{Interest Paid}$$

Michigan uses the addition method to calculate the VAT base. This method has two advantages over the subtraction method. First, taxpayers can use their federal taxable income (FTI) as the starting point in their calculation of the tax base. FTI represents the business income or profits of a firm. Second, the addition approach is more explicit, allowing taxpayers to see the specific components of the VAT base.

Comparison of a Pure VAT With the Michigan SBT

A simplified calculation of SBT liability is shown in Exhibit 7 (see next page). As shown, the SBT base is equal to:

$$\text{FTI} + \text{Depreciation} + \text{Compensation} - \text{Capital Expenditures}^* + \text{Additions} - \text{Subtractions}$$

* no longer fully deducted for tax years beginning after 1996.

The federal taxable income calculation is reduced by depreciation; therefore, depreciation must be added back to the SBT tax base. Until 1997, if depreciation had not been added back, capital would have been deducted twice from the SBT tax base because Michigan SBT allowed for the complete deduction of capital purchases from the SBT base. After 1999, depreciation will still be added back, but capital expenses will no longer be deducted from the SBT base. Instead, after the SBT liability is calculated, firms will be able to claim an investment tax credit based on their capital expenditures.

Interest, depreciation, and other payments **paid** (“Additions”) are added to the taxable base. Interest, dividends, or royalties **received** and income from partnerships (“Subtractions”) are subtracted from the SBT base. Both Additions and Subtractions are modifications to the derivation of FTI so as to conform to the value-added concept.

The calculation of the SBT tax base is similar to the calculation of a pure VAT base. The main difference is that the Michigan SBT has been amended to allow numerous deductions, reductions, exemptions, and credits in order to provide tax relief, particularly for smaller,

low-profit firms. The remaining chapters explore these differences and examine which firms benefit. In general, these deviations from a pure VAT reduce the efficiency of the SBT. They create larger administrative and compliance costs and distort the economic behavior of firms to a greater extent than if they did not exist.

Exhibit 7
Comparison:
Pure Value-Added Tax and Michigan SBT

	<u>Tax Base</u>	<u>Minus</u>	<u>Exemptions, Reductions and Deductions</u>	<u>Times</u>	<u>Tax Rate</u>	<u>Minus</u>	<u>Credits</u>
Pure VAT (Consumption Type)	Profits Interest Paid Dividends Paid Compensation (Capital Expenditures)	-	None	x	Determined	-	None
Michigan Single Business Tax	FTI* Additions Compensation Depreciation (Subtractions) (Capital Expenditures)**	-	Agricultural Producers Exemption FICA, UI and WC Exemption Business Loss Deduction Compensation Exemption Excess Compensation Reduction Floor Plan Interest Deduction Government Utilities Exemption Gross Receipts Reduction Statutory Exemption Multiple Welfare Dental Exemption	x	1.9% ***	-	Supplemental Workers Comp. Community Foundation Corporate Farm Property Tax Enterprise Zone Higher Education Homeless Shelter/Food Bank Insurers' Facility Assessment MEGA Credits Small Business/Low Profit Unincorporated Business Credit Utility Property Tax Credit Apprenticeship Tax Credit Brownfield Zone Credit Renaissance Zone Credit Investment Tax Credit** Historic Preservation Credit Low Grade Iron Ore Credit

* Federal Taxable Income is equal to revenue minus costs minus depreciation.

** Capital Expenditures are no longer deducted from tax base for tax years after 1999 and will be replaced by an Investment Tax Credit (Public Act 115 of 1999).

*** Effective January 1, 1999, rate is cut 0.1 percentage point annually, unless the Countercyclical Budget and Economic Stabilization Fund (BSF) fiscal year ending balance is \$250 million or less (Public Act 115 of 1999). In fiscal years 2002 through 2004, the BSF is likely to remain below \$250 million. Thus, the SBT rate will remain at 1.9 percent through 2004. PA 531 of 2002 repeals the SBT entirely for tax years beginning after December 31, 2009.

History of the Michigan SBT

As proposed originally, the SBT rate was set at 2 percent, and the only deduction from this pure VAT (besides the capital deduction) was an exemption for firms with small tax bases. However, a gross receipts reduction, excess compensation reduction, and numerous other exemptions, deductions, and credits were soon added during the initial enactment of the tax.⁶ These changes made it necessary to increase the rate from 2.0 to 2.35 percent in order to maintain the same revenue. In addition to requiring the higher rate, these tax reductions and exemptions made the SBT more cyclical compared to a pure VAT, because they narrowed the VAT base and tied several deductions and credits to profitability.

Before January 1, 1999, the SBT included six exemptions, five deductions, and over 15 credits to provide relief for certain taxpayers. Effective January 1, 1999, the capital acquisition deduction (CAD) was replaced by an investment tax credit. Changes have focused over the issues of apportionment, the treatment of capital purchases, and provisions for low-profit firms.

Apportionment

When enacted in 1975, the rationale for the SBT was to impose a tax on value-added in Michigan; i.e., a tax on labor and capital costs in Michigan. Professor Robin Barlowe, of the University of Michigan, noted in 1981 in *The Michigan Tax Structure* that the SBT deviated from this rationale by requiring multistate manufacturing firms to report their national VAT base and to use an apportionment formula to apportion the national tax base to Michigan. Apportionment was used for three reasons: multistate firms were already used to apportioning national income for state corporate income tax purposes, it was impossible for multistate firms to determine Michigan net income or interest expense, and apportionment provided a tax reduction to Michigan-based multistate manufacturing firms. In *Trinova v. State of Michigan*, the Michigan and U.S. Supreme Courts upheld the use of a national VAT base apportioned to Michigan using an apportionment formula.

The following table summarizes the changes to the SBT apportionment formula:

<u>Public Act</u>	<u>Year Effective</u>	<u>Sales Factor Weight</u>	<u>Payroll Factor Weight</u>	<u>Property Factor Weight</u>
228 of 1975	1976	33.3%	33.3%	33.3%
77 of 1991	1991	40.0%	30.0%	30.0%
	1993	50.0%	25.0%	25.0%
282 and 283 of 1995	1997	80.0%	10.0%	10.0%
	1999	90.0%	5.0%	5.0%

⁶In particular, unincorporated firms and firms with high ratios of payroll to profits saw their tax liability increase dramatically with the adoption of the SBT. To address these concerns, a statutory exemption, unincorporated credit, and labor compensation reduction were enacted.

The 1995 laws also amended the capital acquisition deduction (CAD) by allowing only Michigan apportioned investments to be eligible to the deduction. The law further provided that if the revised CAD were ruled unconstitutional, the apportionment formula would revert to 50-25-25 for tax years beginning in 1997, 60-20-20 for tax years beginning in 1998, and 70-15-15 thereafter. Public Act 115 of 1999 provides that for tax years beginning after 1999, the apportionment formula will be 90-5-5 regardless of the outcome of the CAD litigation.

The apportionment changes have largely turned the SBT from an origin-based tax to a destination-based tax for firms that sell property. These firms are now taxed mainly on the value-added of sales to Michigan customers, rather than the value-added of work done in Michigan. These changes in the apportionment formula follow a trend that has been observed in various other states that use the apportionment formula as an economic development tool: a heavier weighted sales factor apportionment formula decreases the tax burden on firms producing within the state and exporting to other states, while increasing the tax burden on firms that produce in other states and import into that state. Besides Michigan, 10 other states currently allow use of an apportionment formula with a sales factor weighting greater than 50 percent (see Exhibit 8, page 18).

The SBT's throwback rule was repealed in 1998. Under that rule, if for SBT purposes a firm were not taxable in a U.S. state, then sales into that state would be considered a Michigan sale for calculating the apportionment formula sales factor. The new nexus standard made this rule less relevant, since under the new nexus standard (see below) many Michigan-based firms became taxable in other states for SBT purposes, even if, in fact, they were not taxable in those states for corporate income tax purposes.

Treatment of Capital Purchases

The SBT was designed to be a consumption-type VAT, which provides an immediate deduction for capital investment, instead of an allowance for depreciation. This deduction, called the CAD, was promoted in 1975 as an incentive for investment in Michigan; and therefore, the deduction for real property was limited to investment in Michigan, rather than apportioned worldwide investment. The personal property CAD for multistate firms was apportioned, but to better approximate investment in Michigan the CAD apportionment formula used only the payroll and property factors, excluding the sales factor. Compared to the three-factor formula, this CAD formula provided a significant tax cut to Michigan-based multistate firms and a tax increase to out-of-state firms selling into Michigan.

Caterpillar v. Dept of Treasury challenged the constitutionality of the CAD, claiming that it discriminated against interstate commerce. In 1989, the Michigan Court of Claims found the CAD to be unconstitutional and struck the deduction from the tax—an annual \$500 million tax increase. On appeal in 1991, the Michigan Court of Appeals also found the CAD to be unconstitutional, but ruled that multistate firms should be allowed a worldwide, unapportioned deduction—an annual \$500 million tax cut. In 1992, the Michigan Supreme Court ruled on a 4-3 vote that the CAD for personal property was constitutional, and ruled on a 5-2 vote that the real property CAD was constitutional. However, Michigan lawmakers did not wait for the Michigan

Exhibit 8
State Standard Apportionment Formulas of Corporate Income*
(Formulas for TY 2001)**

State	Weights			State	Weights		
	Sales Factor	Property Factor	Payroll Factor		Sales Factor	Property Factor	Payroll Factor
Alabama	33.3	33.3	33.3	Missouri	(8) 33.3	33.3	33.3
Alaska	33.3	33.3	33.3		100	0	0
Arizona	50	25	25	Montana	33.3	33.3	33.3
Arkansas	50	25	25	Nebraska	100	0	0
California	50	25	25	New Hampshire	50	25	25
Colorado	(1) 33.3	33.3	33.3	New Jersey	50	25	25
	50	50	0	New Mexico	(9) 33.3	33.3	33.3
Connecticut	(2) 50	25	25		50	25	25
	(3) 100	0	0	New York	50	25	25
Delaware	33.3	33.3	33.3	North Carolina	50	25	25
Florida	50	25	25	North Dakota	33.3	33.3	33.3
Georgia	50	25	25	Ohio	60	20	20
Hawaii	33.3	33.3	33.3	Oklahoma	(10) 33.3	33.3	33.3
Idaho	50	25	25		50	25	25
Illinois	100	0	0	Oregon	50	25	25
Indiana	50	25	25	Pennsylvania	60	20	20
Iowa	100	0	0	Rhode Island	33.3	33.3	33.3
Kansas	33.3	33.3	33.3	South Carolina	(11) 50	25	25
Kentucky	50	25	25		(12) 100	0	0
Louisiana	(4) 50	25	25	Tennessee	50	25	25
Maine	50	25	25	Utah	33.3	33.3	33.3
Maryland	50	25	25	Vermont	33.3	33.3	33.3
Massachusetts	50	25	25	Virginia	50	25	25
Minnesota	75	12.5	12.5	West Virginia	50	25	25
Mississippi	(5) 33.3	33.3	33.3	Wisconsin	50	25	25
	(6) 50	25	25				
	(7) 100	0	0				

Summary:

Number of States using 1/3, 1/3, 1/3 formula	10	Number of states using multiple formulas:	
Number of States using 50-25-25 formula	21	with highest sales factor at 50 percent	3
Number of States using sales factor above 50 percent	6	with highest sales factor above 50 percent	4

* Does not include special apportionment rules that apply to specific industries, nor formulas for states with no Corporate Income Tax.
 ** as of January 1, 2002

- | | |
|---|---|
| (1) Option between three-factor or two-factor formulae. | (9) Firms that meet certain requirements have the option to use double-weighted sales factor formula. |
| (2) Formula used by manufacturing. | (10) Some corporations are allowed to use the double-weight sales factor formula. |
| (3) Formula used by other sectors. | (11) Formula used by manufacturers or dealers in tangible personal property. |
| (4) Formula for manufacturing and merchandising. | (12) Formula used by other sectors. |
| (5) Formula used by manufacturers selling at wholesale. | |
| (6) Formula used by manufacturers selling at retail. | |
| (7) Formula used by retailers, service companies, and lessors. | |
| (8) Corporations other than certain public utilities and transportation companies may choose between three-factor formula and single-factor of sales. | |

Source: Commerce Clearing House and Federation of Tax Administrators, February 2002.

Supreme Court decision. Following the Court of Appeals decision, a 1991 law rewrote the CAD for both real and personal property to provide a deduction for worldwide investment apportioned like the tax base. The law also revised the apportionment formula used for both the tax base and CAD (see Apportionment on page 16).

Public Acts 282 and 283 of 1995 rewrote the CAD. For tax years beginning after 1996, the law limited the CAD to investments in Michigan (except for mobile property), but required multistate firms to multiply their Michigan investment by their apportionment formula. The law provided that if this new CAD were found unconstitutional, the CAD would revert to its previous version of worldwide apportioned CAD. In 2001, the Michigan Court of Appeals ruled that the Michigan-only CAD did not discriminate against interstate commerce. This overturned a 1999 Michigan Court of Claims ruling. For tax years beginning after 1999, the CAD is replaced with an ITC.

Nexus

The SBT Act does not spell out when firms become taxable in Michigan, or another state, for SBT purposes. The Department of Treasury determined in 1980 that it would be guided by court cases determining nexus under U.S. Public Law 86-272, which sets the nexus standard for state corporate income taxes, also applied to the SBT. Under PL 86-272, firms that only solicit sales in a state and conduct no other business activity in that state are not taxable in that state. In the 1990s several court decisions determined that because the SBT is not a corporate income tax and because the SBT Act is silent on the issue, PL 86-272 does not apply to the SBT. As a result, in 1998 the Department of Treasury adopted new nexus standards (Revenue Administrative Bulletin 1998-01). Under the new standards a firm is taxable in Michigan if it has a resident employee or agent in Michigan or if it regularly and systematically conducts business in Michigan through employees or agents, whether or not they live in Michigan.

Royalties

Under the VAT theory, all costs for the use of property, including rent, interest, and royalties, are taxed to the user of the property (i.e., payer of the charges, not the recipient of the income). When the SBT was enacted in 1975, two exceptions were made to the theory: 1) rent was taxed to the recipient of the rental income, not the payer of rent; and 2) financial institutions were required to pay tax on interest (i.e., not allowed to deduct interest income, except interest from U.S. obligations). The second exception was made so financial institutions would have a tax liability.

Since 1975, the SBT's treatment of royalty income has undergone substantial change. The following types of royalty income are now taxed, like rent, to the recipient, not the payer: oil and gas royalties; cable franchise fees paid to units of government (who are exempt from SBT); film rental payments made by a theater owner to a distributor or to a producer; payments made by radio or TV broadcasters for syndication or royalty fees, or any other charges for program matter; and computer software royalties (royalty income from certain system software is not taxed to the recipient or payer). In addition, in 1986, the tax on franchise fees was switched from the franchisee to the franchisor. In 1997, however, the Michigan Court of Appeals, in *Little Caesar Enterprises v. Michigan Department of Treasury*, ruled that the altered treatment of

franchise fees applied only to the initial fee paid at the time of the franchise agreement, and not to monthly payments equal to a percentage of a franchise's gross receipts. Therefore, monthly (or periodic) franchise fees remain taxable to the franchisee. For tax years beginning after 2000, Public Act 230 of 2001 makes franchise fees part of the tax base of the franchisor and not the franchisee.

Provisions for Small and Low-Profit Firms

To exclude small firms from the SBT, the SBT provides an adjusted gross receipts filing threshold. When the SBT was enacted in 1975, firms with adjusted gross receipts under \$34,000 did not have to file a return or pay SBT. The filing threshold was increased to \$40,000 beginning 1977, to \$60,000 for 1991, to \$100,000 for 1992 and 1993, and to \$137,500 for 1994. Beginning in 1995, the threshold was increased to \$250,000. Public Act 531 of 2002 raises the gross receipts filing threshold to \$350,000 beginning in 2003.

Many firms are strongly opposed to the VAT concept because they may have liability in years when they do not realize a profit. This concern was partially addressed by the enactment of a small business credit and alternate tax. These provisions are available to firms that are relatively small (adjusted gross receipts less than \$10 million) and have relatively low income (adjusted business income minus loss adjustment less than \$475,000 for corporations and partnerships, or less than \$95,000 (\$115,000 after 1997) for an individual or any one shareholder). Essentially, the small business credit and the alternate tax rate convert the SBT into a tax on earnings. In this manner, smaller firms that qualify for the credit/alternate tax are able to eliminate most of their liability in years when their owners have low earnings.

