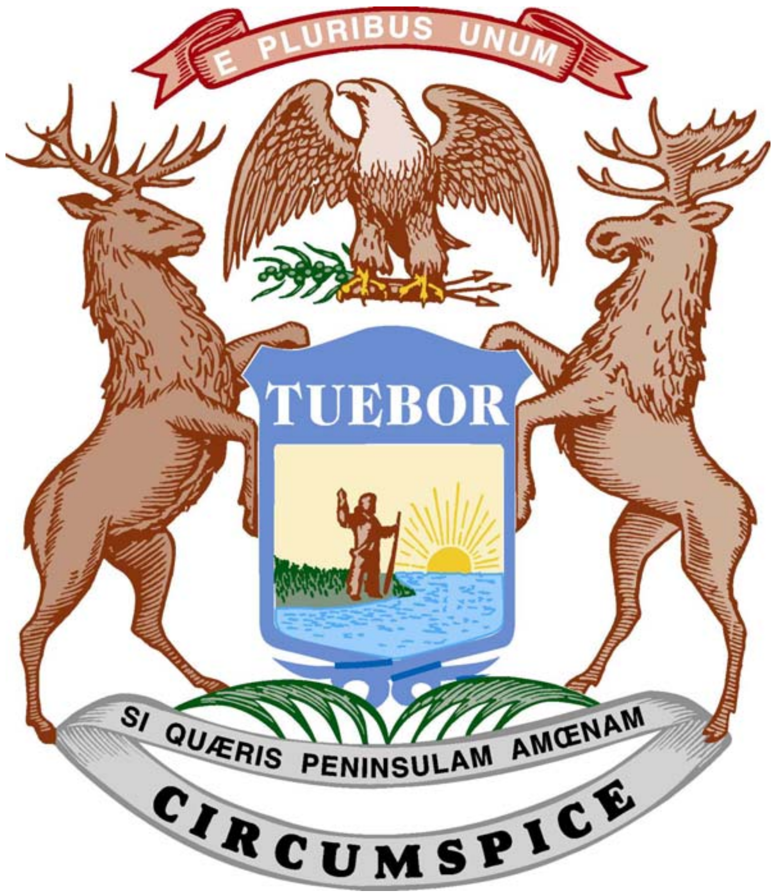
The Michigan Single Business Tax
2000-2001



Michigan Department of Treasury
Bureau of Tax and Economic Policy
Tax Analysis Division
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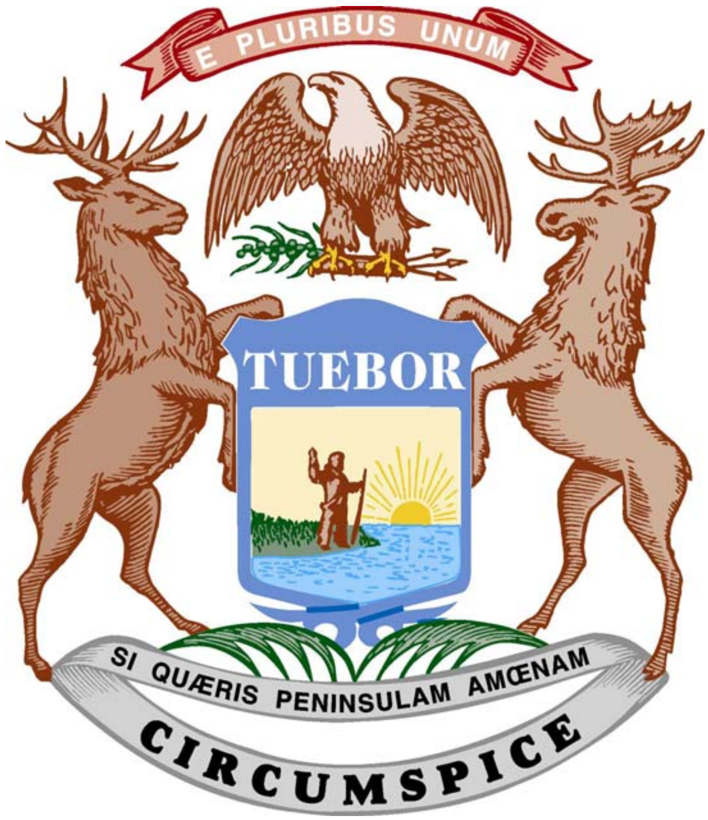

Michigan Department of Treasury
Tax Analysis Division
February 2006

This report was prepared by Thomas Patchak-Schuster, Economic and Revenue Forecasting Division, under the direction of Howard Heideman, Director of the Tax Analysis Division (TAD). Denise Heidt, TAD, provided guidance, instruction, and analytical and editorial assistance. Eric Krupka, TAD, provided research and editorial assistance. Jeri Trotter of the Tax Policy Division provided tables. Diane Burton of TAD provided editorial and secretarial assistance.

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EXECUTIVE SUMMARY

- The Single Business Tax (SBT) is a modified value-added tax (VAT). A pure VAT's tax base equals 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. For firms taxable in another state, the SBT's tax base is apportioned based mainly on the share of the firm's sales in Michigan.

- FY 2003 SBT revenues totaled $2,074 million, down 6.2 percent from FY 2002 and down 19.0 percent from FY 1999's peak revenues. FY 2003 SBT revenues equaled 0.67 percent of Michigan personal income and accounted for 9.2 percent of State taxes and 26.1 percent of General Fund/General Purpose tax revenue.

- The SBT rate dropped from 2.3 percent to 2.2 percent for 1999, to 2.1 percent for 2000 and to 2.0 percent for 2001.

- 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 24.0 percent decline and a 47.1 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 2000-2001 is the first year that the investment tax credit replaced the capital acquisition deduction.

- Larger firms pay the majority of the SBT. Firms with a 2000-2001 SBT liability greater than $10,000 accounted for only 23.5 percent of firms with an SBT liability, but 89.6 percent of total SBT revenues. Conversely, firms with an SBT liability less than $1,000 comprised 44.8 percent of all filers but only 0.6 percent of total revenues.

- Among major industrial classifications, manufacturing firms accounted for the largest share of 2000-2001 SBT revenue (30.1 percent), followed by the services sector (24.3 percent).

- The business loss deduction (claimed capital acquisition deductions (CADs) not used in prior years and carried forward), reduced Michigan tax base by 4.4 percent. Recapture of previously claimed CADs increased Michigan tax base by 2.1 percent.

- Firms for which compensation accounts for more than 63 percent of their tax base may claim an excess compensation deduction. The excess compensation deduction reduced 2000-2001 SBT tax liability by $326.5 million. The gross receipts reduction method assures that no firm's tax base exceeds half of its adjusted gross receipts. The gross receipts reduction method reduced firms' SBT liability by $277.6 million.

- The investment tax credit (ITC) is the SBT's largest tax credit. In 2000-2001, firms claimed \$320.8 million. Effective investment tax credits totaled \$225.7 million. The ITC effectively reduced SBT tax base by 7.1 percent.

- The small business/alternate tax credit is the SBT's second largest tax credit. In 2000-2001, firms claiming the credit reduced their SBT liability by \$157.9 million.

- The Unincorporated/S Corporation credit reduced 2000-2001 SBT liability by \$79.3 million.

- Corporations paid 68.6 percent of the 2000-2001 SBT liability. S Corporations paid 18.0 percent.

- In 2000-2001, the overall effective SBT tax rate equaled 1.3 percent. Across all major industrial classes, the effective SBT tax rate tends to rise as company size increases.

- In 2000-2001, SBT liability equaled 1.8 percent of apportioned compensation and 0.3 percent of apportioned gross receipts.

- If the SBT were to be substituted with a standard CIT, the average rate necessary to generate the same amount of revenue today from corporations based on history from 1977 until 2000 would be 7.19 percent. This rate is not much higher than the CIT rates imposed by many other states.

- When comparing the FY 2002 corporation tax burden among all 50 states on a per-person basis and as a percent of personal income, Michigan ranks eighth and ninth highest, respectively. This ranking reduces SBT revenue by 31.4 percent, the portion of tax paid by unincorporated firms and S corporations.

- In fiscal year 2004, Michigan's *total* state/local business tax burden was tied for 15th lowest as a percent of private sector gross state product and ranked 16th lowest as a percent of personal income. Because business taxes other than corporate taxes comprise a larger share of most other states' business taxes, Michigan's total state/local business tax ranking is more favorable than Michigan's corporate tax ranking.

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 tax; 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 2000-2001 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. Chapter 2 also 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 2000-2001 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.

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[1] New 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 2003 the Business Profits Tax generated $178.2 million and the Business Enterprise Tax, $215.2 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 since its enactment as a result of legislative modifications which have narrowed or altered the pure VAT base (see Exhibit 9, page 22).

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 44 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 is not 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)

Fiscal Year	Corporate Income Tax	Percent Change
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

[2]The 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.