Yet, to argue that firms should not pay any SBT when they earn no profits ignores the fact that a VAT charges firms for government services consumed or benefits received. Firms consume government services whether or not they realize a profit. In this manner, the SBT is similar to local property taxes, which firms pay regardless of their profitability. The argument also runs counter to one of the main advantages of value-added taxation: revenue stability. Allowing firms to forego payment of the tax when they do not realize a profit would make revenues more cyclical and possibly necessitate a higher tax rate.

Despite the many statutory reductions to the SBT, in 1999, with actual revenues exceeding forecasts and continued complaints from the business community that the SBT erodes their competitiveness (see Exhibit 29, page 57), Public Act 115 reduces the SBT rate by 0.1 of a percentage point each year.⁷ Effective January 1, 1999, the SBT rate, which had been reduced to 2.3 percent beginning in 1995, will be reduced yearly by 0.1 percentage point each January 1. A given year's rate cut is delayed if the Countercyclical Budget and Economic Stabilization Fund (BSF) balance in the prior fiscal year is \$250 million or lower. SBT rate reductions resume the year after the BSF fiscal year ending balance rises above \$250 million. Public Act 531 of 2002 repeals the SBT entirely for tax years beginning after December 31, 2009.

⁷The bill also provides clarification on foreign firms' tax base, a revised apportionment formula for firms that undergo tax-free industrial restructuring after January 1, 1999, and replaces the CAD with an ITC.

Exhibit 9 provides a chronology of SBT changes. Exhibit 10 on pages 25-26 presents a progression of the SBT filing requirement changes. Several new SBT credits are described in Chapter 3, Section 4.

Exhibit 9 SBT Legislative History

<u>Year</u>	<u>Public Act</u>	<u>Tax Law Change</u>
1975	228	SBT Enacted Rate Apportionment Capital Acquisition Deduction (CAD) Gross Receipts Reduction Excess Compensation Reduction Business Loss Deduction Statutory Exemption S Corp/Unincorporated Credit Higher Education Credit--50% Utility Property Tax Credit
		7 other taxes repealed. 2.35% 1/3 property, 1/3 payroll, 1/3 sales Real property--Michigan only Personal property--Apportion national investment using 50% property factor, 50% payroll factor Limit tax base to 50% of adjusted gross receipts Compensation greater than 65% of tax base Negative tax base may be carried forward up to 10 years \$34,000/\$36,000 for 1977 From 10% to 20% of SBT liability, according to business income Maximum--lesser of 5% of tax, or \$5,000 5% of State property tax
1976	389	Exempt nonprofit housing corporations
1977	273	Raise statutory exemption to \$40,000 Enact Small Business Credit (SBC): Gross receipts limit < \$3 million Individual Adjusted Business Income (ABI) < \$60,000 Total Adjusted Business Income < \$300,000 Excess compensation reduction--compensation>63% tax base Exempt agricultural production Add in tax base all depreciation from pre-1976 investment
1980	468	Enact Child Care Credit (later repealed)
1981	208	Update IRC code reference to 1/1/81
1982	216	Increase SBC gross receipts limit to \$6 million Increase SBC business income limit to \$475,000 Increase SBC individual income limit to \$95,000
	388	Update IRC code reference to 1/1/82
	393	Enact credit for new business federal unemployment tax penalty

<u>Year</u>	<u>Public Act</u>	<u>Tax Law Change</u>	<u>FY 2001 Revenue Loss (millions)</u>
1984	45 & 46	Enact Worker's Disability Compensation Credit	n.a.
1985	27	Oil and gas royalties, cable TV franchise fees, and franchise fees; tax recipients, not payers	n.a.
	80	Enact Floor Plan Inventory Exemption	n.a.
	226	Enact Enterprise Zone Credit	n.a.
1986	136	Enact Minority Venture Capital Credit (never used)	n.a.
	283	Enact high-tech. central city credit; sunset 12/31/91	n.a.
1987	253	Update IRC code reference to 1/1/87	n.a.
	262	Enact gross receipts tax for insurers	n.a.
1988	390	Phase in statutory exemption increase to \$45,000 Enact Alternative Tax Rate calculation method at 4% for firms with GR less than \$7.5 million	n.a.
	514	Enact Community Foundation Credit--50% Maximum--lesser of 5% of tax, or \$5,000 12/31/91 sunset; \$3 million cap with income tax credit	n.a.
1989	285	Farmers' cooperatives; exempt certain tax base	n.a.
1991	77	Apportion national CAD like rest of tax base Increase adjusted gross receipts filing threshold to \$100,000. Phase in apportionment of 50-25-25	\$14.1 \$45.2
	170	Extend community foundation credit through 1994; increase cap to \$6 million Enact foodbank/homeless shelter credit--50% Maximum--lesser of 5% of tax, or \$5,000 \$1.5 million cap with income tax credit	n.a. n.a.
1992	98	Cut alternative tax rate to 3% Raise SBC gross receipts limit to \$10 million	\$12.8 \$10.6

<u>Year</u>	<u>Public Act</u>	<u>Tax Law Change</u>	<u>FY 2001 Revenue Loss (millions)</u>
1993	105	Motion picture and TV/ radio broadcast royalties; tax recipients, not payers	n.a.
	267	Foodbank/homeless shelter credit; replace dollar cap with 12/31/94 sunset	\$0.0
1994	231	Extend community foundation and homeless shelter/ foodbank credits through 1997	\$0.0
	245	Cut alternative tax rate to 2%	\$13.3
	246	Increase gross receipts filing threshold to \$250,000	\$40.0
	247	Cut SBT rate to 2.3%	\$63.9
1995	1 & 6	Exclude UI, FICA, and workers compensation from tax base	\$134.4
	23	Enact MEGA credits	\$20.0
	282 & 283	Phase in 90-5-5 apportionment; enact apportioned Michigan-only CAD; enact credit to limit a firm's 1997-1999 tax increase from change to \$5 million; provide national apportioned CAD to qualified retailers	-\$18.6
	284	Phase out small business credit if individual ABI between \$95,000 and \$115,000	\$24.0
1996	347	Expand 1993 change for motion picture royalties	n.a.
	382	Enact brownfield zone 10% investment tax credit; max. \$1 million lifetime/taxpayer;12/31/00 sunset	\$2.5
	441	Enact renaissance zone credit	\$3.7
	578	Narrow insurance company tax base	\$1.1
	593	Enact youth apprenticeship credit	\$0.1
1997	190	Community foundation credit; eliminate sunset	\$0.0
	191	Homeless shelter/foodbank credit; eliminate sunset	\$0.0

<u>Year</u>	<u>Public Act</u>	<u>Tax Law Change</u>	FY 2001 Revenue Loss (millions)
1998	225	Eliminate throwback rule (net of voluntary disclosure)	\$0.0
	240	Expand exemption for farmers cooperatives	\$2.0
	493	Revise Voluntary Disclosure Agreement	n.a.
	504	Expand national unapportioned CAD for qualified retailers	n.a.
	534	Enact credit for restoration of historical buildings	\$0.2
	539	Computer software royalties; tax licensors, not users; exempt for 1995-1997; exempt systems software	\$0.0
1999	100	Expand deadline for the initial certification of authorized businesses by the MEGA for tax credits until 12/31/03	n.a.
	115	Phase out of SBT over the next 22 years; revise tax base for foreign companies; revise tax base and appt. factors used by restructured entities; replace CAD with an Investment Tax Credit (ITC)	\$409.1
	184	Youth Apprentice Credit; eliminate sunset	\$0.0
	213	Technical amendments on Historic Preservation Credit	\$0.0
2000	44	Investment Tax Credit, revise calculation	\$13.0
	143	Extend and expand Brownfield zone investment tax credit Allow MEGA credits for job retention investments	\$40.7 \$10.0
	144	Allow MEGA credits for high technology firms	\$4.0
	373	Exempt foreign-based trucking companies	n.a.
	429	Exempt from tax base portion attributable to services performed by an attorney-in-fact; expand criteria for community foundations	\$0.0
	477	Revise definition of Gross Receipts	\$3.1
2001	241	Low-grade iron-ore (hematite) credit	\$1.4
	229	Exclude certain franchise fees from apportionment sales factor calculation	n.a.
	230	Franchise fees; tax recipients, not payers	n.a.

Exhibit 10
Michigan Single Business Tax Filing Requirements
(1976-1993)

	<u>MCL Section</u>	<u>RAB,Q&A</u>	<u>1976</u>	<u>1977-1983</u>	<u>1984</u>	<u>1985-1997</u>	<u>1988</u>	<u>1989</u>	<u>1990</u>	<u>1991</u>	<u>1992</u>	<u>1993</u>
Gross Receipts Filing Requirements	208.73(1)		\$34,000	\$40,000	\$40,000	\$40,000	\$40,000	\$40,000	\$40,000	\$60,000	\$100,000	\$100,000
SBT Tax Rate Percentage	208.31(1)		2.35%	2.35%	2.35%	2.35%	2.35%	2.35%	2.35%	2.35%	2.35%	2.35%
Alternate Tax Rate Percentage	208.36(4)							4%	4%	4%	3%	3%
Apportionment % (Property/Payroll/Sales)	208.45, 45a		33-33-33	33-33-33	33-33-33	33-33-33	33-33-33	33-33-33	33-33-33	30-30-40	30-30-40	25-25-50
CAD Apportionment %	(b) 208.23, 23b	RAB 92-03	50-50	50-50	50-50	50-50	50-50	33-33-33	33-33-33	30-30-40	30-30-40	25-25-50
Statutory Exemption	208.35(1)(a)	RAB 89-51	\$34,000*	\$40,000	\$40,000	\$40,000	\$40,000	\$41,000	\$42,000	\$43,000	\$44,000	\$45,000
Additional Exemption	208.35(1)(a)	RAB 89-51	\$10,000	\$12,000	\$12,000	\$12,000	\$12,000	\$12,000	\$12,000	\$12,000	\$12,000	\$12,000
FICA, WC, UI in Compensation	208.4(3)(c)(d)(e)		Yes	Yes	Yes	Yes	Yes	Yes	Yes	Yes	Yes	Yes
SBC Gross Receipts Disqualifier (disqualified if > \$)	208.36(2)			\$3,000,000	\$6,000,000	\$6,000,000	\$6,000,000	\$7,000,000	\$7,250,000	\$7,500,000	\$10,000,000	\$10,000,000
SBC Excess Gross Receipts Reduction	208.36(6)			\$2,000,000	\$5,000,000	\$5,000,000	\$5,000,000	\$6,000,000	\$6,250,000	\$6,500,000	\$9,000,000	\$9,000,000
SBC ABI Disqualifier - Corp	208.36(2)			\$300,000	\$450,000	\$475,000	\$475,000	\$475,000	\$475,000	\$475,000	\$475,000	\$475,000
SBC ABI & Allocated Income Disqualifier	208.36(2)(a)(b)			\$60,000	\$90,000	\$95,000	\$95,000	\$95,000	\$95,000	\$95,000	\$95,000	\$95,000
Maximum Small Business Credit Allowed	208.36(6)	Q&A S 1-S 22		50%	90%	90%	100%	100%	100%	100%	100%	100%
Public/College Contrib. Credit (Not Ind/Fdcy)	(a) 208.38	RAB 92-10	(a)	(a)	(a)	(a)	(a)	(a)	(a)	(a)	(a)	(a)
Public Utilities Credit (Corp only)	208.39		5%	5%	5%	5%	5%	5%	5%	5%	5%	5%
Community Foundation Credit	(a) (c) 208.38c	RAB 92-10, 95-10						(a)	(a)	(a)	(a)	(a)
Homeless Credit	(a) 208.38c	RAB 92-10									(a)	(a)
Enterprise Zone Credit	208.37a	RAB88-01,93-10				85 No 86 Yes	Yes	Yes	Yes	Yes	Yes	Yes
Workers Comp (WDSB) Refundable Credit	208.38b				Yes	Yes	Yes	Yes	Yes	Yes	Yes	Yes
Unincorporated/S-Corp Credit	208.37		No	Yes	Yes	Yes	Yes	Yes	Yes	Yes	Yes	Yes
High Tech Credit	208.37b		No	No	No	85 No 86 Yes	Yes	Yes	Yes	Yes	No	No

(a) Smaller of \$5,000, 50 percent of contribution, or 5 percent of tax.

(b) Property/payroll until 10/1/89, then property/payroll/sales for tax years beginning after 09/30/89.

(c) Includes 1989 fiscal year filers.

* 1977 fiscal year filers \$36,000.

Source: Technical Services Division, Michigan Department of Treasury.

**Exhibit 10 (cont.)
(1994-2002)**

		<u>MCL Section</u>	<u>RAB, Q & A</u>	<u>1994</u>	<u>1995-1996</u>	<u>1997</u>	<u>1998</u>	<u>1999</u>	<u>2000</u>	<u>2001</u>	<u>2002</u>
Gross Receipts Filing Requirements	(d) (i)	208.73(1)		\$137,500	\$250,000	\$250,000	\$250,000	\$250,000	\$250,000	\$250,000	\$250,000
Gross Receipts Threshold, Controlled Group	(d) (i)	208.73(5)		\$100,000	\$100,000	\$100,000	\$100,000	\$100,000	\$100,000	\$100,000	\$100,000
SBT Tax Rate Percentage		208.31(1)		(c)	2.3%	2.3%	2.3%	2.2% (g)	2.1% (g)	2.0% (g)	1.9% (g)
Alternate Tax Rate Percentage		208.36(4)		(c)	2%	2%	2%	2%	2%	2%	2%
Apportionment % (Property/Payroll/Sales)	(e)	208.45, 45a		25-25-50	25-25-50	10-10-80 (e)	10-10-80 (e)	5-5-90 (e)	5-5-90	5-5-90	5-5-90
CAD Apportionment %	(b) (e)	208.23, 23b	RAB 92-03	25-25-50	25-25-50	10-10-80 (e)	10-10-80 (e)	5-5-90 (e)	No CAD	No CAD	No CAD
Investment Tax Credit		208.35a		No	No	No	No	No	Yes	Yes	Yes
FICA, WC, UI in Compensation		208.4(3)(c)(d)(e)		Yes	No	No	No	No	No	No	No
Statutory Exemption		208.35(1)(a)	RAB 89-51	\$45,000	\$45,000	\$45,000	\$45,000	\$45,000	\$45,000	\$45,000	\$45,000
Additional Exemption		208.35(1)(a)	RAB 89-51	\$12,000	\$12,000	\$12,000	\$12,000	\$12,000	\$12,000	\$12,000	\$12,000
SBC Gross Receipts Disqualifier (disqualified if > \$)	(i)	208.36(2)		\$10,000,000	\$10,000,000	\$10,000,000	\$10,000,000	\$10,000,000	\$10,000,000	\$10,000,000	\$10,000,000
SBC Excess Gross Receipts Reduction	(i)	208.36(6)		\$9,000,000	\$9,000,000	\$9,000,000	\$9,000,000	\$9,000,000	\$9,000,000	\$9,000,000	\$9,000,000
SBC ABI (ABI) Disqualifier - Corp		208.36(2)		\$475,000	\$475,000	\$475,000	\$475,000	\$475,000	\$475,000	\$475,000	\$475,000
SBC ABI & Allocated Income Disqualifier		208.36(2)(a)(b)		\$95,000	\$95,000	\$95,000	\$115,000	\$115,000	\$115,000	\$115,000	\$115,000
SBC ABI & Allocated Income Reduct	(f)	208.36(2)(c), 36d					(f)	(f)	(f)	(f)	(f)
Public/College Contrib. Credit (Not Ind/Fdcy)	(a)	208.38	RAB 92-10	(a)	(a)	(a)	(a)	(a)	(a)	(a)	(a)
Community Foundation Credit	(a)	208.38c	RAB 92-10, 95-10	(a)	(a)	(a)	(a)	(a)	(a)	(a)	(a)
Homeless Credit	(a)	208.38c	RAB 92-10	(a)	(a)	(a)	(a)	(a)	(a)	(a)	(a)
Public Utilities Credit (Corp only)		208.39		5%	5%	5%	5%	5%	5%	5%	5%
Unincorporated/S-Corp Credit		208.37		Yes	Yes	Yes	Yes	Yes	Yes	Yes	Yes
Enterprise Zone Credit		208.37a	RAB 88-01, 93-10	Yes	Yes	Yes	Yes	Yes	Yes	Yes	Yes
MEGA Credit, (Partially Refundable)		208.37c & d			Yes	Yes	Yes	Yes	Yes	Yes	Yes
Low Grade Hematite Pellet Credit		208.39d					Yes	Yes	Yes	Yes	Yes
Renaissance Zone Credit		208.39b				Yes	Yes	Yes	Yes	Yes	Yes
Michigan Historic Preservation Credit	(h)	208.39c					Yes	Yes	Yes	Yes	Yes
Brownfield Credit - "old"		208.38d				Yes	Yes	Yes	Yes	No	No
Brownfield Credit - "new" approval window		208.38g						Yes	Yes	Yes	Yes
Workers Comp (WDSB) Refundable Credit		208.38b		Yes	Yes	Yes	Yes	Yes	Yes	Yes	Yes
Apprentice Refundable Credit		208.38e				Yes	Yes	Yes	Yes	Yes	Yes
CAD Credit		208.36c				Yes	Yes	Yes	No	No	No

(a) Smaller of \$5,000, 50 percent of contribution, or 5 percent of tax.

(b) Property/payroll until 10/1/89, then property/payroll/sales.

(c) Effective 10/1/94 SBT rate from 2.35 percent to 2.3 percent and Alternate Tax Rate from 3-2 percent. Blended rates required for TYE 10/94 thru 8/95.

(d) If total gross receipts for controlled group are over filing requirement, all members must file returns, effective for all tax years ending after 06/30/94. Members of controlled groups whose GR are less than \$100,000 should not be included in the summing of GRs to determine filing requirement. These members are not required to file, but are required to be on the C-8009.

(e) Apportionment Formula. If MCL208.23e is not in effect then: 1997=25/25/50; 1998=20/20/60; 1999=15/15/70.

(f) Reduce credit by: 20 percent with \$95,001-\$99,999; 40 percent with \$100,000-\$104,999; 60 percent with \$105,000-\$109,999; 80 percent with \$110,000-\$114,999; no credit if greater than \$115,000.

(g) Tax rate reduced by 0.1 percent annually beginning 1/1/99 whenever Rainy Day Fund balance for the prior fiscal year exceeds \$250M. Blended rates required for FYE & short period returns.

(h) Tax years beginning after 12/31/98 and before 1/1/2003. Credit equals 25 percent of qualified expenditures less federal credit.

(i) Definition of gross receipts changed 01/11/2001. Notice regarding adjusted gross receipts issued for tax years beginning on or after 01/01/2001.

Nexus standard for MI SBT: Department's position is found in RAB 98-1 (1989 to current). Throwback sales eliminated for TY beginning 1/1/98.

IRC reference changed to that in effect on 1/1/1999 or, at the option of the taxpayer, in effect for the tax year (effective 7/14/99, PA 115 of 1999).

The column for the year 2002 is based on the law in effect at the time of this printing. PA 531 of 2002 repeals SBT for tax years after 12/31/2009.

Source: Technical Services Division, Michigan Department of Treasury.

Subsequent changes will be posted on the Treasury web site at: www.michigan.gov/treasury.

CHAPTER 3

CALCULATING SBT LIABILITY

This chapter demonstrates how SBT liability is determined by depicting the steps a taxpayer would take to complete an SBT tax form. Exhibit 11 summarizes these steps by dividing the SBT calculation into four separate sections: (1) computation of the Michigan tax base (MTB), (2) computation of the adjusted tax base (ATB), (3) calculation methods, and (4) credits. Summary statistics for each item listed in Exhibit 11 based on MTB, liability class, and/or business sector are provided in this chapter. Summary statistics were tabulated from the total population of 1998-99 cleared returns, unless noted otherwise.

Exhibit 11 Calculation of SBT Liability

	Compensation + Business Income + Additions - Subtractions
	<i>equals</i>
Section 1	Total Tax Base
	<i>times</i>
Computation of the Michigan Tax Base	Apportionment Factor
	<i>equals</i>
	Michigan Tax Base (MTB)
	<i>minus</i>
	Net Capital Acquisition Deduction *
	Business Loss Deduction
	Statutory Exemption
	<i>equals</i>
Section 2	Adjusted Tax Base (ATB)
Computation of the Adjusted Tax Base	Excess Compensation Reduction Method
	Gross Receipts Reduction/Short Method
	Alternate Tax Rate Method
	Straight Percentage Method
	<i>times</i>
Section 3	Tax Rate
Filing Methods	<i>equals</i>
	Tax Liability Before Credits
	<i>less</i>
	Investment Tax Credit (ITC) *
	Small Business Credit
	Unincorporated/S Corporation Credit
	Public Utility Credit
	MEGA Credits
	Renaissance Zone Credit
	Other Credits
	<i>equals</i>
Section 4	SBT Tax Liability
Credits	

* Public Act 115 of 1999 replaces the capital acquisition deduction with an ITC.

Section 1: Computation of the Michigan Tax Base

As noted, a VAT base can be computed using an addition or subtraction method. The Michigan SBT utilizes the addition method where the value-added base is determined by adding up a firm's cost of transforming materials purchased into an end product or service.

The starting point in determining SBT liability is the calculation of the total tax base. Using the addition method, the primary components of the total tax base are compensation, business income (as defined for federal tax purposes), and several subtractions or additions to federal business income. Compensation includes salaries, wages, and employee benefits, such as insurance plans, retirement and pension plans, and profit sharing.⁸ Subtractions include dividends, interest, certain royalty or partnership income received. Additions include depreciation, taxes, capital loss carryover, net operating loss carryover or carryback, and dividends, interest or certain royalties paid. The total tax base includes all business activity whether or not it is attributable to Michigan. To derive the business activity attributable to Michigan, the SBT apportions the total tax base to Michigan.

For the 1998-99 tax year, Michigan apportionment was calculated by weighting three factors:⁹

1. The ratio of property in Michigan to total property times 10 percent.
2. The ratio of payroll in Michigan to total payroll times 10 percent.
3. The ratio of sales in Michigan to total sales times 80 percent.

As an example of how a multistate firm would apportion its tax base to Michigan, begin with a multistate firm that reports a total tax base of \$1 million. Assume further that 70 percent of the firm's payroll and property are attributable to Michigan, while only 15 percent of its sales take place in Michigan. The apportionment factor is then equal to:

Payroll	.10 x .70	=	.07
Property	.10 x .70	=	.07
Sales	.80 x .15	=	<u>.12</u>
Apportionment Factor		=	.26

The apportionment factor is a measure of a firm's overall share of business activity in Michigan. Multiplying the total tax base by the apportionment factor yields an apportioned or MTB of \$260,000. Firms that only do business in Michigan have an apportionment factor equal to one, hence their apportioned tax base equals the total tax base.

⁸Public Acts 1 and 6 of 1995 removed social security (FICA), unemployment and worker's compensation payments from the SBT base for tax years beginning after December 31, 1994. The combined tax cut from these acts is estimated at \$134.4 million in FY 2002.

⁹For apportionment factor formula used in other years, see page 16.

For tax years beginning in 1998, the total tax base prior to apportionment equaled \$1,520.1 billion, while the MTB totaled \$150.1 billion (including negative tax bases), or 9.9 percent of the total tax base (see Exhibit 12). Industries with a relatively large percentage of value-added in Michigan compared to total value-added included the construction (44.0 percent), agriculture, forestry and fishing (21.1 percent) and fabricated metals (19.9 percent) industries. Industries with a relatively low ratio include the other durable manufacturing (5.2 percent), transportation (3.1 percent), and mining (2.2 percent) sectors.

Exhibit 12
Michigan Tax Base, 1998-99*

<u>Business Sector</u>	<u>Number of Firms</u>	<u>Total Tax Base</u>	<u>Michigan Tax Base (MTB)</u>	<u>MTB as a Percent of Total Tax Base</u>
Agriculture, Forestry, and Fishing	2,016	\$3,275,374,851	\$689,695,787	21.06 %
Mining	500	8,490,331,431	185,738,701	2.19
Construction	14,430	18,843,433,715	8,299,450,714	44.04
Manufacturing	14,436	616,294,189,548	50,243,254,010	8.15
Other Durable Manufacturers	5,098	202,392,739,789	10,461,450,881	5.17
Non-Durable Manufacturers	3,497	201,491,561,899	11,228,244,450	5.57
Primary Metals	543	20,926,940,834	2,655,981,288	12.69
Fabricated Metals	2,284	24,540,713,758	4,892,431,514	19.94
Machinery--Except Electrical	2,328	40,880,591,899	4,656,699,216	11.39
Transportation Equipment	686	126,061,641,369	16,348,446,661	12.97
Transportation	3,956	107,591,989,170	3,370,202,264	3.13
Communications and Utilities	1,426	62,118,290,453	11,100,035,837	17.87
Wholesale Trade	5,262	94,479,030,973	6,196,036,750	6.56
Retail Trade	34,428	185,854,817,989	21,384,427,493	11.51
Finance, Ins., and Real Estate	15,699	64,207,962,980	9,820,985,406	15.30
Services	41,474	311,696,039,692	34,451,885,301	11.05
Not Elsewhere Classified/Misc.	<u>7,794</u>	<u>47,206,284,903</u>	<u>4,308,515,620</u>	9.13
All Businesses	141,421	\$1,520,057,745,705	\$150,050,227,883	9.87 %

* Most gross receipts short-method filers do not report these statistics. Thus, figures are understated.

Source: Office of Revenue and Tax Analysis, Michigan Department of Treasury.

Exhibit 13, page 31, shows the individual components of the MTB (compensation, business income, additions, and subtractions).¹⁰ As expected, compensation represented the main component of the MTB, comprising 67.4 percent of the total value added in Michigan. Compensation comprised over 75 percent of value added in six industries: mining, construction, non-electrical machinery, retail trade, other durable manufacturing and services. The communication and utilities sector and finance, insurance and real estate sector (besides firms not elsewhere classified) were the two sectors where compensation payments did not dominate, accounting for less than half of the MTB.

Apportioned business income comprised approximately 14.1 percent of the MTB, only slightly higher than in 1997-98 but 1.3 percentage points higher than in 1996-97 and 2.3 percentage points higher than in 1995-1996. For 1996-97, apportioned business income comprised 12.8 percent of the MTB. Because firms doing business in Michigan in 1997-98 and 1998-99 had more profitable years, the small business credit/alternate tax rate method, tied to profitability, declined compared to earlier years.

For most industries, the single largest component of additions was depreciation. For all firms included in the analysis, depreciation comprised 46.3 percent of total additions.

The final two columns of Exhibit 13 show the relative size of the individual business sectors based on Michigan value added. The three largest individual sectors by a significant margin were: services (22.9 percent), retail trade (14.3), and transportation equipment manufacturing (10.9 percent). Together, these three sectors accounted for 48.1 percent of total Michigan value added. The agriculture and mining sectors were the smallest, comprising only 0.6 percent of total Michigan value added. Agricultural production is exempt from SBT.

¹⁰Individual components of the MTB were calculated by adding amounts for firms doing business only in Michigan to an apportioned estimate for multistate firms. The multistate estimates were computed by multiplying each MTB component for each firm by the ratio of the MTB to the total tax base.

Exhibit 13

Components of the Michigan Tax Base, 1998-99*

<u>Business Sector</u>	<u>Total Apportioned Compensation</u>	<u>% of Column Total</u>	<u>% of Row Total</u>	<u>Total Apportioned Business Income</u>	<u>% of Column Total</u>	<u>% of Row Total</u>	<u>Total Apportioned Additions</u>	<u>% of Column Total</u>	<u>% of Row Total</u>	<u>Total Apportioned Subtractions**</u>	<u>% of Column Total</u>	<u>% of Row Total</u>	<u>Apportioned Tax Base Total</u>	<u>% of Column Total</u>
Ag., For., and Fishing	\$495,402,426	0.49	71.87	\$87,740,826	0.42	12.73	\$120,270,601	0.27	17.45	\$14,114,694	0.08	(2.05)	\$689,299,159	0.46
Mining	255,409,202	0.25	137.72	(214,244,384)	(1.02)	(115.53)	310,176,136	0.70	167.26	165,891,253	1.00	(89.45)	185,449,701	0.12
Construction	6,458,353,362	6.40	77.91	1,033,971,874	4.92	12.47	930,344,826	2.09	11.22	133,587,557	0.80	(1.61)	8,289,082,506	5.54
Other Durable Man.	7,926,316,581	7.86	75.93	1,365,298,782	6.49	13.08	2,334,755,409	5.26	22.37	1,188,032,756	7.13	(11.38)	10,438,338,017	6.97
Non-Durable Man.	7,497,797,101	7.43	66.78	1,507,833,759	7.17	13.43	3,387,937,484	7.63	30.17	1,165,816,864	6.99	(10.38)	11,227,751,480	7.50
Primary Metals	1,926,562,627	1.91	72.54	171,460,444	0.82	6.46	738,571,260	1.66	27.81	180,738,905	1.08	(6.81)	2,655,855,426	1.77
Fabricated Metals	3,418,746,966	3.39	69.90	714,077,385	3.40	14.60	897,166,375	2.02	18.34	138,861,999	0.83	(2.84)	4,891,128,728	3.27
Machinery-Exc. Elect.	3,559,371,461	3.53	76.50	334,668,000	1.59	7.19	998,726,580	2.25	21.47	240,214,225	1.44	(5.16)	4,652,551,816	3.11
Trans. Equipment	10,317,287,380	10.23	63.11	963,361,742	4.58	5.89	8,868,560,443	19.97	54.25	3,800,770,979	22.80	(23.25)	16,348,438,586	10.92
Transportation	2,283,106,606	2.26	67.81	427,622,723	2.03	12.70	762,123,738	1.72	22.63	105,759,547	0.63	(3.14)	3,367,093,520	2.25
Comm. and Utilities	4,083,806,711	4.05	36.79	3,061,122,230	14.56	27.58	4,347,451,262	9.79	39.17	392,570,063	2.36	(3.54)	11,099,810,140	7.42
Wholesale Trade	4,160,359,909	4.12	67.17	833,915,505	3.97	13.46	1,506,823,949	3.39	24.33	307,701,927	1.85	(4.97)	6,193,397,437	4.14
Retail Trade	16,262,849,394	16.12	76.12	2,185,384,437	10.39	10.23	4,422,702,633	9.96	20.70	1,504,804,441	9.03	(7.04)	21,366,132,022	14.28
Fin., Ins., and R. Est.	4,637,722,490	4.60	47.58	2,669,826,785	12.70	27.39	5,530,967,260	12.45	56.74	3,090,506,094	18.54	(31.70)	9,748,010,440	6.51
Services	25,765,721,919	25.54	75.09	4,346,923,700	20.67	12.67	7,665,968,719	17.26	22.34	3,463,636,926	20.78	(10.09)	34,314,977,411	22.93
Not Els. Clss./Misc.	<u>1,852,602,946</u>	<u>1.84</u>	44.04	<u>1,540,887,440</u>	<u>7.33</u>	36.63	<u>1,588,545,705</u>	<u>3.58</u>	37.76	<u>775,103,722</u>	<u>4.65</u>	(18.42)	<u>4,206,932,369</u>	<u>2.81</u>
All Businesses	\$100,901,417,080	100.00	67.41	\$21,029,851,246	100.00	14.05	\$44,411,092,381	100.00	29.67	\$16,668,111,947	100.00	(11.14)	\$149,674,248,759	100.00

* Total apportioned tax base numbers differ slightly from figures in Exhibit 12 due to calculation discrepancies and exclusion of gross receipts short filers. Excludes short form alternate tax filers.

** Subtractions are deducted from the tax base.

Source: Office of Revenue and Tax Analysis, Michigan Department of Treasury.

Section 2: Computation of the Adjusted Tax Base

The adjusted tax base (ATB) is derived by subtracting two deductions (CAD and business loss deduction) and one exemption (statutory exemption) from the MTB. All firms can make use of the first two deductions from the MTB, but must qualify for the statutory exemption.