[3]From 1970-76, unemployment in Michigan averaged 8.1 percent compared to a national unemployment rate average of 6.2 percent.

revenues declined and nondiscretionary spending (on education, welfare, and other social 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 2003, SBT revenues (including insurance company retaliatory taxes) totaled $2,074 million and accounted for 9.2 percent of total state tax revenues and 26.1 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 -24.0 percent to 47.1 percent, and declined about half of the period (see Exhibit 28, page 60). In contrast, as a percentage of total state personal income, SBT tax revenues have been relatively stable. Tax cuts account for most of the recent decline in the SBT's share of personal income.

Data

Data for this report were compiled from tax returns filed for tax years ending in December 2000 through November 2001. 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. The second category includes firms that had no liability and provided insufficient information to calculate a liability. Excluding these two categories of returns, aggregated statistics that appear in this report are based on the remaining 148,764 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 33) and effective tax rate calculations (see Exhibits 24 and 25, pages 54 and 55). In addition, a number of firms were omitted from calculation of SBT liability as a percent of gross receipts (see Exhibit 27, page 57), as they did not provide needed information. These instances were noted in the relevant tables and graphs.

Summary of 2000-2001 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*

Fiscal Year	SBT Revenue (Millions)	Percent Change From Prior Year	Percent of Total State Taxes **	Percent of State Personal Income ***
1980	$1,225	10.3 %	20.0 %	1.31 %
1981	1,053	-14.0	17.0	1.04
1982	1,047	-0.6	16.4	1.00
1983	1,143	9.2	15.6	1.05
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	1.21
1989	1,922	2.6	17.7	1.16
1990	1,877	-2.3	17.0	1.08
1991	1,750	-6.8	14.9	0.97
1992	1,863	6.5	15.2	0.98
1993	1,979	6.2	15.4	0.99
1994	2,230	12.7	14.8	1.04
1995	2,344	5.1	13.4	1.04
1996	2,393	2.1	12.9	1.02
1997	2,407	0.6	12.4	0.98
1998	2,492	3.5	12.1	0.96
1999	2,560	2.7	11.7	0.93
2000	2,517	-1.7	11.0	0.86
2001	2,224	-11.6	9.9	0.75
2002	2,211	-0.6	10.0	0.73
2003	2,074	-6.2	9.2	0.67

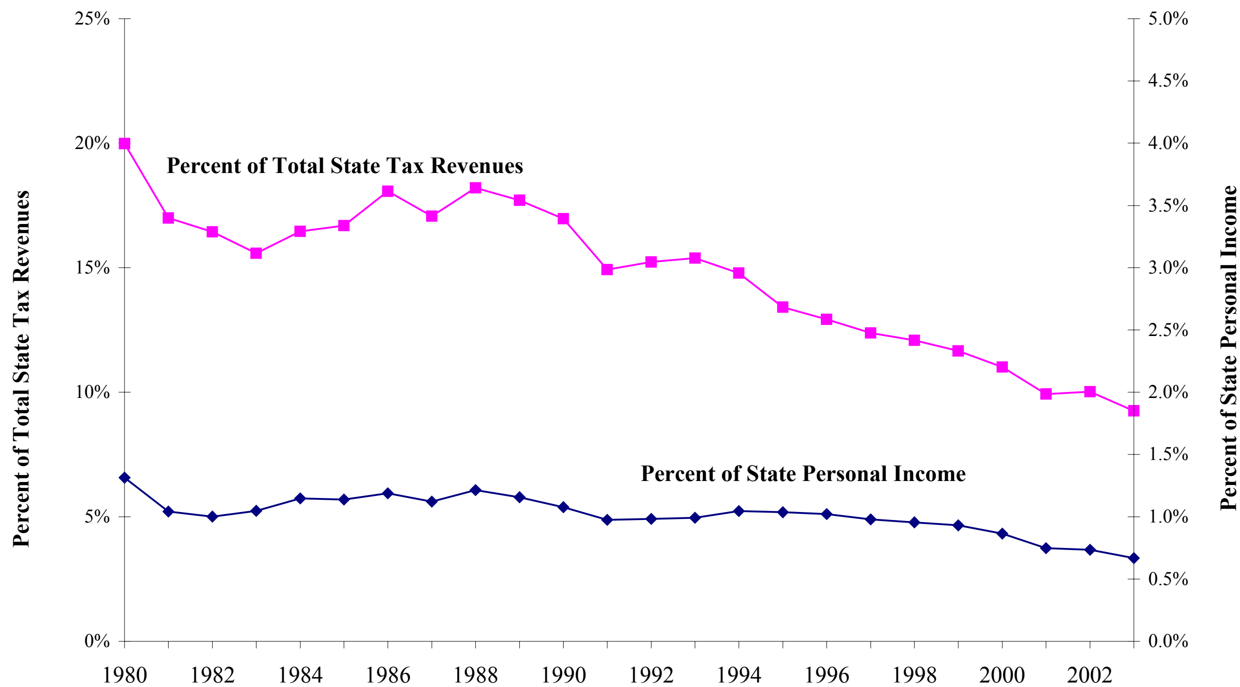
* Includes insurance company retaliatory taxes.

** Does not include fees, permits or licenses.

*** Based on Bureau of Economic Analysis state personal income data, September 28, 2004 release.

Source: State of Michigan Comprehensive Annual Financial Reports and Bureau of Economic Analysis.
Calculations by the Tax Analysis Division, Michigan Dept of Treasury.

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 2000 and November 2001, 148,764 firms filed an SBT return. Of these firms, 107,523 had a positive tax liability totaling $2.1 billion[4] (not including insurance company taxes, see Exhibits 3 and 4, pages 8 and 9). Manufacturing firms paid the highest share of SBT revenue, contributing 30.1 percent of total revenue. The services sector contributed 24.3 percent of total revenues, while the retail trade industry provided 14.6 percent of total SBT revenues.

Firms in the services sector comprised the largest sector of filers, accounting for 29.9 percent of all firms that filed in 2000-2001. The retail trade sector was the next largest representing 23.4 percent of total firms; while the finance, insurance, and real estate sector accounted for 11.1 percent of all firms that filed. The construction sector and manufacturing sector accounted for 10.5 percent and 10.0 percent of total firms, respectively.

[4]This figure differs from $2.0 billion listed in the FY 2001 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, 2000-2001

Business Sector	Number of Firms	Percent of Firms	Tax Liability	Percent of Liability
Agriculture, Forestry, and Fishing	2,253	1.5 %	$9,794,718	0.5 %
Mining	506	0.3	5,969,702	0.3
Construction	15,642	10.5	128,532,014	6.1
Manufacturing	14,924	10.0	634,832,759	30.1
Other Durable Manufacturers	5,649	3.8	161,635,212	7.7
Non-Durable Manufacturers	3,496	2.4	181,899,166	8.6
Primary Metals	555	0.4	35,720,201	1.7
Fabricated Metals	2,263	1.5	65,934,840	3.1
Machinery--Except Electrical	2,241	1.5	65,698,734	3.1
Transportation Equipment	720	0.5	123,944,606	5.9
Transportation	4,034	2.7	49,085,970	2.3
Communications and Utilities	1,522	1.0	139,858,451	6.6
Wholesale Trade	5,349	3.6	107,242,656	5.1
Retail Trade	34,746	23.4	306,928,276	14.6
Finance, Insurance, and Real Estate	16,562	11.1	144,631,610	6.9
Services	44,413	29.9	511,918,242	24.3
Not Elsewhere Classified/Misc.	8,813	5.9	67,688,870	3.2
All Businesses	148,764	100.0 %	$2,106,483,268	100.0 %

Note: Liability figures represent tax years ending December 2000 or January through November 2001.

Source: Tax Analysis Division, Michigan Department of Treasury.

Exhibit 4
2000-2001 Tax Liability Breakdown

Liability Class	Number of Firms	Percent of Firms	Cumulative Percent	Tax Liability	Percent of Liability	Cumulative Percent
$1,000,000 - and over	179	0.12 %	0.12 %	$537,694,339	25.53 %	25.53 %
$500,000 - $999,999	282	0.19	0.31	191,756,337	9.10	34.63
$100,000 - $499,999	2,683	1.80	2.11	516,360,140	24.51	59.14
$50,000 - $99,999	3,332	2.24	4.35	232,067,152	11.02	70.16
$10,000 - $49,999	18,803	12.64	16.99	409,656,966	19.45	89.61
$5,000 - $9,999	14,492	9.74	26.73	102,753,937	4.88	94.48
$1,000 - $4,999	42,353	28.47	55.20	104,547,023	4.96	99.45
$500 - $999	11,191	7.52	62.73	8,342,390	0.40	99.84
$100 - $499	10,599	7.12	69.85	3,139,135	0.15	99.99
$50 - $99	1,604	1.08	70.93	118,936	0.01	100.00
$1 - $49	2,005	1.35	72.28	46,913	0.00	100.00
$0	41,241	27.72	100.00	No Liability	0.00	100.00
Total	148,764	100.00 %		$2,106,483,268	100.00 %	

Michigan Tax Base Class	Number of Firms	Percent of Firms	Cumulative Percent	Tax Liability	Percent of Liability	Cumulative Percent
$100,000,000 - and over	104	0.07 %	0.07 %	$434,217,176	20.61 %	20.61 %
$50,000,000 - $99,999,999	153	0.10	0.17	153,783,630	7.30	27.91
$10,000,000 - $49,999,999	1,673	1.12	1.30	481,064,538	22.84	50.75
$5,000,000 - $9,999,999	2,511	1.69	2.99	249,806,512	11.86	62.61
$2,000,000 - $4,999,999	6,971	4.69	7.67	297,743,477	14.13	76.74
$1,000,000 - $1,999,999	10,394	6.99	14.66	183,204,708	8.70	85.44
$500,000 - $999,999	17,375	11.68	26.34	135,970,452	6.45	91.90
$100,000 - $499,999	61,081	41.06	67.40	142,026,933	6.74	98.64
$50,000 - $99,999	13,881	9.33	76.73	6,441,645	0.31	98.94
$1 - $49,999	13,876	9.33	86.06	1,788,711	0.08	99.03
$0 or less	20,745 *	13.94	100.00	20,435,486	0.97	100.00
Total	148,764	100.00 %		$2,106,483,268	100.00 %	

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

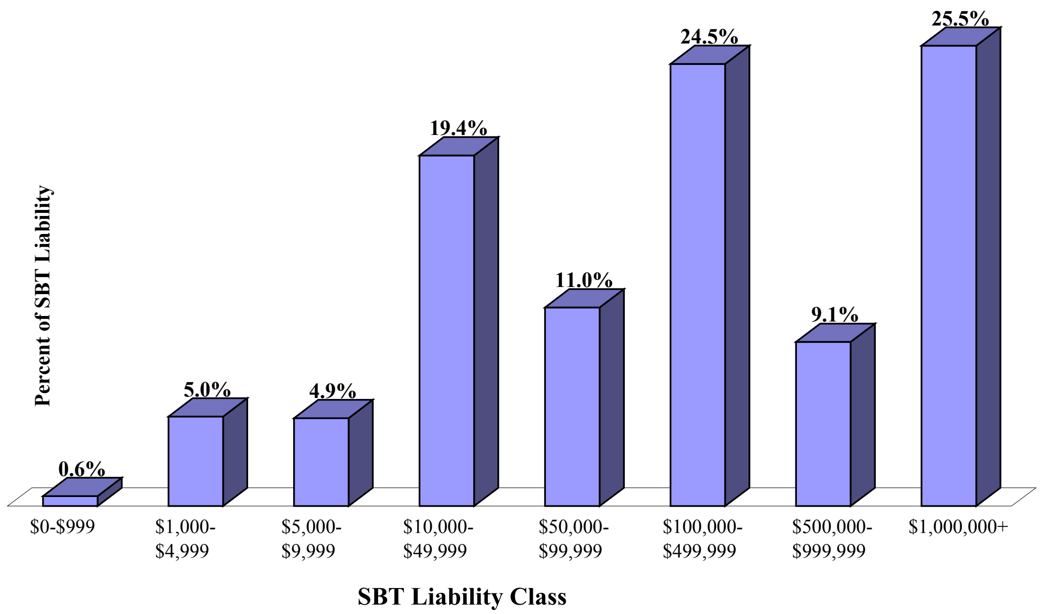
Source: Tax Analysis Division, Michigan Department of Treasury.

Nearly 30 percent of all filers (27.7 percent) had no liability in 2000-2001 (see Exhibit 4, page 9). Almost half of the firms (44.8 percent) that filed had liability of less than $1,000. These firms accounted for only 0.6 percent of total revenues. In contrast, 179 firms (0.1 percent of total filers) accounted for 25.5 percent of total revenues. Firms with liabilities greater than $10,000 supplied 89.6 percent of total SBT revenues while comprising only 17.0 percent of the total number of firms that filed and 23.5 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 50.8 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 41.1 percent of total revenues, while comprising 25.0 percent of total filers. Small firms (firms with an MTB less than $500,000) or firms that had a negative MTB accounted for only 8.1 percent of total revenues, but represented about 73.7 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.

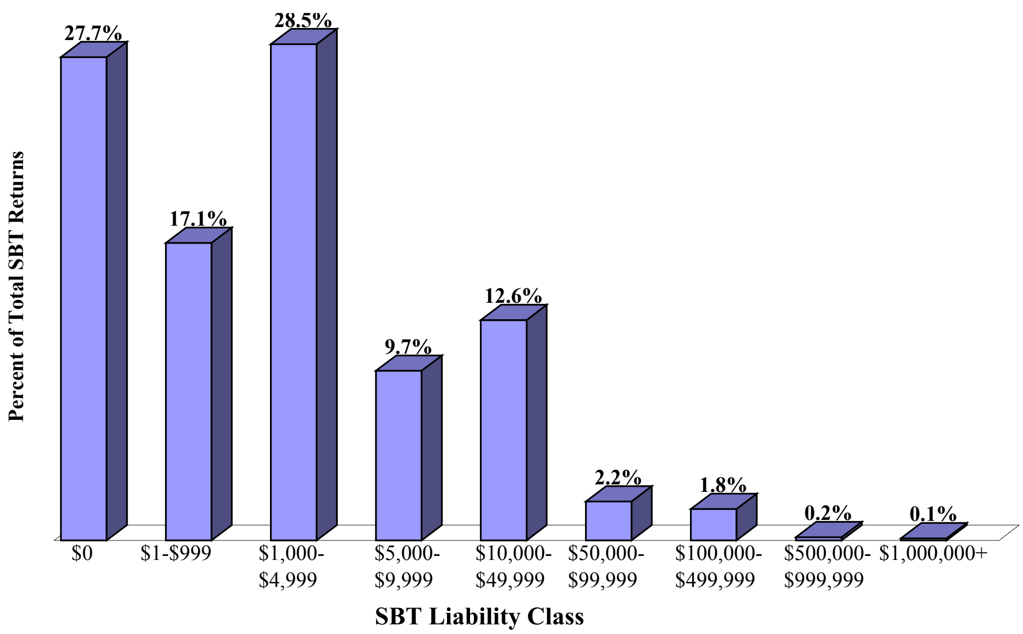
These figures indicate that larger firms are providing the great majority of SBT revenues (see Exhibits 5 and 6, page 11). Chapter 4 discusses effective tax rates and will present evidence regarding the progressivity of the SBT.

Exhibit 5
Distribution of SBT Liability
2000-2001



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

Exhibit 6
Distribution of Firms Filing an SBT Return
2000-2001



Note: Includes all firms filing SBT returns using forms C-8000, and C-8044. Figures may not sum to 100% due to rounding.
Source: Tax Analysis Division, 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 equaled 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). For firms with AGR of $1.0 million or less, the ITC rate is 2.3 percent; for firms with AGR above $1.0 million to $2.5 million, 1.5 percent; and above $2.5 million to $5 million, 1.0 percent. For firms with AGR above $5 million, the ITC rate is 0.85 percent. The credit rate is reduced proportionally as the SBT rate is cut. As a result, for tax years beginning after 1999, for Michigan only firms, the Michigan SBT has the same effect as a consumption-type VAT only for firms with AGR of $1 million or less. For a multi-state firm, the SBT's effect depends not only upon the firm's size but upon its apportionment factor and share of investment in Michigan as well.

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.

<u>Value-Added Tax Example</u>

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

Profits = *Total Revenue (Sales) - Total Costs*

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

Total Revenue = *Profits + Total Costs*

Substituting for total costs yields:

Total Revenue = *Profits + Labor Costs + Cost of Materials + Depreciation + 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:

Value Added = *Total Revenue - Cost of Materials*

Substituting for total revenue yields:

Value Added = *Profits + Labor Costs + **Cost of Materials** + Depreciation + Interest Paid – **Cost of Materials***

or

Value Added = *Profits + Labor Costs + Depreciation + Interest Paid*

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

Value Added = *Profits + Labor Costs + Depreciation + Interest Paid - 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:

<u>Subtraction Method</u> <u>Addition Method</u>

Total Revenues – Cost of Materials = Profits + Labor Costs + Depreciation + 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:

$$FTI + Depreciation + Compensation + Additions - Subtractions *$$

* Between 1997 and 1999, inclusive, capital expenditures not fully deducted. After 1999, deduction of capital expenditures from base replaced with Investment Tax Credit.