Capital Acquisition Deduction

As noted earlier, for tax years beginning before 2000, firms were allowed to deduct immediately the value of capital purchases or acquisitions made during the tax year. The deduction of capital purchases from the MTB is referred to as the CAD. Firms taxable only in Michigan may deduct the total value of real and personal property acquired. For tax years beginning in 1990-96, multistate firms may deduct a portion of their total real and personal property investment, calculated using the same apportionment factor used in their MTB calculation. For tax years beginning in 1997-1999, multistate firms may only deduct an apportioned part of their Michigan real and personal property investment.¹¹ For tax years beginning after 1999, the CAD is replaced by a Michigan ITC.¹²

Under the CAD, if property is disposed of in a subsequent year, then the sales price must be added to that year's tax base. This addition is called CAD recapture. In this way, past CADs are recaptured when property is sold. In calculating the CAD recapture, the sales price is reduced by the gain and increased by the loss included in business income. Subtracting the recapture from total CAD yields the net CAD. The CAD recapture will remain after 1999, until all investment that benefited from the CAD prior to 2000 is recaptured.

In 1998-99, 82,530 firms claimed \$15.8 billion in net CADs, reducing the MTB by 5.9 percent (see Exhibit 14, page 33). The service (\$4.1 billion) and communication and utilities (\$2.6 billion) sectors claimed the greatest amount of CADs. However, not all claimed CADs were effective because, in certain instances, the entire CAD was not needed to offset a firm's MTB. As a result, effective net CADs totaled \$8.9 billion in 1998-99 (see Exhibit 15, page 34). Most manufacturing firms were able to use their entire CAD, while firms in the finance, insurance, and real estate sector were not able to use approximately 94.6 percent of their claimed CAD. Recapture substantially reduced transportation equipment firms' net CAD.

As a result of increased investment, claimed net CAD rose 8.4 percent from 1997-1998 tax year and effective CAD rose 18.5 percent. Compared to tax years before 1997, the CAD statistics for 1997 and 1998 are noticeably smaller. This is attributable to the legislative change that restricted the CAD only to apportioned real and personal property investments made in Michigan. This change reduced the net CAD for multistate firms by nearly 90 percent, since those firms may no longer deduct from their MTB apportioned real and personal investments made outside of Michigan.

¹¹For information on the CAD for other years, see page 17.

¹²For additional information on the ITC, see footnotes on pages 12 and 42.

Exhibit 14
Claimed Capital Acquisition Deductions, 1998-99

<u>Business Sector</u>	<u>Number Claiming CAD*</u>	<u>Percent of Firms Claiming CAD</u>	<u>Claimed CAD</u>	<u>Percent of Total</u>	<u>Recaptured CAD</u>	<u>Percent of Total</u>	<u>Net CAD**</u>	<u>Percent of Total</u>
Agriculture, Forestry, and Fishing	1,402	1.70 %	\$105,373,426	0.49 %	\$8,593,217	0.15 %	\$96,780,209	0.61 %
Mining	309	0.37	164,367,626	0.76	21,832,056	0.37	142,535,570	0.90
Construction	8,962	10.86	730,235,803	3.37	73,174,027	1.24	657,061,776	4.16
Manufacturers	9,970	12.08	4,977,715,838	22.94	2,565,942,675	43.48	2,411,773,163	15.27
Other Durable Manufacturers	3,315	4.02	827,429,931	3.81	115,386,151	1.96	712,043,780	4.51
Non-Durable Manufacturers	2,323	2.81	724,430,395	3.34	157,559,357	2.67	566,871,038	3.59
Primary Metals	388	0.47	219,867,999	1.01	69,944,444	1.19	149,923,555	0.95
Fabricated Metal	1,720	2.08	563,328,617	2.60	150,938,106	2.56	412,390,511	2.61
Machinery--Except Electrical	1,738	2.11	348,090,397	1.60	75,053,142	1.27	273,037,255	1.73
Transportation Equipment	486	0.59	2,294,568,499	10.58	1,997,061,475	33.84	297,507,024	1.88
Transportation	2,474	3.00	556,431,304	2.56	85,840,676	1.45	470,590,628	2.98
Communications and Utilities	898	1.09	2,740,145,741	12.63	154,803,466	2.62	2,585,342,275	16.37
Wholesale Trade	3,085	3.74	615,140,987	2.84	129,407,204	2.19	485,733,783	3.07
Retail Trade	20,050	24.29	2,388,990,570	11.01	492,681,406	8.35	1,896,309,164	12.00
Finance, Ins., and Real Estate	7,704	9.33	3,622,246,480	16.69	1,168,626,682	19.80	2,453,619,798	15.53
Services	24,838	30.10	4,997,107,942	23.03	946,717,524	16.04	4,050,390,418	25.64
Not Elsewhere Classified/Misc.	<u>2,838</u>	<u>3.44</u>	<u>799,926,454</u>	<u>3.69</u>	<u>253,651,571</u>	<u>4.30</u>	<u>546,274,883</u>	<u>3.46</u>
All Businesses	82,530	100.00 %	\$21,697,682,171	100.00 %	\$5,901,270,504	100.00 %	\$15,796,411,667	100.00 %

* Includes firms that claimed a CAD and a recapture, only a CAD or only a recapture.

** Effective net CADs totaled \$8.9 billion.

Source: Office of Revenue and Tax Analysis, Michigan Department of Treasury.

Exhibit 15
Effective Capital Acquisition Deductions, 1998-99

<u>Business Sector</u>	<u>MTB</u>	<u>Percent of Total MTB</u>	<u>Effective Net CADs</u>	<u>Percent of Total Effective Net CADs</u>	<u>Percent Reduction in MTB</u>
Agriculture, Forestry, and Fishing	\$689,695,787	0.46 %	\$78,888,949	0.89 %	11.44 %
Mining	185,738,701	0.12	62,140,277	0.70	33.46
Construction	8,299,450,714	5.53	584,903,866	6.58	7.05
Manufacturing	50,243,254,010	33.48	1,934,222,914	21.75	3.85
Other Durable Manufacturers	10,461,450,881	6.97	542,354,943	6.10	5.18
Non-Durable Manufacturers	11,228,244,450	7.48	456,804,853	5.14	4.07
Primary Metals	2,655,981,288	1.77	87,236,937	0.98	3.28
Fabricated Metals	4,892,431,514	3.26	365,622,534	4.11	7.47
Machinery--Except Electrical	4,656,699,216	3.10	258,037,335	2.90	5.54
Transportation Equipment	16,348,446,661	10.90	224,166,312	2.52	1.37
Transportation	3,370,202,264	2.25	363,039,912	4.08	10.77
Communications and Utilities	11,100,035,837	7.40	2,225,170,121	25.02	20.05
Wholesale Trade	6,196,036,750	4.13	237,282,883	2.67	3.83
Retail Trade	21,384,427,493	14.25	1,449,377,172	16.29	6.78
Finance, Ins., and Real Estate	9,820,985,406	6.55	131,462,722	1.48	1.34
Services	34,451,885,301	22.96	1,674,272,121	18.82	4.86
Not Elsewhere Classified/Misc.	<u>4,308,515,620</u>	<u>2.87</u>	<u>154,162,746</u>	<u>1.73</u>	3.58
All Businesses	\$150,050,227,883	100.00 %	\$8,894,923,684	100.00 %	5.93 %

Source: Office of Revenue and Tax Analysis, Michigan Department of Treasury.

Business Loss Deduction

Although net CADs totaled \$15.8 billion in 1998-99, approximately \$6.9 billion (43.7 percent) were not used. CADs are not used if the CAD exceeds the Michigan tax base or if the Michigan tax base was negative. In these instances, the unused CAD may be carried forward over the next 10 years as a business loss deduction to offset future tax bases. In 1998-99, 11,555 firms deducted losses from prior years, reducing their 1998-99 MTB by \$5.3 billion and liability by approximately \$121.6 million (MTB reduction times 2.3 percent, the nominal SBT rate for most 1998-99 SBT taxpayers and MTB). Exhibit 16 shows that the finance, insurance, and real estate sectors (20.2 percent) used the business loss deduction most intensively. For all business sectors, the business loss deduction reduced the MTB by 3.5 percent in 1998-99.

Exhibit 16 Business Loss Deduction, 1998-99

<u>Business Sector</u>	<u>Number of Firms Claiming</u>	<u>Total Business Loss Deduction Claimed</u>	<u>Percent Reduction in MTB</u>
Agriculture, Forestry, and Fishing	74	\$7,967,905	1.16 %
Mining	60	22,106,186	11.90
Construction	499	38,905,759	0.47
Manufacturing	590	515,463,211	1.03
Other Durable Manufacturers	217	93,665,125	0.90
Non-Durable Manufacturers	141	133,588,981	1.19
Primary Metals	29	23,683,215	0.89
Fabricated Metals	90	46,743,145	0.96
Machinery--Except Electrical	75	20,933,848	0.45
Transportation Equipment	38	196,848,897	1.20
Transportation	316	79,789,223	2.37
Communications and Utilities	140	216,555,545	1.95
Wholesale Trade	199	171,990,219	2.78
Retail Trade	2,165	313,938,316	1.47
Finance, Insurance, and Real Estate	3,785	1,982,951,345	20.19
Services	2,538	1,547,299,086	4.49
Not Elsewhere Classified/Misc.	<u>1,189</u>	<u>392,086,016</u>	9.10
All Businesses	11,555	\$5,289,052,811	3.52 %

* Percent reduction in the sector's total MTB after CAD adjustments.

Source: Office of Revenue and Tax Analysis, Michigan Department of Treasury.

Statutory Exemption

After prior business losses have been deducted, firms may claim a statutory exemption. For the 1998-99 tax year, the exemption equals \$45,000. Each qualified partner or shareholder of an S or professional corporation may claim an additional \$12,000 up to \$48,000. The exemption is reduced \$2 for every dollar that modified business income exceeds the exemption. Modified business income is business income plus any loss carryovers or carrybacks and compensation and director fees of all shareholders. Consequently, most taxpayers are unable to claim the statutory exemption when modified business income approaches \$67,500.

In 1998-99, 48,165 firms claimed a statutory exemption, reducing the MTB by \$1.9 billion, a reduction of \$44.6 million in tax revenue (see Exhibit 17, page 37). This \$44.6 million reduction, however, underestimates the aggregate tax savings from the statutory exemption because many small businesses who could benefit from it (the exemption would eliminate their tax liability) were not required to file an SBT return because they were below the filing threshold.

However, the \$1.9 billion in claimed statutory exemptions overstates the true exemption's impact because effective exemptions were much smaller. Some firms were unable to use part or all of their claimed statutory exemption because they did not need the entire exemption after deductions for capital acquisitions and business losses. Exhibit 17 shows that effective statutory exemptions totaled \$1.3 billion in 1998-99 and reduced SBT revenues by \$30.6 million.

Industries comprised of smaller firms tended to benefit most from the statutory exemption. The agriculture, forestry, and fishing industries used effective statutory exemptions to offset 3.4 percent of their MTB. In contrast, industries with larger firms, like the transportation equipment manufacturing sector, offset much less (0.03 percent) of their MTB through effective statutory exemptions.

When combined, the net effect of effective CADs, business loss deductions and effective statutory exemptions was substantial. They reduced the Michigan tax base from \$150.1 billion to an adjusted tax base of \$134.5 billion, a 10.3 percent reduction.¹³

Section 3: Calculation Methods

After the adjusted tax base has been determined, firms calculate their tax liability using one of five calculation methods: excess compensation reduction method, gross receipts reduction method, alternate tax rate method, gross receipts short method, or straight percentage method. To use one of the first three calculation methods, firms must meet certain criteria. If a business does not meet any of the criteria, then it uses the straight percentage or gross receipts short method. Credits are then applied to determine final liability.

¹³Excludes simplified filers and firms that used the gross receipts short method to file.

Exhibit 17
Statutory Exemption, 1998-99

<u>Business Sector</u>	<u>Number of Firms Claiming</u>	<u>Total Statutory Exemptions Claimed</u>	<u>Effective Statutory Exemptions</u>	<u>Percent Reduction in MTB From Eff. Statutory Exemptions</u>
Agriculture, Forestry, and Fishing	808	\$31,370,588	\$23,181,725	3.36 %
Mining	175	7,367,698	3,532,620	1.90
Construction	5,258	207,255,717	162,363,465	1.96
Manufacturing	3,414	137,341,782	110,322,575	0.22
Other Durable Manufacturers	1,280	51,579,093	39,855,934	0.38
Non-Durable Manufacturers	912	36,704,966	29,200,042	0.26
Primary Metals	101	4,016,304	3,458,886	0.13
Fabricated Metals	474	18,958,583	16,229,561	0.33
Machinery--Except Electrical	498	20,144,150	16,873,938	0.36
Transportation Equipment	149	5,938,686	4,704,214	0.03
Transportation	1,538	63,352,666	42,836,694	1.27
Communications and Utilities	426	16,959,065	9,735,901	0.09
Wholesale Trade	1,461	59,285,709	44,547,923	0.72
Retail Trade	16,072	650,337,484	501,874,211	2.35
Finance, Insurance, and Real Estate	4,975	203,956,652	73,319,269	0.75
Services	11,568	458,907,069	312,641,598	0.91
Not Elsewhere Classified/Misc.	<u>2,470</u>	<u>102,086,862</u>	<u>44,112,553</u>	1.02
All Businesses	48,165	\$1,938,221,292	\$1,328,468,534	0.89 %

* Percent reduction in the sector's total MTB after CAD adjustments.

Source: Office of Revenue and Tax Analysis, Michigan Department of Treasury.

Excess Compensation Reduction Method

If total compensation exceeds 63 percent of the tax base, then a firm may use the excess compensation reduction to reduce its tax base. The reduction is equal to the percent by which compensation exceeds 63 percent of the tax base, up to a maximum of 37 percent. The reduction is then applied to the adjusted tax base. For example, if compensation represents 80 percent of a firm's total tax base, then that firm may reduce its adjusted tax base by 17 percent ($80\% - 63\% = 17\%$).

In 1998-99, 44,627 firms (31.6 percent of total filers) used the excess compensation reduction to reduce their tax liability by \$305.8 million (see Exhibit 18, page 39). Because the excess compensation reduction depends on the compensation segment of the tax base, industries with large compensation expenses used this reduction most. For instance, approximately half of all manufacturing firms filing an SBT return used this reduction. However, the excess compensation reduction was used infrequently by industries where compensation does not represent a large portion of their SBT tax base. For example, compensation comprised only 47.6 percent of the MTB for firms in the finance, insurance, and real estate sector, and the excess compensation reduction was used infrequently (8.9 percent of filers).

Gross Receipts Reduction Method

If a firm's adjusted tax base exceeds 50 percent of adjusted gross receipts, then a firm may use the gross receipts reduction method. The reduction equals the amount that the adjusted tax base exceeds 50 percent of adjusted gross receipts. Adjusted gross receipts are equal to apportioned gross receipts plus any CAD recapture. In 1998-99, 16,797 firms (11.9 percent of all SBT filers) used either the gross receipts reduction method or gross receipts short method to reduce their SBT liability by \$250.1 million (see Exhibit 18). Industries that utilized the gross receipts reduction method most often include the service (21.0 percent) and finance, insurance, and real estate (20.7 percent) sectors.¹⁴

Gross Receipts Short Method

The gross receipts short method is a simplified version of the gross receipts reduction method. Instead of calculating a percentage reduction to the adjusted tax base, the short method simply recalculates the adjusted tax base as the adjusted gross receipts times 50 percent.

¹⁴Following the *Single Business Tax Report 1993-1994*, this edition uses the new methodology to estimate tax revenue foregone due to the gross receipts reduction. In editions prior to 1997, filers using the gross receipts short method were not attributed with a gross receipts reduction. However, the gross receipts short method and gross receipts reduction method are equivalent; both calculation methods yield the same tax base before credits. Therefore, filers choosing to use the gross receipts short method were attributed a gross receipts reduction. This was done using the average percentage that the gross receipts reduction comprises of apportioned gross receipts for gross receipts reduction long method filers.