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 is still to be added back, but capital expenses are no longer deducted from the SBT base. Instead, after the SBT liability is calculated, firms are 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

	Tax Base	Minus	Exemptions, Reductions and Deductions	Times	Tax Rate	Minus	Credits
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)	-	Agricultural Producers Exemption Government Utilities Exemption Multiple Welfare Dental Exemption FICA, UI and WC Exemption Compensation Exemption PEO Compensation Exemption Floor Plan Interest Deduction Business Loss Deduction Statutory Exemption Gross Receipts Reduction Excess Compensation Reduction Health Insurance Deduction **** Nonprofit Organization Exemption	x	1.9% ***	-	Investment Tax Credit** Small Business/Low Profit Insurers' Facility Assessment Community Foundation Homeless Shelter/Food Bank Higher Education Utility Property Tax Unincorporated Business Enterprise Zone MEGA Non Refundable Renaissance Zone Historic Preservation Low Grade Iron Ore Brownfield Next Energy Non Refundable Pharmaceutical R&D MEGA Refundable Supplemental Workers Comp. Apprenticeship Corporate Farm Property Tax Next Energy Refundable Venture Captial Fund

* 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 have been 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 year 2002, the BSF year ending balance fell below $250 million and remained below $250 million through the end of FY 2004. Thus, the SBT rate will remain at 1.9 percent through 2005. PA 531 of 2002 repeals the SBT entirely for tax years beginning after December 31, 2009.

**** For tax years beginning in 2004, 5 percent of payments for health benefits are exempt. The exempt percentage will rise to 20 percent for tax years beginning in 2005, 40 percent for tax years beginning in 2006, and 50 percent for tax years beginning after 2006.

History of the Michigan SBT

As proposed originally, the SBT rate was set at 2.0 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 added during the initial enactment of the tax.[5] 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.

For tax years beginning before January 1, 2000, the SBT included six exemptions, five deductions, and over 15 credits to provide relief for certain taxpayers. For tax years beginning after 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:

Public Act	Year Effective	Sales Factor Weight	Payroll Factor Weight	Property Factor Weight
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%

[5]In 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, labor compensation reduction, and gross receipts reduction were enacted.

The 1995 laws also amended the capital acquisition deduction (CAD) by allowing only Michigan apportioned investments to be eligible for 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 provided that for tax years beginning after 1998, the apportionment formula would 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, 11 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.

<u>Treatment of Capital Purchases</u>

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 2003)**

State		Weights: Sales Factor	Property Factor	Payroll Factor
Alabama		33.3	33.3	33.3
Alaska		33.3	33.3	33.3
Arizona		50	25	25
Arkansas		50	25	25
California		50	25	25
Colorado	(1)	33.3	33.3	33.3
		50	50	0
Connecticut	(2)	50	25	25
	(3)	100	0	0
Delaware		33.3	33.3	33.3
Florida		50	25	25
Georgia		50	25	25
Hawaii		33.3	33.3	33.3
Idaho		50	25	25
Illinois		100	0	0
Indiana		50	25	25
Iowa		100	0	0
Kansas		33.3	33.3	33.3
Kentucky		50	25	25
Louisiana	(4)	50	25	25
		33.3	33.3	33.3
Maine		50	25	25
Maryland		50	25	25
Massachusetts		50	25	25
Minnesota		75	12.5	12.5
Mississippi	(5)	33.3	33.3	33.3
	(6)	50	25	25
	(7)	100	0	0

State		Weights: Sales Factor	Property Factor	Payroll Factor
Missouri	(8)	33.3	33.3	33.3
		100	0	0
Montana		33.3	33.3	33.3
Nebraska		100	0	0
New Hampshire		50	25	25
New Jersey		50	25	25
New Mexico	(9)	33.3	33.3	33.3
		50	25	25
New York		50	25	25
North Carolina		50	25	25
North Dakota		33.3	33.3	33.3
Ohio		60	20	20
Oklahoma	(10)	33.3	33.3	33.3
		50	25	25
Oregon		80	10	10
Pennsylvania		60	20	20
Rhode Island		33.3	33.3	33.3
South Carolina	(11)	50	25	25
	(12)	100	0	0
Tennessee		50	25	25
Utah		33.3	33.3	33.3
Vermont		33.3	33.3	33.3
Virginia		50	25	25
West Virginia		50	25	25
Wisconsin		50	25	25

Summary:

Number of States using 1/3, 1/3, 1/3 formula	10
Number of States using 50-25-25 formula	19
Number of States using sales factor above 50 percent	7
Number of states using multiple formulas:	
with highest sales factor at 50 percent	4
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, 2003. Except for Oregon which is as of 5/1/2003.

(1) Option between three-factor or two-factor formulae.
(2) Formula used by manufacturing (not NAICS 31-33).
(3) Formula used by other sectors.
(4) Formula for manufacturing and merchandising.
(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.
(9) Firms that meet certain requirements have the option to use double-weighted sales factor formula.
(10) Some corporations are allowed to use the double-weight sales factor formula.
(11) Formula used by manufacturers or dealers in tangible personal property.
(12) Formula used by other sectors.

Source: RIA Checkpoint and Federation of Tax Administratiors.

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 the 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 in *Jefferson Smurfit v. Dept of Treasury* that the Michigan-only CAD was constitutional. In overturning a 1999 Court of Claims decision, the Appeals Court held that the Michigan-only CAD did not discriminate against interstate commerce. In December 2002, the Michigan Supreme Court denied review of the Appeals Court ruling. In May 2003, the U.S. Supreme Court denied review. As a result, the Appeals Court ruling that the Michigan-only CAD was constitutional stands. For tax years beginning after 1999, the CAD is replaced with an investment tax credit (ITC).

In September 2004, the U.S. Court of Appeals for the sixth circuit ruled that Ohio's investment tax credit was unconstitutional. The State of Ohio will appeal the decision to the full sixth circuit. The outcome of the case may have implications for Michigan's investment tax credit. Legislation is currently being introduced in Congress that would give state's explicit right to enact investment tax credits.

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 apply to the SBT U.S. Public Law 86-272, which sets the nexus standard for state corporate income taxes and be guided by court cases pertaining to PL 86-272. 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 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. Dept 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 remained 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 increased 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 (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 $115,000 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, Public Act 115 reduces the SBT rate by 0.1 of a percentage point each year.[6] 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.

Exhibit 9 provides a chronology of SBT changes. Exhibit 10 on pages 27-28 presents a progression of the SBT filing provision changes. Several new SBT credits are described in Chapter 3, Section 4.

[6] The Act 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
SBT Legislative History

Year	Public Act	Tax Law Change	
1975	228	SBT Enacted	7 other taxes repealed.
		Rate	2.35%
		Apportionment	1/3 property, 1/3 payroll, 1/3 sales
		Capital Acquisition Deduction (CAD)	Real property--Michigan only Personal property--Apportion national investment using 50% property factor, 50% payroll factor
		Gross Receipts Reduction	Limit tax base to 50% of adjusted gross receipts
		Excess Compensation Reduction	Compensation greater than 65% of tax base
		Business Loss Deduction	Negative tax base may be carried forward up to 10 years
		Statutory Exemption	$34,000/$36,000 for 1977
		S Corp/Unincorporated Credit	From 10% to 20% of SBT liability, according to business income
		Higher Education Credit--50%	Maximum--lesser of 5% of tax, or $5,000
		Utility Property Tax Credit	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	

Year	Public Act	Tax Law Change	FY 2003 Revenue Loss (millions)
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	$46.6
		Increase adjusted gross receipts filing threshold to $100,000.	$14.5
	170	Extend community foundation credit through 1994; increase cap to $6 million	n.a.
		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.
1992	98	Cut alternative tax rate to 3%	$13.2
		Raise SBC gross receipts limit to $10 million	$10.9

Year	Public Act	Tax Law Change	FY 2003 Revenue Loss (millions)
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%	$13.7
	246	Increase gross receipts filing threshold to $250,000	$41.2
	247	Cut SBT rate to 2.3%	$65.8
1995	1 & 6	Exclude UI, FICA, and workers compensation from tax base	$138.4
	23	Enact MEGA credits	$12.7
	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	-$18.8
	284	Phase out small business credit if individual ABI between $95,000 and $115,000	$24.7
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	$1.5
	578	Narrow insurance company tax base	$1.2
	593	Enact youth apprenticeship credit	$0.1
1997	190	Community foundation credit; eliminate sunset	$0.8
	191	Homeless shelter/foodbank credit; eliminate sunset	$0.4

Year	Public Act	Tax Law Change	FY 2003 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	$0.0
	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)	$465.4
	184	Youth Apprentice Credit; eliminate sunset	$0.1
	213	Technical amendments on Historic Preservation Credit	$0.0
2000	44	Investment Tax Credit, revise calculation	$12.8
	143	Extend and expand Brownfield zone investment tax credit	$50.0
		Allow MEGA credits for job retention investments	$5.7
	144	Allow MEGA credits for high technology firms	$3.5
	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