Exhibit 18
Excess Compensation and Gross Receipts Filing Methods, 1998-99

<u>Business Sector</u>	<u>Excess Compensation Reduction</u>			<u>Gross Receipts Reduction and Gross Receipts Short Method</u>		
	<u>Number of Firms Claiming</u>	<u>Percentage of Firms in Sector Claiming</u>	<u>Reduction in SBT Liability</u>	<u>Number of Firms Claiming</u>	<u>Percentage of Firms in Sector Claiming</u>	<u>Reduction in SBT Liability</u>
Agriculture, Forestry, and Fishing	558	27.68 %	\$1,284,288	152	7.54 %	\$946,548
Mining	100	20.00	360,937	43	8.60	\$889,023
Construction	4,709	32.63	26,556,939	695	4.82	4,840,582
Manufacturing	7,301	50.57	93,172,873	1,149	7.96	36,521,384
Other Durable Manufacturers	2,561	50.24	25,296,870	367	7.20	5,790,339
Non-Durable Manufacturers	1,674	47.87	19,803,990	200	5.72	12,596,744
Primary Metals	304	55.99	6,534,720	37	6.81	1,553,751
Fabricated Metals	1,229	53.81	9,494,642	234	10.25	5,762,152
Machinery--Except Electrical	1,195	51.33	12,338,722	263	11.30	4,528,288
Transportation Equipment	338	49.27	19,703,929	48	7.00	6,290,109
Transportation	1,298	32.81	8,015,912	316	7.99	5,334,273
Communications and Utilities	360	25.25	4,716,980	152	10.66	15,683,926
Wholesale Trade	2,493	47.38	13,821,488	199	3.78	2,397,826
Retail Trade	11,690	33.95	56,184,113	772	2.24	9,117,280
Finance, Insurance, and Real Estate	1,395	8.89	14,056,445	3,245	20.67	34,809,657
Services	13,647	32.90	83,453,160	8,707	20.99	121,271,143
Not Elsewhere Classified/Misc.	<u>1,076</u>	13.81	<u>4,193,021</u>	<u>1,367</u>	17.54	<u>18,294,402</u>
All Businesses	44,627	31.56 %	\$305,816,155	16,797	11.88 %	\$250,106,043

Source: Office of Revenue and Tax Analysis, Michigan Department of Treasury.

The gross receipts short method and the gross receipts reduction method ensure that no firm's tax base, after apportionment and CAD recapture, is greater than 50 percent of adjusted gross receipts. Using either gross receipts method, 1998-99 tax liability before credits equals 2.3 percent of 50 percent of adjusted gross receipts. As a result, no firm's SBT liability could exceed 1.15 percent of adjusted gross receipts in 1998-99 (50 percent times 2.3 percent). Approximately 1,204 firms used the gross receipts short method, while 15,593 used the gross receipts reduction filing long method.

Alternate Tax Rate Method

Firms that used the alternate tax rate method for tax years beginning in 1998 had to meet three criteria: (1) gross receipts less than or equal to \$10 million, (2) adjusted business income less than \$475,000, and (3) individual shareholder or officer-allocated income less than \$115,000. In addition, firms using this method are not eligible for the small business credit. Both the small business credit and the alternate tax rate method convert the SBT into a tax on owners' earnings and are meant to help smaller, low-profit firms. Firms that utilized the alternate tax rate method paid a tax of 2.0 percent on adjusted business income.¹⁵

In 1998-99, 33,048 filers used the alternate tax rate method (see Exhibit 19, page 41). These filers accounted for 23.4 percent of total filers and provided \$41.4 million (1.7 percent) of SBT revenues. Firms eligible to use this method, however, may have used another method instead and claimed a small business credit which reduced their liability to less than 2.0 percent of adjusted business income.

Straight Percentage Method

The straight percentage filing method multiplies the adjusted tax base by the prevailing tax rate. In 1998-99, 46,949 firms (33.2 percent of all filers) used this filing method. Straight method filers paid \$707.1 million (29.9 percent) of 1998-99 SBT revenues. Firms used this method if they did not qualify for other calculation methods and did not opt to use the gross receipts short method.

Section 4: Credits and Final Tax Liability

After selecting a calculation method and deriving the final tax base, firms multiply the result by the prevailing tax rate. For 1998-99, the rate was 2.3 percent (unless the alternate tax rate method was used). The result is tax liability before credits.¹⁶

¹⁵Public Act 245 of 1994 reduced the alternate tax rate from 3.0 to 2.0 percent effective October 1, 1994. Public Act 284 of 1995 increased the income limit from \$95,000 to \$115,000 beginning in 1998. See page 42 for a definition of adjusted business income.

¹⁶Public Act 115 of 1999 phases out the SBT. Starting January 1, 1999, the SBT rate of 2.3 percent was reduced to 2.2 percent, and by 0.1 percentage point January 1 of each year thereafter as long as the Countercyclical BSF balance exceeds \$250 million. Public Act 531 of 2002 repeals the SBT entirely for tax years beginning after December 31, 2009.

Exhibit 19
Alternate Tax Rate and Straight Percentage Methods, 1998-99

Business Sector	Alternate Tax Rate Method			Straight Percentage Method		
	Number of Firms	Percentage of Firms in Sector	Final Tax Liability	Number of Firms	Percentage of Firms in Sector	Final Tax Liability
Agriculture, Forestry, and Fishing	740	36.71 %	\$913,759	566	28.08 %	\$1,439,643
Mining	75	15.00	75,859	282	56.40	3,294,205
Construction	4,985	34.55	6,577,702	4,041	28.00	19,106,086
Manufacturing	2,468	17.10	3,666,556	3,518	24.37	296,646,374
Other Durable Manufacturers	829	16.26	1,146,651	1,341	26.30	44,623,204
Non-Durable Manufacturers	599	17.13	885,221	1,024	29.28	71,448,079
Primary Metals	72	13.26	110,903	130	23.94	12,310,459
Fabricated Metals	421	18.43	667,130	400	17.51	19,460,710
Machinery--Except Electrical	472	20.27	758,597	398	17.10	18,188,397
Transportation Equipment	75	10.93	98,054	225	32.80	130,615,525
Transportation	790	19.97	898,629	1,552	39.23	10,007,874
Communications and Utilities	185	12.97	283,916	729	51.12	131,877,298
Wholesale Trade	806	15.32	1,120,029	1,764	33.52	40,422,299
Retail Trade	10,814	31.41	12,110,207	11,152	32.39	76,346,049
Finance, Insurance, and Real Estate	2,208	14.06	2,980,299	8,851	56.38	44,617,617
Services	8,964	21.61	11,541,426	10,156	24.49	56,521,886
Not Elsewhere Classified/Misc.	<u>1,013</u>	13.00	<u>1,222,235</u>	<u>4,338</u>	55.66	<u>26,844,342</u>
All Businesses	33,048	23.37 %	\$41,390,617	46,949	33.20 %	\$707,123,673

Source: Office of Revenue and Tax Analysis, Michigan Department of Treasury.

The SBT offered a number of credits to taxpayers in 1998-99 including the small business credit (SBC); the unincorporated/S corporation credit; the public utility credit; the public contribution credit; the community foundation credit; the enterprise zone credit; the corporate farm property tax credit; the minority venture capital credit; the apprenticeship credit; renaissance zone credits and brownfield credits. Several other credits were enacted for future tax years, including the investment tax credit,¹⁷ additional brownfield and MEGA credits and a low-grade iron ore credit.

Credits are presented in order according to the degree to which they reduce SBT liability. The SBC is subtracted before all other credits. However, for tax years beginning after 1999, the investment tax credit will be the first credit subtracted from the tax before credits.

Small Business Credit

The largest SBT credit is the SBC. The SBC is available to firms that meet the same criteria as the alternate tax rate calculation method. Eligible firms receive a credit based on the ratio of adjusted business income (ABI) to 45 percent of the SBT base, to a maximum of 100 percent of tax liability. For 1998-99, the credit was phased out for firms with gross receipts between \$9 and \$10 million. The intent of the credit is to base tax liability on ABI, rather than value added. Adjusted business income is equal to business income plus compensation and director fees of active shareholders and officers plus loss carryovers.

The credit is calculated as follows:

$$\textit{Small Business Credit} = \left(1 - \left(\frac{\textit{ABI}}{0.45 * \textit{Tax Base}} \right) \right) * \textit{Tax Before Credit}$$

As a result, the tax of an eligible business after the credit equals:

$$\textit{Tax After Credit} = \textit{Tax Before Credit} - \textit{Small Business Credit}$$

Substituting Small Business Credit:

$$\textit{Tax After Credit} = \textit{Tax Before Credit} - \left(\left(1 - \left(\frac{\textit{ABI}}{0.45 * \textit{Tax Base}} \right) \right) * \textit{Tax Before Credit} \right)$$

¹⁷Public Act 115 of 1999 institutes a nonrefundable ITC, which replaces the CAD for tax years beginning after December 31, 1999. All Michigan investments in real and tangible personal property and apportioned national investments in mobile property are eligible for the ITC. The credit rate will vary according to the size of each business, measured by the firm's AGR, and will be reduced proportionally as the SBT rate declines. For firms with AGR of \$1 million or less, the ITC rate is 2.3 percent, for firms with AGR between \$1 and \$2.5 million, 1.5 percent, and between \$2.5 and \$5 million, 1.0 percent. Taxpayers using the excess compensation reduction will receive a reduced ITC and taxpayers using the gross receipts reduction method are not eligible for the credit.

or

$$\text{Tax After Credit} = \text{Tax Before Credit} * \left(\frac{ABI}{0.45 * \text{Tax Base}} \right)$$

If a firm does not use the CAD, business loss deduction, statutory exemption, excess compensation, or gross receipts reduction, then:

$$\text{Tax After Credit} = (\text{Tax Base} * \text{SBT rate}) * \left(\frac{ABI}{0.45 * \text{Tax Base}} \right)$$

Using the SBT tax rate of 2.30 percent, this may be rewritten as:

$$\text{Tax After Credit} = \left(\frac{2.30\%}{45\%} \right) * ABI$$

or

$$\text{Tax After Credit} = (5.11\%) * ABI$$

If a firm used the CAD, business loss deduction, statutory exemption, excess compensation, or gross receipts reduction, then the tax becomes an even smaller fraction of income. The tax is then reduced by the ratio of the tax base after reductions to the tax base before reductions:

$$\text{Tax After Credit} = (\text{Tax Base After Reductions} * 2.30\%) * \left(\frac{ABI}{0.45 * \text{Tax Base Before Reductions}} \right)$$

or

$$\text{Tax After Credit} = (5.11\%) * ABI * \left(\frac{\text{Tax Base After Reductions}}{\text{Tax Base Before Reductions}} \right)$$

As an illustration, consider Example 2 in Exhibit 20 (page 44). Given the MTB, the tax before the small business credit is equal to the MTB after reductions (\$50,000) multiplied by the tax rate (2.30 percent), yielding \$1,150. The credit can be calculated following three steps. First, divide ABI (\$40,000) by the product of the value-added base (\$100,000) multiplied by 45 percent. This is equal to 0.888. Second, subtract this result from 1, which yields a figure of 0.111. Finally, multiply this new figure by the tax before the credit, resulting in a credit of \$128 (0.111 times \$1,150) and a tax liability of \$1,022.

Exhibit 20
SBT Small Business Credit:
Illustrative Examples

<u>Example Number</u>	<u>Michigan Tax Base</u>	<u>Base After Reductions</u>	<u>Adjusted Business Income</u>	<u>Tax Before Credit</u>	<u>Credit</u>	<u>Tax After Credit</u>	<u>Tax as a % of Adjusted Business Income</u>
1	\$100,000	\$50,000	\$50,000	\$1,150	\$0	\$1,150	2.30 %
2	100,000	50,000	40,000	1,150	128	1,022	2.56
3	100,000	70,000	50,000	1,610	0	1,610	3.22
4	1,000,000	700,000	50,000	16,100	14,311	1,789	3.58
5	1,000,000	700,000	200,000	16,100	8,944	7,156	3.58
6	1,000,000	800,000	400,000	18,400	2,044	16,356	4.09
7	2,000,000	1,000,000	50,000	23,000	21,722	1,278	2.56
8	2,000,000	1,000,000	400,000	23,000	12,778	10,222	2.56
9	3,000,000	1,000,000	100,000	23,000	21,296	1,704	1.70
10	3,000,000	1,000,000	200,000	23,000	19,593	3,407	1.70

Note: Taxpayers who qualify for the small business credit may instead opt to file using the alternate tax rate method. The alternate tax rate is equal to 2 percent of adjusted business income.

Source: Office of Revenue and Tax Analysis, Michigan Department of Treasury.

Alternatively, since we know that reductions lowered the firm's tax base by 50 percent (base after reductions divided by MTB), the last formula above demonstrates that the CAD, all reductions, exemptions, and the SBC decrease tax liability to 2.56 percent of ABI (5.11% times 50%).

For businesses that qualify and have gross receipts less than \$9 million, the SBC essentially transforms the SBT from a VAT into an income tax. Firms that qualify for the SBC can opt to use the alternate tax rate method instead of the SBC, depending which option reduces their liability more.

In 1998-99, 40,085 firms claimed the SBC or used the alternate tax rate method, reducing their tax liability by \$90.5 million (see Exhibit 21, page 46). Smaller firms in the service, retail trade, and construction sectors made extensive use of the SBC.

Unincorporated/S Corporation Credit

Unincorporated businesses and S corporations are allowed a credit against tax liability depending on their business income. If business income is less than \$20,000, the credit equals 20 percent of SBT liability. If business income is between \$20,000 and \$40,000, then the credit is equal to 15 percent of SBT liability. If business income is greater than \$40,000, then the credit is equal to 10 percent of SBT liability. In 1998-99, 51,006 firms claimed a total of \$69.2 million in unincorporated/S corporation credits.

Public Utility and Public Contribution Credits

The public utility credit is equal to 5 percent of the tax imposed on certain public utility property up to a maximum of the total tax liability. In 1998-99, 48 firms (most in the communications and utilities industry) claimed public utility credits totaling \$11.8 million.

The public contribution credit is equal to 50 percent of the contributions made during the tax year to Michigan colleges and universities, public libraries, and public broadcasting stations. The maximum credit is \$5,000 or 5 percent of the tax after the SBC, whichever is less. In 1998-99, 1,818 firms claimed \$2.1 million in public contribution credits.

Miscellaneous Credits

The SBT allowed many other minor credits in 1998-99. In 1998-99, the enterprise zone credit totaled approximately \$1.5 million; the corporate farm property credit equaled about \$1.0 million, while the community foundation credit and homeless/foodbank credit each totaled less than \$1.0 million. Thus, these credits had a negligible impact on overall SBT liability.

SBT credits have been expanded in the past years. Employers are eligible for a youth apprentice credit of up to \$2,000 per high school student per year. The credit is for 50 percent of salaries and fringe benefits paid to apprentices and 100 percent of classroom instruction and related expenses.

Exhibit 21
Major Tax Credits, 1998-99

<u>Business Sector</u>	<u>Small Business Credit/ Alternate Tax Rate</u>		<u>Unincorporated/ S Corp. Credit</u>		<u>Public Contributions/ Public Utility Credits</u>	
	<u>Number of Firms</u>	<u>Amount</u>	<u>Number of Firms</u>	<u>Amount</u>	<u>Number of Firms</u>	<u>Amount</u>
Agriculture, Forestry, and Fishing	897	\$1,562,917	896	\$483,299	18	\$11,126
Mining	98	245,449	124	292,815	7	13,429
Construction	5,868	11,348,219	6,154	6,338,172	146	180,041
Manufacturing	3,032	11,376,491	4,169	14,651,213	442	821,865
Other Durable Manufacturers	1,036	3,708,740	1,439	3,496,532	134	211,338
Non-Durable Manufacturers	736	2,230,022	993	3,415,111	129	273,583
Primary Metals	90	418,836	138	1,118,769	17	41,146
Fabricated Metals	506	2,123,657	746	3,242,700	70	138,294
Machinery--Except Electrical	567	2,541,812	681	2,035,557	66	103,047
Transportation Equipment	97	353,424	172	1,342,544	26	54,457
Transportation	1,072	3,389,089	1,211	1,405,788	35	34,046
Communications and Utilities	232	878,563	328	1,897,743	61	11,819,547
Wholesale Trade	1,012	1,618,960	1,546	3,219,364	117	103,279
Retail Trade	13,559	20,232,805	13,109	12,861,095	377	347,664
Finance, Insurance, and Real Estate	2,604	7,430,033	5,457	5,118,994	197	234,049
Services	10,509	30,189,551	15,091	20,165,367	445	350,381
Not Elsewhere Classified/Misc.	<u>1,202</u>	<u>2,244,729</u>	<u>2,921</u>	<u>2,770,761</u>	<u>21</u>	<u>10,425</u>
All Businesses	40,085	\$90,516,806	51,006	\$69,204,611	1,866	\$13,925,852

Note: There were 12,373 simplified filers who used the alternate method. Since they do not report their tax base, but only their calculated liability before credits, their alternate credit was estimated using the average reduction on the calculated liability before credits observed in the non-simplified filers who used the alternate method.

Source: Office of Revenue and Tax Analysis, Michigan Department of Treasury.

For firms that would otherwise locate outside Michigan, the Michigan Economic Growth Authority (MEGA) may approve a credit for up to 20 years for the income tax paid each year by the firms' new employees and for the SBT attributable to their new investment and employees. Laws passed in 2000 allow MEGA to approve credits for high-technology firms and for firms that are retaining at least 500 jobs and making new investment in Michigan. While MEGA credits totaled \$6.0 million for 1998, MEGA has awarded credits of nearly \$1.3 billion. MEGA estimates that the new investments will generate over 3½ times that amount in net new tax revenue.

A credit is now available for 100 percent of the tax attributable to business activity in a renaissance zone. As of 1998, there were 11 renaissance zones in portions of 30 townships and cities. By 2002, there were 22 renaissance zones located in parts of 92 cities and townships. Renaissance SBT credits totaled approximately \$4.5 million in tax year 1998.

A 10 percent credit is now available for new investment on environmentally contaminated property included in a brownfield plan. Prior to 2001, the maximum lifetime credit was \$1 million per taxpayer for investments made in tax years beginning before 2001. A 2000 law provides a revised brownfield credit for projects approved by the state before 2003, with a greater maximum credit, and allows credit for investment on blighted and functionally obsolete property in 88 communities. Brownfield credits totaled approximately \$1.0 million in tax year 1998.

CHAPTER 4

EFFECTIVE TAX RATES

This chapter examines the progressivity of the SBT by comparing effective tax rates across both MTB classes and business sectors. When a tax is referred to as progressive, it means that effective tax rates fall as income falls or, in the case of the SBT, as value added or the size of the firm falls. This chapter also calculates SBT liability as a percentage of apportioned gross receipts and apportioned labor compensation. These calculations allow for a clearer understanding of the magnitude of SBT liabilities, particularly when comparing the SBT to other states' business taxes.

SBT Liability by Business Type

By a wide margin, corporations other than S corporations or professional corporations paid most SBT revenues in 1998-99 (74.0 percent, see Exhibit 22, page 49). Corporations paying most SBT were in the retail trade, service, manufacturing, or finance, insurance, and real estate sectors. Individuals paid \$32.3 million of the total SBT liability (1.4 percent) while S corporations accounted for \$368.3 million (15.6 percent). Firms using other forms of business organization (fiduciary, professional corporations, partnerships, and limited liability companies) paid \$213.7 million (9.0 percent) in SBT revenues.

Effective Tax Rates

Effective tax rates refer to the rates that firms actually pay once all reductions, deductions, and credits are taken into account. Effective tax rates were calculated by dividing total tax liability for firms in a given MTB category and business sector by the total MTB for those firms (see Exhibits 23 and 24, pages 50 and 51). As shown, effective tax rates were usually, but not always, significantly below the 1998-99 nominal rate of 2.3 percent. For all firms, the average effective SBT rate was 1.5 percent. Values ranged from a high of 2.1 percent for transportation equipment firms with MTBs over \$100 million to a low of 0.16 percent for firms in the finance, insurance, and real estate sector with MTBs less than \$50,000.

Effective tax rates decreased substantially for all business sectors as the MTB or size of the firm decreased (from left to right in Exhibit 23). Exhibit 24 shows this trend as well. It compares an industry with the average effective rates for the manufacturing sector, the service producing sectors and all sectors.¹⁸ The average effective tax rate for all sectors is also shown. The effective tax rates for all three decline as the MTB decreases. This pattern held for all business sectors.

¹⁸The service producing sector includes transportation; communications and utilities; wholesale trade; retail trade; finance, insurance, and real estate; and services sectors.

Exhibit 22
Single Business Tax by Type of Firm, 1998-99

<u>Business Sector</u>	<u>Individuals</u>		<u>S Corporations</u>		<u>Corporations</u>		<u>Other*</u>	
	<u>Number of Firms</u>	<u>Liability</u>	<u>Number of Firms</u>	<u>Liability</u>	<u>Number of Firms</u>	<u>Liability</u>	<u>Number of Firms</u>	<u>Liability</u>
Ag., For., and Fishing	346	\$740,801	720	\$2,251,316	644	\$4,081,484	306	\$1,437,490
Mining	32	72,375	128	675,819	228	3,859,054	112	1,815,380
Construction	2,037	3,160,205	5,034	43,857,176	6,402	66,088,384	957	4,678,685
Other Durable Man.	163	239,625	1,422	25,120,086	3,244	152,261,463	269	5,039,837
Non-Durable Man.	122	234,417	963	19,496,404	2,228	179,588,076	184	8,932,747
Primary Metals	n.a.	n.a.	145	6,308,532	368	40,562,024	22	1,481,367
Fabricated Metals	36	71,155	773	24,996,300	1,418	51,955,984	57	2,113,589
Machinery--Exc. Electrical	60	86,685	686	14,920,635	1,501	61,494,494	81	1,310,643
Transportation Equipment	n.a.	n.a.	179	7,964,055	462	318,333,995	35	1,856,102
Transportation	328	375,281	1,339	7,231,758	2,000	36,323,457	289	3,435,587
Communications and Utilities	42	106,541	338	2,706,761	851	149,856,150	195	13,813,312
Wholesale Trade	212	300,934	1,565	21,206,308	3,257	83,929,018	228	4,593,683
Retail Trade	4,201	4,355,138	13,581	83,564,085	14,553	231,628,640	2,093	12,471,155
Finance, Ins., and Real Estate	1,650	5,076,188	2,902	13,347,611	3,257	86,686,243	7,890	24,183,213
Services	4,611	15,076,593	12,140	86,862,332	14,969	242,816,579	9,754	114,538,270
Not Elsewhere Class./Misc.	<u>1,024</u>	<u>2,352,294</u>	<u>1,869</u>	<u>7,742,497</u>	<u>2,333</u>	<u>42,018,655</u>	<u>2,568</u>	<u>12,023,658</u>
All Businesses	14,882	\$32,293,561	43,784	\$368,251,675	57,715	\$1,751,483,700	25,040	\$213,724,718

* Includes fiduciary companies, professional corporations, partnerships and limited liability companies.

Source: Office of Revenue and Tax Analysis, Michigan Department of Treasury.

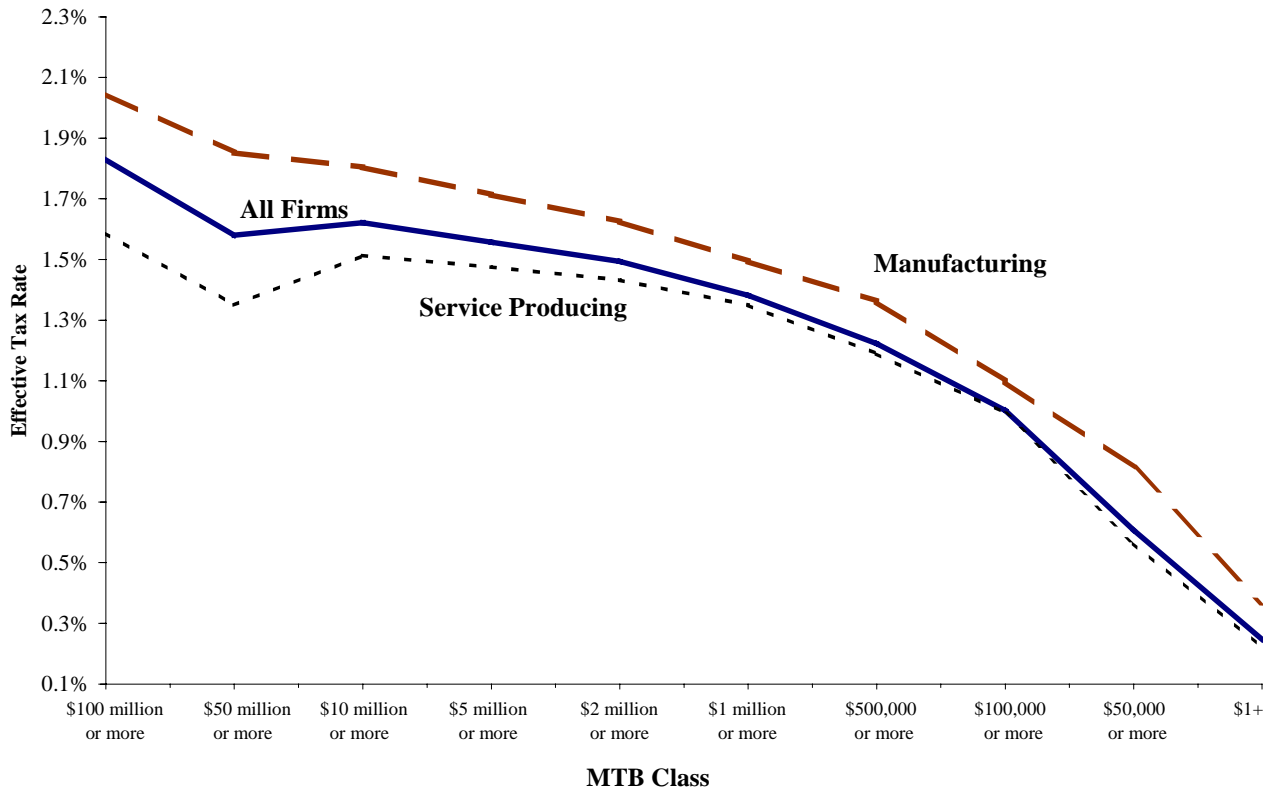
Exhibit 23
Ratio of Tax Liability to Michigan Tax Base, 1998-99

<u>Business Sector</u>	<u>All Businesses</u>	<u>\$100,000,000 or more</u>	<u>\$50,000,000-\$99,999,999</u>	<u>\$10,000,000-\$49,999,999</u>	<u>\$5,000,000-\$9,999,999</u>	<u>\$2,000,000-\$4,999,999</u>	<u>\$1,000,000-\$1,999,999</u>	<u>\$500,000-\$999,999</u>	<u>\$100,000-\$499,999</u>	<u>\$50,000-\$99,999</u>	<u>\$1-\$49,999</u>
Agriculture, For., and Fishing	0.0118	n.a.	n.a.	n.a.	n.a.	0.0147	0.0124	0.0124	0.0087	0.0039	0.0018
Mining	0.0146	n.a.	n.a.	n.a.	0.0173	0.0108	0.0139	0.0102	0.0073	0.0055	0.0023
Construction	0.0139	n.a.	n.a.	0.0163	0.0157	0.0151	0.0139	0.0128	0.0099	0.0070	0.0027
Other Durable Manufacturers	0.0173	n.a.	0.0190	0.0182	0.0172	0.0165	0.0152	0.0136	0.0114	0.0087	0.0038
Non-Durable Manufacturers	0.0179	0.0184	0.0206	0.0186	0.0180	0.0165	0.0157	0.0145	0.0111	0.0080	0.0036
Primary Metals	0.0181	n.a.	n.a.	0.0188	0.0178	0.0164	0.0139	0.0130	0.0110	0.0083	0.0024
Fabricated Metals	0.0161	n.a.	n.a.	0.0172	0.0160	0.0160	0.0143	0.0129	0.0105	0.0072	0.0021
Machinery--Except Electrical	0.0164	n.a.	n.a.	0.0172	0.0165	0.0156	0.0146	0.0129	0.0101	0.0076	0.0038
Transportation Equipment	0.0200	0.0209	0.0157	0.0173	0.0167	0.0167	0.0145	0.0157	0.0115	0.0070	0.0060
Transportation	0.0139	n.a.	n.a.	0.0160	0.0158	0.0145	0.0128	0.0113	0.0090	0.0063	0.0042
Communications and Utilities	0.0147	0.0153	n.a.	0.0125	0.0115	0.0132	0.0125	0.0112	0.0103	0.0100	0.0044
Wholesale Trade	0.0175	n.a.	n.a.	0.0188	0.0182	0.0178	0.0170	0.0156	0.0133	0.0088	0.0050
Retail Trade	0.0152	0.0177	0.0181	0.0182	0.0167	0.0162	0.0148	0.0125	0.0090	0.0051	0.0017
Finance, Ins., and Real Estate	0.0120	n.a.	0.0135	0.0128	0.0135	0.0115	0.0107	0.0087	0.0076	0.0046	0.0016
Services	0.0127	0.0134	0.0098	0.0138	0.0133	0.0133	0.0129	0.0121	0.0110	0.0064	0.0024
Not Elsewhere Classified/Misc.	0.0137	n.a.	n.a.	0.0130	0.0138	0.0154	0.0128	0.0117	0.0108	0.0088	0.0044
All Businesses	0.0153	0.0183	0.0158	0.0162	0.0156	0.0149	0.0138	0.0122	0.0100	0.0061	0.0025

Notes: Does not include gross receipts short method filers or simplified return filers.
To maintain taxpayer confidentiality, "n.a." was used. These firms were included in column and row averages.

Source: Office of Revenue and Tax Analysis, Michigan Department of Treasury.

Exhibit 24
Effective Rates, 1998-99



Source: Office of Revenue and Tax Analysis, Michigan Department of Treasury.

The main difference across business sectors was the location of peak effective tax rates. In most sectors, the highest effective rates were faced by businesses in the highest MTB class. Compared to 1997-1998, effective tax rates fell slightly. However, compared to previous years, effective tax rates in tax year 1998 were generally higher for all businesses, especially for large and very large firms (MTB of \$10 million or more). The main reason for this change is because effective in tax year 1998, multistate firms, which often constitute most of the large firm group, could no longer claim the CAD for their apportioned investments made outside of Michigan. In earlier years, effective net CAD deductions reduced the tax base of firms with MTBs of \$5 million or more by an average of more than 15.0 percent, compared to an average of 5.7 percent in 1998 (see Exhibit 25). However, for firms with MTBs of \$100 million or more, the CAD and excess compensation reduction still remain the main tools used to offset much of their MTB (7.0 and 4.8 percent respectively). Firms with MTBs between \$50 million and \$100 million made more use of the gross receipts reduction and excess compensation methods to reduce their tax bases (11.9 and 7.9 percent, respectively). Firms with MTBs between \$5 million and \$50 million relied both on the CAD and either the gross receipts reduction or the excess compensation reduction. Firms with MTBs between \$100,000 and \$5 million relied heavily on the excess compensation reduction and the SBC to reduce their liability. Very small firms (MTBs below \$100,000) relied on the statutory exemption to reduce most of their MTB.

The tables and chart in this chapter demonstrate that the numerous SBT exemptions, deductions, reductions, and credits make the SBT a progressive tax. This result is consistent with results from previous reports using 1995-96 through 1997-98 tax data.

Exhibit 25 Tax Adjustments as a Percent of Michigan Tax Base, 1998-99

<u>Michigan Tax Base Class</u>	<u>Net Capital Acquisition Deduction*</u>	<u>Business Loss Deduction</u>	<u>Statutory Exemption*</u>	<u>Gross Receipts Reduction</u>	<u>Excess Compensation Reduction</u>	<u>Small Business Credit**</u>	<u>Other Credits***</u>
\$100,000,000 - and over	7.04 %	1.14 %	0.00 %	4.32 %	4.84 %	0.00 %	2.03 %
\$50,000,000 - \$99,999,999	5.53	5.41	0.01	11.91	7.89	0.00	1.25
\$10,000,000 - \$49,999,999	4.52	3.94	0.02	9.59	8.87	n.a.	2.47
\$5,000,000 - \$9,999,999	5.15	2.82	0.05	8.54	10.22	0.95	3.03
\$2,000,000 - \$4,999,999	5.83	2.87	0.12	6.83	11.52	1.78	3.21
\$1,000,000 - \$1,999,999	5.37	3.60	0.29	7.23	12.11	3.48	3.03
\$500,000 - \$999,999	6.42	4.88	0.70	6.56	11.23	6.06	2.76
\$100,000 - \$499,999	7.56	6.32	4.56	5.53	7.75	7.86	3.01
\$50,000 - \$99,999	9.45	10.55	33.40	1.14	5.23	5.02	2.42
\$1 - \$49,999	5.85	18.38	57.70	1.18	2.22	2.17	1.74
Total	5.93 %	3.52 %	0.89 %	7.25 %	8.86 %	2.58 %	2.67 %

* Effective deductions and exemptions only.