Year	Public Act	Tax Law Change	FY 2003 Revenue Loss (millions)
2001	224	Exclude Multiple Employer Welfare Arrangement from tax base	$0.0
	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.
2002	531	Increase gross receipts filing threshold to $350,000 beginning in tax year 2003	$13.7
		Repeal SBT entirely for tax years after 12/31/2009	$0.0
		NEXT Energy credit	$0.9
	588	Pharmaceutical research and development credit	$5.3
	603	Alter treatment of officer compensation paid by professional employer organizations	$2.3
	606	Revise gross receipts definition	$0.0
	726	Extend brownfield project approval deadline to 2008	$0.0
2003	240 & 241	Remove portion of health plan payments from SBT base	$0.0
	248	Amend MEGA Act to expand definition of eligible business	$0.0
	249-251	Extend MEGA authority to award credits until 12/31/09	$0.0
	266	Allow creation of up to 20 tool and die Renaissance zones	$0.0
	273	Increase apprenticeship training credit effective 12/31/03	$0.0
	295-297	Provide for Venture Capital credit	$0.0

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

		MCL Section	RAB,Q&A	1976	1977-1983	1984	1985-1987	1988	1989	1990	1991	1992	1993
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 Apportioment %	(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
Additonal 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 (d)		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 Adjusted Business Income (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						(a)	(a)	(a)	(a)	(a)
Homeless Credit	(a)	208.38f	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
Job Tax Credit		208.36a			1983 only								
Federal Unemployment Tax Act Credit		208.38a			1983	yes					yes	yes	
Child Care Credit		208.39a			1981, 1982								

(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.

(d) FICA denotes federal insurance contributions act (Social Security and Medicare). WC denotes workers compensation. UI denotes unemployment insurance.

* 1977 fiscal year filers $36,000.

Source: Tax Policy Division, Michigan Department of Treasury.

Exhibit 10 (cont.)
(1994-2004)

		MCL Section	RAB, Q & A	1994	1995-1996	1997	1998	1999	2000	2001	2002	2003-2004
Gross Receipts Filing Requirements (f)		208.73(1), 39e(8)		$137,500	$250,000	$250,000	$250,000	$250,000	$250,000	$250,000	$250,000	$350,000
Gross Receipts Threshold, Controlled Group	(c)	208.73(5)		$100,000	$100,000	$100,000	$100,000	$100,000	$100,000	$100,000	$100,000	$100,000
SBT Tax Rate Percentage	(b)(e)	208.31(1)		(b)	2.3%	2.3%	2.3%	2.2% (e)	2.1% (e)	2.0% (e)	1.9% (e)	1.9% (e)
Alternate Tax Rate Percentage	(b)	208.36(4)		(b)	2%	2%	2%	2%	2%	2%	2%	2%
Apportionment % (Property/Payroll/Sales)		208.45, 45a		25-25-50	25-25-50	10-10-80	10-10-80	5-5-90	5-5-90	5-5-90	5-5-90	5-5-90
CAD Apportioment %		208.23, 23b	RAB 92-03	25-25-50	25-25-50	10-10-80	10-10-80	5-5-90	No CAD	No CAD	No CAD	No CAD
Investment Tax Credit		208.35a							Yes	Yes	Yes	Yes
FICA, WC, UI in Compensation		208.4(3)(c)(d)(e)		Yes	No	No	No	No	No	No	No	No
Health and Welfare Plans in Compensation		208.4(3)(f)		Yes	Yes	Yes	Yes	Yes	Yes	Yes	Yes	(g)
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	$45,000
Additonal Exemption		208.35(1)(a)	RAB 89-51	$12,000	$12,000	$12,000	$12,000	$12,000	$12,000	$12,000	$12,000	$12,000
SBC Gross Receipts Disqualifier		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	$10,000,000
SBC Excess Gross Receipts Reduction		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	$9,000,000
SBC Adjusted Business Income (ABI) Disqualifier - Corp		208.36(2)		$475,000	$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	$115,000
SBC ABI & Allocated Income Reduct	(d)	208.36(2)(c), 36d					(d)	(d)	(d)	(d)	(d)	(d)
Public/College Contrib. Credit (Not Ind/Fdcy)	(a)	208.38	RAB 92-10	(a)	(a)	(a)	(a)	(a)	(a)	(a)	(a)	(a)
Community Foundation Credit	(a)	208.38c	RAB 92-10	(a)	(a)	(a)	(a)	(a)	(a)	(a)	(a)	(a)
Homeless Credit	(a)	208.38f	RAB 92-10	(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%
Unincorporated/S-Corp Credit		208.37		Yes	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	Yes
MEGA Credit, (Partially Refundable)		208.37c & d			Yes	Yes	Yes	Yes	Yes	Yes	Yes	Yes
Low Grade Hematite Pellet Credit		208.39d								Yes	Yes	Yes
Renaissance Zone Credit		208.39b				Yes	Yes	Yes	Yes	Yes	Yes	Yes
Michigan Historic Preservation Credit		208.39c						Yes	Yes	Yes	Yes	Yes
Brownfield Credit - "old"		208.38d				Yes	Yes	Yes	Yes	No	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	Yes
Apprentice Refundable Credit		208.38e				Yes	Yes	Yes	Yes	Yes	Yes	Yes
CAD Credit		208.36c				Yes	Yes	Yes	No	No	No	No
NEXT Energy Credit		208.39e										Yes
Pharmaceutical R&D Credit		208.39f										Yes

(a) Smaller of $5,000, 50 percent of contribution, or 5 percent of tax.
(b) 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.
(c) 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.
(d) 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.
(e) Tax rate reduced by 0.1 percentage point 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.
(f) Beginning 2003, gross receipts filing threshold based on apportioned or allocated gross receipts. Prior to 2003, threshold based on apportioned or allocated gross receipts plus CAD recapture.
(g) Excludes a percent of health and welfare plan payments. Beginning after 12/31/03, 5%; After 12/31/04, 20%; after 12/31/05, 40%; after 12/31/06, 50%.
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 2003 is based on the law in effect at the time of this printing. PA 531 of 2002 repeals SBT for tax years beginning after 12/31/2009.
Source: Tax Policy 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 2000-2001 cleared returns, unless noted otherwise.

Exhibit 11
Calculation of SBT Liability

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

* Public Act 115 of 1999 replaces the capital acquisition deduction with an ITC for tax years beginning after 1999. CADs still recaptured upon sale of capital on which CAD was previously eligible to be claimed.

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.[7] 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 2000-2001 tax year, Michigan apportionment was calculated by weighting three factors:[8]

1. The ratio of property in Michigan to total property times 5 percent.
2. The ratio of payroll in Michigan to total payroll times 5 percent.
3. The ratio of sales in Michigan to total sales times 90 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	.05 x .70	=	.035
Property	.05 x .70	=	.035
Sales	.90 x .15	=	.135
Apportionment Factor		=	.205

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 $205,000. Firms that only do business in Michigan have an apportionment factor equal to one, hence their apportioned tax base equals the total tax base.

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[7]Public 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. Public Acts 240 and 241 of 2003 remove a portion of health plan payments from the SBT base.

[8]For apportionment factor formula used in other years, see page 16.

For tax years beginning in 2000, the total tax base prior to apportionment equaled $1,740.6 billion, while the MTB totaled $151.9 billion (including negative tax bases), or 8.7 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 (42.5 percent), agriculture, forestry and fishing (20.5 percent) and fabricated metals (17.0 percent) industries. Industries with a relatively low ratio include the mining (1.9 percent), transportation (3.4 percent), and non-durable manufacturing (4.8 percent) sectors.

Exhibit 12
Michigan Tax Base, 2000-2001*

Business Sector	Number of Firms	Total Tax Base	Michigan Tax Base (MTB)	MTB as a Percent of Total Tax Base
Agriculture, Forestry, and Fishing	2,253	$4,210,707,113	$861,350,889	20.46 %
Mining	506	17,790,592,407	345,844,675	1.94
Construction	15,642	23,294,896,228	9,893,074,195	42.47
Manufacturing	14,924	629,191,511,496	42,821,927,894	6.81
Other Durable Manufacturers	5,649	195,544,876,060	10,227,304,437	5.23
Non-Durable Manufacturers	3,496	229,020,514,559	10,887,421,085	4.75
Primary Metals	555	18,989,944,028	2,318,359,589	12.21
Fabricated Metals	2,263	25,339,124,054	4,311,022,596	17.01
Machinery--Except Electrical	2,241	50,914,357,933	4,372,862,573	8.59
Transportation Equipment	720	109,382,694,862	10,704,957,615	9.79
Transportation	4,034	105,212,860,967	3,615,577,124	3.44
Communications and Utilities	1,522	65,412,286,321	9,123,299,502	13.95
Wholesale Trade	5,349	118,248,854,560	6,527,252,225	5.52
Retail Trade	34,746	219,480,874,622	21,619,107,290	9.85
Finance, Ins., and Real Estate	16,562	101,070,107,151	10,973,184,881	10.86
Services	44,413	380,468,598,178	40,508,161,889	10.65
Not Elsewhere Classified/Misc.	8,813	76,250,042,038	5,646,639,752	7.41
All Businesses	148,764	$1,740,631,331,081	$151,935,420,317	8.73 %

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

Source: Tax Analysis Division, Michigan Department of Treasury.