** Claimed credits were divided by the tax rate (.023) to allow for a comparison to other deductions, exemptions and reductions.

*** Other credits include unincorporated, public utility, community foundation, college, homeless, and other credits.

Source: Office of Revenue and Tax Analysis, Michigan Department of Treasury.

Other Measures of Liability

To provide a clearer understanding of the magnitude of SBT liabilities, Exhibit 26 presents SBT liability as a percent of compensation and gross receipts. For multistate firms, both compensation and gross receipts were apportioned to Michigan. Due to apportionment, statistics for multistate firms may not necessarily represent measures of tax liability as a fraction of compensation paid in Michigan or sales only in Michigan. This may occur if the payroll factor is significantly different than the sales factor. However, Exhibit 26 does allow for a general comparison of SBT costs relative to other costs incurred by firms.

Exhibit 26
SBT Liability Statistics, 1998-99

<u>Business Sector</u>	<u>All Businesses</u>		<u>Michigan-Only Businesses</u>	
	<u>Liability as a % of Apportioned Compensation*</u>	<u>Liability as a % of Apportioned Gross Receipts**</u>	<u>Liability as a % of Compensation*</u>	<u>Liability as a % of Gross Receipts**</u>
Agriculture, Forestry, and Fishing	1.62 %	0.43 %	1.41 %	0.37 %
Mining	2.38	0.17	1.93	0.31
Construction	1.76	0.39	1.71	0.38
Manufacturing	2.64	0.48	1.75	0.23
Other Durable Manufacturers	2.29	0.31	1.67	0.10
Non-Durable Manufacturers	2.69	0.52	1.80	0.43
Primary Metals	2.51	0.49	1.79	0.40
Fabricated Metals	2.30	0.60	1.82	0.56
Machinery, Except Electrical	2.16	0.55	1.75	0.54
Transportation Equipment	3.16	0.56	1.78	0.43
Transportation	1.91	0.49	1.51	0.31
Communications and Utilities	3.92	0.62	4.09	0.68
Wholesale Trade	2.59	0.24	2.02	0.22
Retail Trade	1.99	0.25	1.69	0.21
Finance, Ins., and Real Estate	2.29	0.18	2.33	0.47
Services	1.63	0.53	1.42	0.53
Not Elsewhere Classified/Misc.	2.18	0.43	1.96	0.39
All Businesses	2.22 %	0.38 %	1.74 %	0.33 %

* Only firms that reported compensation or apportioned compensation greater than zero.

** Only firms that reported gross receipts or apportioned gross receipts greater than zero.

Source: Office of Revenue and Tax Analysis, Michigan Department of Treasury.

On average, in 1998-99 the SBT equaled approximately 0.38 percent of sales and 2.22 percent of compensation. In other words, the SBT is less than half a cent per dollar of sales and less than 2.5 cents for each dollar of compensation paid. Using these measures, it is easy to see that the SBT is a much lower tax than others paid by firms such as payroll taxes. This approach also facilitates comparison to taxes in other states, which can also be converted into measures of tax relative to sales or compensation.

There may be some concern regarding the apportionment of gross receipts and compensation using the apportionment factor for the calculations in Exhibit 26. To address this concern, Exhibit 26 also presents similar measures for 100 percent Michigan firms. For these firms, the SBT is 0.33 percent of sales and 1.74 percent of compensation. Given that 100 percent Michigan firms tend to be smaller on average than multistate firms and the fact that the SBT favors smaller firms, these results are not unexpected.

Comparing SBT With Corporate Income Tax

Another way of understanding the magnitude of SBT liabilities is to compare the SBT to a corporate income tax (CIT). This report makes the comparison by calculating the corporate income tax rate necessary to provide the same revenue generated by the SBT. Exhibit 27 (page 55) presents the total liability of all SBT payers for 1977 through 1998 and the total taxable income derived only from professional and other corporations that paid the Michigan SBT in each year, which is the tax base of a standard CIT. Dividing the total SBT liability by the total taxable income of corporations for each year provides a rate that varies from as low as 6.6 percent in 1977, up to 58.2 percent in 1992. If the SBT were to be substituted with a standard CIT, the average rate necessary to generate the same amount of revenue generated by the SBT from 1977 until 1998 would be 14.3 percent. This rate is much higher than the CIT rates imposed by other states (see Exhibit 28, page 56).

There are several reasons why this rate is so much higher than the CIT rates levied in other states. First, when enacted, the SBT replaced the local government property tax on inventories, a corporate franchise tax, a CIT, and several other taxes. At the time, it was estimated that only 44 percent of the total SBT revenue was needed to replace Michigan's CIT. Therefore, most of the 14.3 percent rate accounts for all taxes replaced under the SBT other than the CIT. Second, several states that impose a CIT also impose a corporate franchise tax or special taxes on financial institutions or utilities. This comparison does not take these other state's taxes into account. Third, unlike the CIT, the SBT is a tax imposed on all types of business organizations and not only on corporations. Therefore, the 14.3 percent is the rate necessary to make up for the revenue that is paid by other types of organizations under the SBT but who would not be taxed under the CIT, which only taxes corporations. At the same time, because the nexus standard applied to the SBT is broader than the one applied to a state corporate income tax, certain corporations may be taxable under the SBT but would not be taxable under a corporate income tax.¹⁹

¹⁹For SBT nexus standard, see page 19.

When comparing the FY 2001 corporation tax burden among all 50 states both on a per-person basis and as a percent of personal income (see Exhibit 29, page 57), Michigan ranks fourth highest. If the SBT revenue were reduced by 30 percent, the portion of tax imposed to replace the local property tax on business inventories, Michigan's ranking falls to number 11 and 14 respectively.

Exhibit 27
Comparing SBT With a Corporate Income Tax
(All Filers*)

<u>Year **</u>	<u>Total Liability</u>	<u>Total Taxable Income ***</u>	<u>CIT Rate</u>
1977	\$837,679,639	\$12,716,646,874	6.59 %
1978	919,149,090	11,542,267,742	7.96
1979	961,839,757	11,846,582,502	8.12
1980	871,578,961	8,805,378,282	9.90
1981	960,723,046	8,717,540,899	11.02
1982	945,337,324	2,745,676,585	34.43
1983	1,116,228,445	6,734,623,563	16.57
1984	1,326,047,841	10,383,264,905	12.77
1985	1,415,924,656	15,750,096,908	8.99
1986	n.a.	n.a.	n.a.
1987	1,561,521,511	6,681,863,683	23.37
1988	1,686,947,965	16,195,378,221	10.42
1989	1,617,953,630	13,204,264,823	12.25
1990	1,623,900,618	8,917,780,397	18.21
1991	1,577,112,865	3,039,351,936	51.89
1992	1,907,877,940	3,279,580,373	58.17
1993	1,809,441,719	10,224,640,304	17.70
1994	2,163,396,174	14,613,609,161	14.80
1995	2,078,937,489	14,257,604,020	14.58
1996	2,005,055,986	13,368,953,197	15.00
1997	2,243,209,647	12,994,700,555	17.26
1998	1,812,344,992	13,582,070,865	13.34
Average	\$1,497,248,062	\$10,457,232,181	14.32 %

* Gross receipts filers that provided business income, compensation, total additions, and total subtractions equal to zero were assumed to not have reported their taxable income; therefore, they were excluded from the analysis.

** Data from 1977 to 1994 refer to calendar years.
Data from 1995 to present refer to tax years.

*** Taxable Income was calculated as (Business Income + Net Operating Loss Carryover or Carryback) times Apportionment factor. Also, only Professional Corporations and Other Corporations were used to calculate the Taxable Income.

Exhibit 28
States With a Corporate Income Tax:
TY 2002 Highest Marginal Rate for Each State*

<u>State</u>	<u>Rate</u>	<u>State</u>	<u>Rate</u>
Alabama	6.5 %	Mississippi	5.0 %
Alaska	9.4	Missouri	6.25
Arizona	6.968	Montana	6.75 ⁽⁶⁾
Arkansas	6.5	Nebraska	7.81
California	8.84	New Hampshire	8.5 ⁽⁷⁾
Colorado	4.63	New Jersey	9.0
Connecticut	7.5	New Mexico	7.6
Delaware	8.7	New York	7.5
Florida	5.5	North Carolina	6.9
Georgia	6.0	North Dakota	10.5
Hawaii	6.4	Ohio	8.5
Idaho	7.6	Oklahoma	6.0
Illinois	7.3 ⁽¹⁾	Oregon	6.6
Indiana	7.9 ⁽²⁾	Pennsylvania	9.99
Iowa	12.0	Rhode Island	9.0
Kansas	4.0 ⁽³⁾	South Carolina	5.0
Kentucky	8.25	Tennessee	6.0
Louisiana	8.0	Utah	5.0
Maine	8.93	Vermont	9.75
Maryland	7.0	Virginia	6.0
Massachusetts	9.5 ⁽⁴⁾	West Virginia	9.0
Minnesota	9.8 ⁽⁵⁾	Wisconsin	7.9

* As of January 1, 2002

- ⁽¹⁾ Includes a 2.5 percent personal property replacement tax.
- ⁽²⁾ Consists of 3.4 percent on income from sources within the state plus a 4.5 percent supplemental income tax.
- ⁽³⁾ Plus a surtax of 3.35 percent taxable income in excess of \$50,000.
- ⁽⁴⁾ Includes a 14 percent surtax, as does the following: an additional tax of \$7 per \$1,000 on taxable tangible property (or net worth allocable to MA, for intangible property corporations).
- ⁽⁵⁾ Plus a 5.8 percent tax on any Alternative Minimum Taxable Income over the base tax.
- ⁽⁶⁾ A 7 percent tax on taxpayers using water's edge combination.
- ⁽⁷⁾ Plus a 0.5 percent tax on the enterprise base (total compensation, interest, and dividends paid).

Source: Federation of Tax Administrators, February 2002.

Exhibit 29
FY 2000 State Corporation Taxes
Per Person and as a Percent of Personal Income

	FY 2000 State Corporation Taxes Total (thousands)	2000 State Population	FY 2000 State Corporation Taxes Per Person	Rank	FY 2000 State Personal Income (millions)	FY 2000 State Corporation Taxes as a Percent of Personal Income	Rank
Alabama	\$551,754	4,447,100	\$124	28	\$103,623	0.53%	25
Alaska	473,781	626,932	756	2	18,001	2.63%	2
Arizona	587,445	5,130,632	114	33	124,335	0.47%	30
Arkansas	323,699	2,673,400	121	31	57,340	0.56%	22
California	8,214,410	33,871,648	243	6	1,043,593	0.79%	7
Colorado	385,608	4,301,261	90	45	133,599	0.29%	47
Connecticut	515,238	3,405,565	151	18	134,488	0.38%	39
Delaware	961,893	783,600	1,228	1	23,414	4.11%	1
Florida	1,557,134	15,982,378	97	42	430,670	0.36%	42
Georgia	816,330	8,186,453	100	41	220,933	0.37%	41
Hawaii	98,972	1,211,537	82	47	33,098	0.30%	46
Idaho	167,886	1,293,953	130	25	29,696	0.57%	21
Illinois	2,705,808	12,419,293	218	8	384,262	0.70%	9
Indiana	982,091	6,080,485	162	15	159,570	0.62%	16
Iowa	318,347	2,926,324	109	35	75,258	0.42%	35
Kansas	328,337	2,688,418	122	30	71,827	0.46%	32
Kentucky	606,355	4,041,769	150	19	94,207	0.64%	13
Louisiana	568,915	4,468,976	127	26	101,339	0.56%	23
Maine	189,068	1,274,923	148	20	31,657	0.60%	19
Maryland	599,747	5,296,486	113	34	171,656	0.35%	43
Massachusetts	1,404,525	6,349,097	221	7	228,789	0.61%	17
Michigan	\$2,608,186	9,938,444	\$262	4	\$286,728	0.91%	4
Minnesota	1,031,638	4,919,479	210	10	151,756	0.68%	11
Mississippi	349,046	2,844,658	123	29	58,312	0.60%	18
Missouri	509,467	5,595,211	91	44	147,916	0.34%	44
Montana	126,124	902,195	140	22	19,737	0.64%	14
Nebraska	205,653	1,711,263	120	32	46,582	0.44%	34
Nevada	135,648	1,998,257	68	48	57,651	0.24%	48
New Hampshire	365,479	1,235,786	296	3	39,187	0.93%	3
New Jersey	1,674,565	8,414,350	199	11	299,976	0.56%	24
New Mexico	191,238	1,819,046	105	38	38,853	0.49%	27
New York	2,944,206	18,976,457	155	17	623,025	0.47%	29
North Carolina	1,464,873	8,049,313	182	12	208,325	0.70%	10
North Dakota	113,962	642,200	177	13	15,410	0.74%	8
Ohio	1,481,490	11,353,140	130	24	310,795	0.48%	28
Oklahoma	352,638	3,450,654	102	39	79,264	0.44%	33
Oregon	582,208	3,421,399	170	14	92,118	0.63%	15
Pennsylvania	2,996,280	12,281,054	244	5	352,247	0.85%	5
Rhode Island	111,095	1,048,319	106	36	29,738	0.37%	40
South Carolina	379,402	4,012,012	95	43	93,835	0.40%	37
South Dakota	99,942	754,844	132	23	19,096	0.52%	26
Tennessee	1,201,684	5,689,283	211	9	143,584	0.84%	6
Texas	2,624,440	20,851,820	126	27	567,187	0.46%	31
Utah	197,575	2,233,169	88	46	50,886	0.39%	38
Vermont	64,413	608,827	106	37	15,922	0.40%	36
Virginia	708,358	7,078,515	100	40	212,455	0.33%	45
Washington	197,751	5,894,121	34	49	180,939	0.11%	49
West Virginia	255,486	1,808,344	141	21	38,336	0.67%	12
Wisconsin	834,864	5,363,675	156	16	147,093	0.57%	20
Wyoming	10,152	493,782	21	50	13,165	0.08%	50
U.S. Average	\$46,175,206	280,849,847	\$164		\$8,011,468	0.58%	

Notes:

* Population from April 2000 Census.

** Personal income data calculated for each state fiscal year from April 23, 2002 release.

*** Total corporation taxes include corporation net income, corporation license taxes, and occupation and business licenses.

Sources: Bureau of the Census and Bureau of Economic Analysis, U.S. Department of Commerce

APPENDIX

QUESTIONS AND ANSWERS

ON THE SBT

**Office of Revenue and Tax Analysis
Michigan Department of Treasury
July 2002**

QUESTIONS AND ANSWERS

Why Is the Tax Called the “Single Business Tax”?

The SBT is the only general business tax levied by the State of Michigan. It replaced seven business taxes, most importantly the corporate income tax (7.8 percent rate), the local property tax on business inventory, and the corporate franchise tax (based on net worth). The SBT was designed initially to raise the same revenue as the taxes it replaced.

The SBT Is Called a Modified Value-Added Tax. What Is a Value-Added Tax?

A value-added tax is a tax on the value a business adds to goods and services it purchases from other firms. A business adds value by handling or processing its purchases with its labor force, machinery, buildings and capital.

What Is the Rationale of a Value-Added Tax?

State business taxes raise revenue for state-provided services used by businesses within the state. Value added reflects the amount of business activity a firm performs and thus is considered a reasonable proxy for the amount of government services received by the firm on an ongoing basis. The benefits of the state-provided services go to the firm’s owners and customers, who may or may not reside in Michigan.

How Is a Value-Added Tax Measured?