Exhibit 13, page 33, shows the individual components of the MTB (compensation, business income, additions, and subtractions).[9] As expected, compensation represented the main component of the MTB, comprising 72.6 percent of the total value added in Michigan. Compensation comprised over 75 percent of value added in nine industries: primary metals, non-electrical machinery, construction, services, other durable manufacturing, transportation equipment, mining, fabricated metals, and retail trade. The communication and utilities sector (besides firms not elsewhere classified) was the only sector where compensation payments did not dominate, accounting for less than half of the MTB.

Apportioned business income comprised 7.3 percent of the MTB, substantially less than in 1999-2000, 1998-99 and 1997-98 (11.8, 14.1 and 14.0 percent respectively).

For most industries, the single largest component of additions was depreciation. For all firms included in the analysis, depreciation comprised 42.8 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 two largest individual sectors by a significant margin were: services (26.6 percent) and retail trade (14.3 percent). Together, these two sectors accounted for 40.9 percent of total Michigan value added. The agriculture and mining sectors were the smallest, comprising only 0.8 percent of total Michigan value added. Agricultural production is exempt from SBT.

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[9]Individual 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 apportionment factor.

Exhibit 13
Components of the Michigan Tax Base, 2000-2001*

Business Sector	Total Apportioned Compensation	% of Column Total	% of Row Total	Total Apportioned Business Income	% of Column Total	% of Row Total	Total Apportioned Additions	% of Column Total	% of Row Total	Total Apportioned Subtractions**	% of Column Total	% of Row Total	Apportioned Tax Base Total	% of Column Total
Ag., For., and Fishing	$616,162,247	0.56	71.64	$96,724,379	0.88	11.25	$156,789,316	0.30	18.23	$9,542,910	0.04	(1.11)	$860,133,032	0.57
Mining	265,575,538	0.24	76.92	(245,245,879)	(2.22)	(71.03)	452,353,633	0.85	131.01	127,401,490	0.56	(36.90)	345,281,803	0.23
Construction	7,928,453,564	7.22	80.17	959,242,199	8.69	9.70	1,202,905,207	2.26	12.16	201,088,889	0.89	(2.03)	9,889,512,081	6.53
Other Durable Man.	8,068,442,065	7.35	78.92	461,237,871	4.18	4.51	2,898,281,648	5.45	28.35	1,204,580,645	5.32	(11.78)	10,223,380,939	6.76
Non-Durable Man.	7,427,935,116	6.76	68.28	1,127,690,287	10.21	10.37	3,668,314,108	6.90	33.72	1,344,523,252	5.94	(12.36)	10,879,416,259	7.19
Primary Metals	1,942,200,557	1.77	83.77	(312,328,130)	(2.83)	(13.47)	828,900,637	1.56	35.75	140,413,475	0.62	(6.06)	2,318,359,589	1.53
Fabricated Metals	3,311,221,704	3.02	76.81	178,200,802	1.61	4.13	942,899,748	1.77	21.87	121,323,820	0.54	(2.81)	4,310,998,435	2.85
Machinery-Exc. Elect.	3,559,069,908	3.24	81.40	(48,465,953)	(0.44)	(1.11)	1,040,652,070	1.96	23.80	178,687,828	0.79	(4.09)	4,372,568,197	2.89
Trans. Equipment	8,427,000,538	7.67	78.72	(1,393,332,652)	(12.62)	(13.02)	7,166,953,132	13.49	66.95	3,495,560,411	15.43	(32.65)	10,705,060,607	7.07
Transportation	2,556,726,039	2.33	70.72	181,481,686	1.64	5.02	997,986,795	1.88	27.61	121,101,724	0.53	(3.35)	3,615,092,796	2.39
Comm. and Utilities	3,841,757,099	3.50	42.12	1,000,032,020	9.06	10.96	4,674,956,747	8.80	51.25	395,550,141	1.75	(4.34)	9,121,195,726	6.03
Wholesale Trade	4,495,003,735	4.09	68.88	757,836,780	6.86	11.61	1,619,112,709	3.05	24.81	346,197,554	1.53	(5.31)	6,525,755,670	4.31
Retail Trade	16,483,504,988	15.01	76.32	1,874,470,041	16.98	8.68	5,222,347,290	9.83	24.18	1,981,149,856	8.75	(9.17)	21,599,172,463	14.27
Fin., Ins., and R. Est.	6,649,885,380	6.06	61.05	719,252,883	6.51	6.60	9,915,697,394	18.66	91.04	6,392,979,437	28.22	(58.70)	10,891,856,219	7.20
Services	31,850,336,272	29.00	79.11	3,679,553,966	33.33	9.14	9,959,562,254	18.74	24.74	5,230,223,736	23.09	(12.99)	40,259,228,755	26.60
Not Else Clss./Misc.	2,393,947,830	2.18	44.12	2,005,065,579	18.16	36.96	2,389,014,862	4.50	44.03	1,362,612,276	6.02	(25.12)	5,425,415,996	3.58
All Businesses	$109,817,222,581	100.00	72.56	$11,041,415,878	100.00	7.30	$53,136,727,551	100.00	35.11	$22,652,937,443	100.00	(14.97)	$151,342,428,567	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: Tax Analysis Division, Michigan Department of Treasury.

Section 2: Computation of the Adjusted Tax Base

For SBT returns whose tax year began after December 31, 1999, the adjusted tax base (ATB) is derived by subtracting one deduction (business loss deduction) and one exemption (statutory exemption) from the MTB. All firms can make use of the business loss deductions from the MTB, but must qualify for the statutory exemption. For tax years beginning after 1999, the capital acquisition deduction was replaced by an Investment Tax Credit (ITC). Thus, in tax year 2000-2001, firms could not claim a CAD. However, when firms sold property, past CADs are recaptured to the extent to which depreciation had not already been added back into the base. This addition is called CAD recapture. Thus, for all 2000-2001, firms could not claim a CAD but did have CAD recapture added back to the adjusted tax base if they sold property that had been eligible for a CAD when purchased. See Exhibit 14.

In 2000-2001, CAD recapture totaled $3.3 billion (21,676 firms). The services sector accounted for slightly more than one-fourth of the firms with CAD recapture and total amount of CAD recapture (26.1 percent and 25.6 percent, respectively).

Exhibit 14
Capital Acquisition Deduction Recapture, 2000-2001

Business Sector	Number with CAD Recapture	Percent of Firms	Recaptured CAD	Percent of Total
Agriculture, Forestry, and Fishing	395	1.82 %	$17,748,394	0.54 %
Mining	121	0.56	9,404,534	0.29
Construction	2,495	11.51	63,394,723	1.93
Manufacturers	3,637	16.78	687,633,053	20.93
Other Durable Manufacturers	1,218	5.62	90,516,084	2.76
Non-Durable Manufacturers	891	4.11	117,577,631	3.58
Primary Metals	163	0.75	13,840,204	0.42
Fabricated Metal	616	2.84	46,617,758	1.42
Machinery--Except Electrical	533	2.46	47,886,269	1.46
Transportation Equipment	216	1.00	371,195,107	11.30
Transportation	855	3.94	60,122,168	1.83
Communications and Utilities	291	1.34	109,833,209	3.34
Wholesale Trade	1,070	4.94	77,785,734	2.37
Retail Trade	4,701	21.69	407,282,340	12.40
Finance, Ins., and Real Estate	1,773	8.18	847,895,844	25.81
Services	5,654	26.08	839,258,183	25.55
Not Elsewhere Classified/Misc.	684	3.16	164,966,039	5.02
All Businesses	21,676	100.00 %	$3,285,324,221	100.00 %

Source: Tax Analysis Division, Michigan Department of Treasury.

Business Loss Deduction

For tax years beginning before January 1, 2000, CADs were not used if the CAD exceeded 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 2000-2001, 13,521 firms deducted losses from prior years, reducing their 2000-2001 MTB by $6.7 billion and liability by approximately $139.8 million (MTB reduction times 2.1 percent, the nominal SBT rate for most 2000-2001 SBT taxpayers). Exhibit 15 shows that the finance, insurance, and real estate sector used the business loss deduction most intensively. For all business sectors, the business loss deduction reduced the MTB by 4.4 percent in 2000-2001.

Exhibit 15
Business Loss Deduction, 2000-2001

Business Sector	Number of Firms Claiming	Total Business Loss Deduction Claimed	Percent Reduction in MTB*
Agriculture, Forestry, and Fishing	132	$28,139,023	3.27 %
Mining	75	36,724,973	10.62
Construction	605	73,618,074	0.74
Manufacturing	603	471,541,162	1.10
Other Durable Manufacturers	247	166,560,794	1.63
Non-Durable Manufacturers	153	122,197,027	1.12
Primary Metals	23	31,853,841	1.37
Fabricated Metals	64	41,620,295	0.97
Machinery--Except Electrical	79	40,093,305	0.92
Transportation Equipment	37	69,215,900	0.65
Transportation	408	155,633,851	4.30
Communications and Utilities	177	413,858,972	4.54
Wholesale Trade	205	50,451,339	0.77
Retail Trade	2,242	428,173,536	1.98
Finance, Insurance, and Real Estate	4,477	2,157,335,489	19.66
Services	3,369	2,308,086,568	5.70
Not Elsewhere Classified/Misc.	1,228	533,547,666	9.45
All Businesses	13,521	$6,657,110,653	4.38 %

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

Source: Tax Analysis Division, Michigan Department of Treasury.

Statutory Exemption

After prior business losses have been deducted, firms may claim a statutory exemption. For the 2000-2001 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 2000-2001, 55,115 firms claimed a statutory exemption, reducing the MTB by $2.2 billion, a reduction of $46.7 million in tax revenue (see Exhibit 16, page 38). This $46.7 million reduction, however, underestimates the aggregate tax savings from the statutory exemption. Many small businesses were not required to file because their gross receipts fell below the filing threshold amount ($250,000 through 2002; $350,000 beginning 2003). Thus, many small businesses that could have benefited from the statutory exemption did not because they were not required to file.

However, the $2.2 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 CAD recapture and the business loss deduction. Exhibit 16 shows that effective statutory exemptions totaled $1.6 billion in 2000-2001 and reduced SBT revenues by $34.6 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 3.8 percent of their MTB. In contrast, industries with larger firms, like the transportation equipment manufacturing sector, offset much less (0.06 percent) of their MTB through effective statutory exemptions.

When combined, the net effect of effective recaptured CADs, business loss deductions and effective statutory exemptions reduced the Michigan tax base from $151.9 billion to an adjusted tax base of $146.8 billion, a 3.4 percent reduction.[10]

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.

[10] Excludes simplified filers and firms that used the gross receipts short method to file.

Exhibit 16
Statutory Exemption, 2000-2001

Business Sector	Number of Firms Claiming	Total Statutory Exemptions Claimed	Effective Statutory Exemptions	Percent Reduction in MTB From Eff. Statutory Exemptions*
Agriculture, Forestry, and Fishing	998	$39,584,518	$32,998,602	3.83 %
Mining	195	8,117,016	5,011,300	1.45
Construction	6,548	259,245,283	214,550,171	2.17
Manufacturing	4,166	171,090,866	145,877,775	0.34
Other Durable Manufacturers	1,639	67,250,493	56,401,576	0.55
Non-Durable Manufacturers	1,003	41,524,165	34,764,727	0.32
Primary Metals	146	5,796,028	5,430,704	0.23
Fabricated Metals	584	23,802,151	21,039,196	0.49
Machinery--Except Electrical	614	25,125,673	21,946,176	0.50
Transportation Equipment	180	7,592,356	6,295,396	0.06
Transportation	1,805	75,331,948	58,658,470	1.62
Communications and Utilities	504	19,929,946	13,459,039	0.15
Wholesale Trade	1,576	63,903,621	49,602,139	0.76
Retail Trade	17,607	711,622,298	578,813,547	2.68
Finance, Insurance, and Real Estate	5,202	214,936,854	91,400,187	0.83
Services	13,763	550,243,994	394,906,852	0.97
Not Elsewhere Classified/Misc.	2,751	111,444,470	61,493,827	1.09
All Businesses	55,115	$2,225,450,814	$1,646,771,909	1.08 %

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

Source: Tax Analysis Division, 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%). For tax years beginning after 1999, taxpayers may claim an Investment Tax Credit (ITC). Taxpayers using the excess compensation reduction method must reduce their ITC in proportion to their compensation reduction. In the above example, the firm would reduce its ITC by 17 percent, the same percentage by which the firm reduced its tax base.

In 2000-2001, 49,396 firms (33.2 percent of total filers) used the excess compensation reduction to reduce their tax liability by $326.5 million (see Exhibit 17, page 40). 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, 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 42.1 percent of the MTB for firms in the communications and utilities sector, and the excess compensation reduction was used relatively infrequently (26.9 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 2000-2001, 19,735 firms (13.3 percent of all SBT filers) used either the gross receipts reduction method or gross receipts short method to reduce their SBT liability by $277.6 million (see Exhibit 17). Industries that utilized the gross receipts reduction method most often include the services and finance, insurance, and real estate sectors.[11]

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 calculates the adjusted tax base as the adjusted gross receipts times 50 percent.

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[11]Following 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 17
Excess Compensation and Gross Receipts Filing Methods, 2000-2001

Business Sector	Excess Compensation Reduction			Gross Receipts Reduction and Gross Receipts Short Method		
	Number of Firms Claiming	Percentage of Firms in Sector Claiming	Reduction in SBT Liability	Number of Firms Claiming	Percentage of Firms in Sector Claiming	Reduction in SBT Liability
Agriculture, Forestry, and Fishing	646	28.67 %	$1,599,458	220	9.76 %	$1,140,113
Mining	108	21.34	474,818	51	10.08	$545,423
Construction	5,376	34.37	32,162,665	858	5.49	6,922,897
Manufacturing	8,022	53.75	102,387,668	1,251	8.38	20,319,216
Other Durable Manufacturers	3,021	53.48	26,834,401	409	7.24	5,006,132
Non-Durable Manufacturers	1,804	51.60	21,042,441	212	6.06	8,795,767
Primary Metals	333	60.00	8,467,645	49	8.83	493,773
Fabricated Metals	1,245	55.02	11,021,358	270	11.93	2,536,348
Machinery--Except Electrical	1,220	54.44	13,120,686	274	12.23	3,034,243
Transportation Equipment	399	55.42	21,901,137	37	5.14	452,954
Transportation	1,409	34.93	6,972,503	328	8.13	7,503,098
Communications and Utilities	409	26.87	4,263,569	196	12.88	26,441,541
Wholesale Trade	2,677	50.05	14,608,367	187	3.50	2,771,136
Retail Trade	12,973	37.34	58,598,211	864	2.49	9,223,284
Finance, Insurance, and Real Estate	1,531	9.24	10,174,188	3,905	23.58	35,821,078
Services	14,715	33.13	88,927,664	10,089	22.72	136,515,333
Not Elsewhere Classified/Misc.	1,530	17.36	6,330,958	1,786	20.27	30,445,359
All Businesses	49,396	33.20 %	$326,500,069	19,735	13.27 %	$277,648,477

Source: Tax Analysis Division, 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, 2000-2001 tax liability before credits for most filers equals 2.1 percent of 50 percent of adjusted gross receipts. As a result, no firm's SBT liability could exceed 1.05 percent of adjusted gross receipts in 2000-2001 (50 percent times 2.1 percent). Approximately 1,132 firms used the gross receipts short method, while 18,603 firms used the gross receipts reduction filing long method.

Alternate Tax Rate Method

Firms that used the alternate tax rate method 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.[12]

In 2000-2001, 32,616 filers used the alternate tax rate method (see Exhibit 18, page 42). These filers accounted for 21.9 percent of total filers and provided $39.5 million (1.9 percent) of SBT revenues. Firms eligible to use this method, however, may have used another method instead and claimed a small business credit if doing so 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 2000-2001, 46,921 firms (31.5 percent of all filers) used this filing method. Straight method filers paid $530.4 million (25.2 percent) of 2000-2001 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 2000-2001, the rate for firms with a calendar year 2000 tax year was 2.1 percent (unless the alternate tax rate method was used). For firms with a tax year beginning in 2000 and ending in 2001, the tax rate is annualized based on the number of months in 2000 (taxed at 2.1 percent) and the number of months in 2001 (taxed at 2.0 percent) The result is tax liability before credits.[13]

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[12]Public 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 46 for a definition of adjusted business income.