Value added can be measured two ways. The subtraction method measures value added as the difference between a firm’s sales receipts and its purchases of materials and supplies from other firms. The addition method measures value added as the sum of profits, labor costs, interest paid and depreciation, including direct taxes levied on these expenses. Michigan uses the second, additive method, but both methods arrive at the same number.

How Does the SBT Differ From a Pure Value-Added Tax?

To avoid placing a penalty on firms that prefer to lease rather than buy property, rental payments are excluded from the tax base and rental income is included in the base. Further, the statutory exemption and the small business credit/alternate tax provide tax reductions of up to 100 percent to small, low-profit businesses, and the excess compensation reduction provides tax reductions of up to 37 percent to labor-intensive businesses. In addition, the SBT excludes FICA, unemployment, and worker’s compensation payments made by firms. A pure value-added tax would include these payments in the tax base.

What Is the SBT Rate?

The original rate was set at 2.35 percent in 1976 and has been reduced over the years. Effective January 1, 1999, the SBT rate is 2.2 percent of the tax base after deductions. The 2.2 percent rate will be reduced yearly by 0.1 percentage point each January 1. The annual reduction, however, does not occur if the Countercyclical Budget and Economic Stabilization Fund (BSF) balance for the prior fiscal year is \$250 million or less. The rate reduction will cease until the BSF fiscal year ending balance exceeds \$250 million. In January 1, 2002, the SBT rate was reduced to 1.9 percent. Public Act 531 of 2002 repeals the SBT entirely for tax years beginning after December 31, 2009.

For tax year 1998-99, the tax after deductions and credits actually averages about 1.5 percent of the firm's total Michigan tax base. Data suggest that the SBT averages about 0.38 percent of apportioned gross receipts for all businesses with a tax liability. In addition, the tax base cannot exceed 50 percent of a firm's adjusted gross receipts. Therefore, for 2002, the SBT cannot exceed 0.95 of a percent of a firm's adjusted gross receipts for any business. Adjusted gross receipts equals apportioned gross receipts plus any recapture of a capital acquisition deduction.

Do Very Small Firms Have to Calculate and Pay the SBT?

No. Beginning in 1995, businesses do not owe tax and do not need to file a return if their adjusted gross receipts are under \$250,000. Note that only 100,000 of the approximately 250,000 Michigan businesses pay the SBT. Beginning 2003, the gross receipts filing threshold increases to \$350,000 from \$250,000. With this increase, approximately 13,000 firms will no longer need to file SBT.

How Is the SBT Calculated?

Businesses with an SBT liability file a return which is shown in a simplified version in Table A (see page 64). The SBT calculated the tax base by adding up the components of value added. Next, companies operating in other states use an apportionment formula to determine what fraction of their total value added is subject to the SBT. Several deductions are allowed against the apportioned tax base. The calculated tax is then reduced by several credits.

How Does the SBT Encourage Capital Investment?

Under the capital acquisition deduction (CAD), SBT taxpayers were allowed to deduct against their Michigan tax base 100 percent of all real and personal property investments made in the year in which the expense is incurred. For multistate firms, the deduction was apportioned to Michigan based on their SBT tax base apportionment formula. For tax years 1997-1999, firms could claim a capital acquisition deduction only for Michigan investments, which were then reduced by the apportionment factor.

The immediate investment write-off was more advantageous than the gradual depreciation usually allowed under corporate income taxes. New firms may particularly benefit from the

deduction as their initial capital expenditures can reduce and even eliminate their SBT liability. The CAD reduced the SBT base by about 5.9 percent in tax year 1998.

For tax years beginning after December 31, 1999, the CAD is replaced by an investment tax credit (ITC). The ITC allows a credit against the taxpayer-calculated Michigan tax base before taking into account any credits after deductions on all real and personal property investments made in Michigan in the year in which the expense is incurred. The credit rate varies according to the size of each business. Large firms, with adjusted gross receipts above \$5 million, use an ITC rate of 0.85 percent. Firms with adjusted gross receipts above \$2.5 million up to \$5 million use an ITC rate of 1.00 percent. Firms with adjusted gross receipts above \$1 million up to \$2.5 million use an ITC rate of 1.50 percent, and small businesses with adjusted gross receipts up to \$1 million use an ITC rate of 2.30 percent. The rate is further reduced in proportion to the SBT rate cut in future years. Taxpayers using the excess compensation reduction will receive a reduced ITC and taxpayers using the gross receipts method to calculate their tax are not eligible for the credit.

How Is the Statutory Exemption Calculated?

Businesses are allowed a \$45,000 deduction from the tax base, although this deduction is reduced \$2 for each \$1 that income exceeds \$45,000. An additional exemption of up to \$48,000 is provided for partnerships and S corporations. For purposes of calculating this deduction, income includes business income, compensation paid to the owners of the firm, and any loss carryovers or carrybacks.

Effective statutory exemptions reduced the SBT base by about 0.9 percent in tax year 1998.

How Is the Excess Compensation Deduction Calculated?

If compensation exceeds 63 percent of the tax base before deductions, the adjusted tax base (after the capital acquisition deduction and the statutory exemption) is reduced by the percentage that compensation exceeds 63 percent. The reduction cannot exceed 37 percent of the base.

For example, assume a firm has a tax base of \$400,000, compensation of \$316,000, and a CAD of \$20,000. The compensation percentage equals $316,000/400,000$, or 79 percent. The deduction percentage of 79 minus 63 percent, or 16 percent, is applied to the adjusted tax base of \$400,000 minus \$20,000, or \$380,000. The reduction then is $\$380,000 \times 0.16$, or \$60,800, leaving a reduced base of \$319,200 and a tax liability (before credits) of \$7,342. This example is shown on page 66.

This deduction, intended to aid “labor intensive” firms, also aids relatively unprofitable firms, because the lower profits are, the higher labor costs are in relation to the total value-added base. The excess compensation reduction reduced the SBT base by about 8.9 percent in tax year 1998.

What Is the Small Business Credit?

The small business credit (SBC) can reduce the SBT by up to 100 percent and allows most small businesses to pay an SBT based on the earnings of the firm's owners. Businesses whose adjusted business income (ABI) is less than 45 percent of the tax base receive a credit if: (1) gross receipts are less than \$10 million, (2) ABI is less than \$475,000, and (3) no owner's share of ABI is greater than \$115,000. Adjusted business income includes the firm's net income and the compensation paid to officers and those shareholders who own at least 5 percent of the firm's stock.

The amount of credit is determined by dividing ABI by 45 percent of tax base. If, for example, the ratio is 80 percent, a company pays only 80 percent of its SBT; that is, it receives a 20 percent credit. The maximum credit is 100 percent of the SBT liability.

Using the example started in the previous question, assume net business income equals \$30,000 and compensation to owners equals \$70,000, resulting in ABI of \$100,000. The ratio equals $\$100,000 / (45\% * \$400,000)$ or 55.5 percent, and the firm receives a 44.5 percent credit or \$3,267. Hence, the SBT liability after the SBC is \$7,342 minus \$3,267, or \$4,075, equal to 4.075 percent of ABI.

In addition, firms that qualify for the SBC may calculate their tax using an alternate method. The alternate tax would be a percentage of adjusted business income equal to 3 percent for tax years beginning in 1992 or 1993 and 2 percent for tax years beginning after September 1994. In the case described above, the alternate tax liability for 1998 would be \$2,000 ($\$100,000 * 2\%$).

Does the SBT Penalize a Company for Hiring People Instead of Investing in Machinery?

No. The excess compensation deduction substantially reduces the added SBT "cost" of hiring an employee. Data suggest that for firms using the excess compensation deduction the SBT increases the cost of hiring an employee by 1.5 percent of compensation or less. If the additional costs are paid through a reduction in profits, then the SBT liability will actually decrease. For the 40,000 firms qualifying for the SBC, hiring additional employees usually results in no SBT increase and may actually result in a small tax decrease.

Is the SBT Unfair to Unprofitable Firms?

No. Of the three major taxes repealed by the SBT, only one was based on profits. The local property tax on inventory and the corporate franchise tax had no relationship to profitability. Local property taxes on commercial and industrial property are not tied to profitability. The employer share of social security taxes is paid without regard to profitability. When consideration is given to the excess compensation deduction, as well as the statutory exemption and SBC, the SBT compares favorably with other business taxes.

Is the SBT a Disincentive for New Investment in Michigan?

As stated earlier, prior to January 1, 2000, the SBT allowed a deduction for 100 percent of all real and personal property investments made in Michigan in the year in which the expense was incurred. The deduction was apportioned for multistate firms. This deduction provided an incentive to invest in Michigan. The impact of this CAD was more immediate than the gradual depreciation usually allowed under corporate income taxes. New and expanding firms benefited from the deduction as their capital expenditures could reduce and even eliminate their SBT liability.

Effective January 1, 2000, the ITC allows a credit of at least 0.85 percent of all real and personal property investments made in Michigan in the year in which the expense is incurred, which also reduces in part or whole the taxpayer's liability. For many large firms, the ITC provides only 36 percent of the tax cut provided by the CAD. It remains to be seen whether this change will affect the level of investment in Michigan.

How Is the SBT Affected by Changes in the U.S. Corporate Income Tax?

A change in depreciation schedules can have a dramatic impact on state corporate income taxes. If U.S. depreciation allowances are reduced, state corporate income taxes may also increase. The SBT is mostly unaffected by depreciation changes, because depreciation, subtracted in computing federal income, is added back when computing the SBT base. Instead of depreciation, firms are allowed to fully deduct capital expenditures in the year made for the SBT or, beginning in 2000, claim an investment tax credit. This is one of the features that makes the SBT a stable revenue source for the state.

How Does the SBT Apply to Firms Doing Business in More Than One State?

Firms doing business in other states as well as Michigan apportion their tax bases to Michigan using a formula based on the percentage of payroll, property, and sales in Michigan. Starting in tax year 1999, the sales factor is weighted by 90 percent, and the property and payroll factors are each weighted by 5 percent. Financial organizations, insurance companies, and transportation companies use a single factor formula based on gross business premiums received and revenue miles, respectively. (Note: apportionment formula and CAD changes begin in 1997. See pages 16 and 17 for a brief review of changes.)

Does the SBT Use the Unitary Method of Calculation?

No. The SBT only taxes the business activity of firms actually engaged in business in Michigan. Business activity of foreign subsidiary or parent corporations is not taxed. In fact, the SBT provides a specific deduction for dividend income received.

Table A

CALCULATION OF THE SINGLE BUSINESS TAX

The Single Business Tax is a modified value-added tax. The tax base is value added in the process of business activity; the rate is 2.30 percent for tax years beginning before January 1, 1999. Effective January 1, 1999, the tax rate decreased to 2.2 percent. Every January 1 thereafter, the rate decreases 0.1 percentage point as long as certain requirements are met*. Public Act 531 of 2002 repeals the SBT entirely for tax years beginning after December 31, 2009.

Sum of:	<u>Compensation.</u> Wages, salaries and benefits, excluding FICA, Unemployment Insurance and Worker's Compensation. <u>Federal Taxable Income.</u> <u>Net Interest Paid.</u> Interest paid less interest received. <u>Depreciation.</u> As claimed on federal income tax return.
Equals:	Tax Base.
Multiplied by:	<u>Apportionment Factor.**</u> The weighting of the sales (80 percent), property (10 percent) and payroll (10 percent) factors. <u>Payroll Factor.</u> Proportion of total payroll in Michigan. <u>Property Factor.</u> Proportion of total property in Michigan. <u>Sales Factor.</u> Proportion of total sales in Michigan.
Equals:	Apportioned Tax Base or Michigan Tax Base.
Minus:	<u>Capital Acquisition Deduction (CAD).</u> The apportioned value of real and personal property acquired during the year. Apportionment of property acquisition uses the weighted apportionment factors described above. (Starting January 1, 2000, the CAD is replaced by the investment tax credit (ITC)). <u>Statutory Exemption.</u> An exemption of \$45,000, which is reduced for firms with modified business income exceeding \$45,000, declining to \$0 when modified business income exceeds \$67,500.
Equals:	Adjusted Tax Base.
Minus:	<u>Excess Compensation Reduction.</u> The amount by which total compensation exceeds 63 percent of the tax base prior to apportionment. This deduction cannot be less than zero or exceed 37 percent of the adjusted tax base.

* See page 20.

** See page 16.

Gross Receipts Reduction. The amount by which the adjusted tax base exceeds 50 percent of adjusted gross receipts. The reduction ensures that the tax base does not exceed 50 percent of adjusted gross receipts.

Multiplied by: 2.3 percent tax rate. (See SBT overview on page 60.)

Equals: Tax before credits.

Minus: Investment Tax Credit (starting January 1, 2000). The value of real and personal property acquired during the year multiplied by the ITC rate. ITC rate for firms with adjusted gross receipts up to \$1 million is 2.3 percent. For firms with adjusted gross receipts above \$1 million up to \$2.5 million, ITC rate is 1.50 percent. For firms with adjusted gross receipts above \$2.5 million up to \$5 million, ITC rate is 1.00 percent, and for firms with adjusted gross receipts above \$5 million, credit rate is 0.85 percent. The ITC rate is further reduced proportionally to the SBT rate cut. Taxpayers claiming the excess compensation reduction will receive a reduced ITC. Taxpayers using the gross receipts method are not eligible for the credit.

Small Business/Low Profit Credit. For firms with adjusted business income below \$475,000, gross receipts below \$10 million, and adjusted business income to any business owner below \$115,000. The credit may be up to 100 percent of liability. Eligible businesses claiming this credit have the option of paying an alternative 2.0 percent tax on adjusted business income. (See “Alternative Tax” below.)

Public Contributions Credit. Contributions to Michigan public colleges, universities, and libraries. Equal to 50 percent of the contribution, 5 percent of SBT liability, or \$5,000, whichever is least.

Public Utility Property Tax Credit.

Unincorporated Business Credit. Unincorporated businesses and S corporations may claim a credit of 10 percent if net income exceeds \$40,000, 15 percent if net income is between \$20,000 and \$40,000, and 20 percent if net income is below \$20,000.

Equals: Single Business Tax Liability.

Alternative Tax: Businesses eligible for the Small Business Credit have the option of paying an alternative tax of 2.0 percent of adjusted business income beginning after October 1, 1994.

Note: This example is not meant to be a detailed guide to the calculation of the SBT. In the interest of brevity and clarity, some details were omitted. The instructions for completing the SBT returns should be consulted for precise calculations of SBT liability.

SAMPLE SBT CALCULATION (Michigan-Only Firm)

Federal Taxable Income	\$	30,000
Compensation	+	316,000
Depreciation	+	35,000
Interest Paid	+	<u>19,000</u>
Tax Base		400,000
Capital Acquisition Deduction (CAD) *	-	<u>20,000</u>
Adjusted Tax Base		380,000
Excess Compensation Reduction	-	<u>60,800</u>
Reduced Tax Base		319,200
Tax Rate**	x	<u>.0230</u>
Tax Before Credits		7,342
Small Business Credit	-	<u>3,267</u>
Tax After Credit***		\$4,075

Excess Compensation Calculation

$$\begin{aligned}
 \$316,000 / \$400,000 &= 79\% \\
 &- 63\% \\
 &= 16\%
 \end{aligned}$$

$$16\% \times \$380,000 = \$60,800$$

Small Business Credit Calculation

Profits		\$ 30,000
Compensation to Owners		<u>70,000</u>

Adjusted Business Income (ABI)		\$ 100,000
-----------------------------------	--	------------

$$\begin{aligned}
 \text{Credit} &= 100\% - \$100,000 \\
 & \quad / (45\% \times \$400,000) \\
 &= 100\% - 55.5\% \\
 &= 44.5\% \times \$7,342 \\
 &= \$3,267
 \end{aligned}$$

* Effective January 1, 2000, the CAD is replaced by an investment tax credit (ITC).

** Effective January 1, 1999, the tax rate is 2.2 percent. Every January 1 thereafter, rate further decreases by 0.1 percentage point provided that certain requirements are met. Public Act 531 of 2002 repeals the SBT entirely for tax years beginning after December 31, 2009.

*** Effective October 1, 1994, the alternate tax rate is reduced to 2.0 percent. The alternate tax would equal \$2,000 for calendar year 1998.