[13]Public 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

Exhibit 18
Alternate Tax Rate and Straight Percentage Methods, 2000-2001

Business Sector	Alternate Tax Rate Method: Number of Firms	Alternate Tax Rate Method: Percentage of Firms in Sector	Alternate Tax Rate Method: Final Tax Liability	Straight Percentage Method: Number of Firms	Straight Percentage Method: Percentage of Firms in Sector	Straight Percentage Method: Final Tax Liability
Agriculture, Forestry, and Fishing	855	37.95 %	$1,003,540	530	23.52 %	$1,755,050
Mining	84	16.60	98,003	263	51.98	2,939,849
Construction	5,128	32.78	6,549,577	4,267	27.28	17,130,937
Manufacturing	2,284	15.30	3,138,303	3,362	22.53	199,507,284
Other Durable Manufacturers	821	14.53	1,161,276	1,398	24.75	46,191,225
Non-Durable Manufacturers	544	15.56	671,471	935	26.74	61,413,203
Primary Metals	70	12.61	89,652	103	18.56	6,489,919
Fabricated Metals	369	16.31	534,278	377	16.66	14,619,150
Machinery--Except Electrical	411	18.34	590,583	336	14.99	13,806,703
Transportation Equipment	69	9.58	91,043	213	29.58	56,987,084
Transportation	826	20.48	809,025	1,470	36.44	4,963,177
Communications and Utilities	205	13.47	267,714	710	46.65	33,398,750
Wholesale Trade	720	13.46	998,184	1,762	32.94	38,935,396
Retail Trade	10,198	29.35	11,171,663	10,699	30.79	80,027,111
Finance, Insurance, and Real Estate	2,307	13.93	3,090,484	8,808	53.18	65,721,247
Services	8,909	20.06	11,129,069	10,656	23.99	65,700,646
Not Elsewhere Classified/Misc.	1,100	12.48	1,263,416	4,394	49.86	20,352,693
All Businesses	32,616	21.92 %	$39,518,978	46,921	31.54 %	$530,432,140

Source: Tax Analysis Division, Michigan Department of Treasury.

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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.

The SBT offered a number of credits to taxpayers in 2000-2001 including the investment tax credit, 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; brownfield credits; Michigan Economic Growth Authority (MEGA) credits; low grade iron ore credit; Next Energy credit; and a pharmaceutical R&D credit.

For tax years beginning before 2000, the SBC was subtracted before all other credits. However, for tax years beginning after 1999, the investment tax credit is the first credit subtracted from the tax before credits.

Investment Tax Credit

Public Act 115 of 1999 instituted 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 ITC may be carried forward for nine years.

The credit rate varies according to the size of each business, measured by the firm's adjusted gross receipts (AGR). The credit is reduced proportionally as the SBT rate declines.

At a 2.3 percent SBT rate, the ITC credit rates were as follows: AGR of $1 million or less: 2.3 percent; AGR more than $1.0 million and less than or equal to $2.5 million: 1.5 percent; AGR more than $2.5 million and less than or equal to $5.0 million: 1.0 percent; AGR exceeding $5.0 million: 0.85 percent. The 2000 SBT tax rate was 2.1 percent. Thus, the ITC credit rates for the calendar year 2000 filers equal the above ITC rates multiplied by (2.1%/2.3%).

Taxpayers using the excess compensation reduction receive a reduced ITC and taxpayers using the gross receipts reduction method are not eligible for the ITC.

By far, the ITC is the largest SBT credit. In tax year 2000-2001, 56,453 firms claimed investment tax credits equal to $320.8 million. See Exhibit 19. Because the ITC is a non-refundable credit, the effective ITC totaled less than the ITC claimed, equaling $225.7 million. The ITC may be carried forward for nine years. Retail trade and services together account for the largest share of firms claiming the ITC (27.6 percent and 27.0 percent respectively). However, these sectors account for substantially smaller shares of the amount of claimed ITC, with services accounting for slightly less than one-fifth (19.0 percent) and retail comprising just 7.0 percent. By far, manufacturing accounts for the largest share of the amount of claimed ITC, accounting for 34.6 percent of the amount of claimed ITC. Transportation equipment manufacturing alone accounts for over one-fourth of claimed ITC (25.7 percent). The comparisons are similar when looking at effective ITC. See Exhibit 20. While retail trade and services together comprise 55.3 percent of firms with a positive effective ITC, the sectors comprise only 18.1 percent of total effective ITC. The manufacturing sector, while accounting for only 12.7 percent of the firms with an effective ITC, comprised 47.2 percent of effective ITC. Transportation equipment manufacturing accounted for 36.3 percent of effective ITC.

Exhibit 19
Claimed Investment Tax Credit
2000-2001

Business Sector	Number Claiming ITC	Percent of Firms Claiming ITC	Claimed ITC	Percent of Claimed ITC
Agriculture, Forestry, and Fishing	1,190	2.11 %	$1,200,248	0.37 %
Mining	217	0.38	$4,389,672	1.37
Construction	7,437	13.17	$7,176,619	2.24
Manufacturers	6,519	11.55	111,015,636	34.60
Other Durable Manufacturers	2,283	4.04	10,365,734	3.23
Non-Durable Manufacturers	1,469	2.60	9,674,147	3.02
Primary Metals	248	0.44	1,242,796	0.39
Fabricated Metal	1,127	2.00	3,712,155	1.16
Machinery--Except Electrical	1,076	1.91	3,540,581	1.10
Transportation Equipment	316	0.56	82,480,223	25.71
Transportation	1,613	2.86	4,667,090	1.45
Communications and Utilities	596	1.06	20,644,388	6.43
Wholesale Trade	2,088	3.70	4,717,607	1.47
Retail Trade	15,577	27.59	22,499,224	7.01
Finance, Ins., and Real Estate	4,244	7.52	74,468,806	23.21
Services	15,239	26.99	61,064,357	19.03
Not Elsewhere Classified/Misc.	1,733	3.07	9,003,907	2.81
All Businesses	56,453	100.00 %	$320,847,554	100.00 %

Source: Tax Analysis Division, Michigan Department of Treasury.

Exhibit 20
Effective Investment Tax Credit
2000-2001

Business Sector	**Number Non-Zero Effective ITC**	**Percent of Firms Effective ITC**	**Effective ITC**	**Percent of Effective ITC**
Agriculture, Forestry, and Fishing	1,082	2.23 %	$890,396	0.39 %
Mining	172	0.35	$934,065	0.41
Construction	6,931	14.26	$4,971,569	2.20
Manufacturers	6,148	12.65	106,424,682	47.15
Other Durable Manufacturers	2,117	4.36	8,500,982	3.77
Non-Durable Manufacturers	1,388	2.86	8,067,928	3.57
Primary Metals	237	0.49	1,139,037	0.50
Fabricated Metal	1,084	2.23	3,655,218	1.62
Machinery--Except Electrical	1,031	2.12	3,103,437	1.38
Transportation Equipment	291	0.60	81,958,080	36.31
Transportation	1,380	2.84	3,147,602	1.39
Communications and Utilities	467	0.96	15,956,348	7.07
Wholesale Trade	1,942	4.00	4,532,509	2.01
Retail Trade	13,843	28.49	17,356,701	7.69
Finance, Ins., and Real Estate	2,405	4.95	45,789,067	20.29
Services	13,053	26.86	23,479,325	10.40
Not Elsewhere Classified/Misc.	1,170	2.41	2,209,585	0.98
All Businesses	48,593	100.00 %	$225,691,849	100.00 %

Source: Tax Analysis Division, Michigan Department of Treasury.

Small Business Credit

The second largest SBT credit is the Small Business Credit (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 2000-2001, 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 and carrybacks.

The credit is calculated as follows:

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

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:

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

or

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

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

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

Using the SBT tax rate of 2.10 percent, this may be rewritten as:

$$\textit{Tax After Credit} = \left(\frac{2.10\%}{45\%}\right) * ABI$$

or

$$\textit{Tax After Credit} = (4.67\%) * ABI$$

If a firm used the 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:

$$Tax\ After\ Credit = \left(Tax\ Base\ After\ Reductions * 2.10\%\right) * \left(\frac{ABI}{0.45 * Tax\ Base\ Before\ Reductions}\right)$$

or

$$Tax\ After\ Small\ Business\ Credit = \left(4.67\%\right) * ABI * \left(\frac{Tax\ Base\ After\ Reductions}{Tax\ Base\ Before\ Reductions}\right)$$

Firms eligible for the standard small business credit described above are also eligible for the alternate credit. Under the alternate credit, firms pay a tax equal to 2.0 percent of adjusted business income. Thus, under the alternate credit,

$$Tax\ After\ Alternate\ Credit = 2.0\% * ABI$$

Firms eligible for the Small Business Credit, pay the least of the following three amounts:

(1) *Tax Before Small Business Credit (After the Investment Tax Credit)*
(2) *Tax After Small Business Credit*
(3) *Tax After Alternate Credit*

As an illustration, consider Example 3 in Exhibit 21 (page 48). Exhibit 21's examples assume that the firm has no Investment Tax Credit. Thus, given the MTB, the tax before the small business credit is equal to the MTB after reductions ($40,000) multiplied by the tax rate (2.10 percent), yielding $840, the tax before the Small Business Credit. The small business credit can be calculated following three steps. First, divide ABI ($30,000) by the product of the value-added base ($100,000) multiplied by 45 percent. This is equal to 0.667. Second, subtract this result from 1, which yields a figure of 0.333. Next, multiply this new figure by the tax before the credit, resulting in a credit of $280 (0.333 times $840). This yields a tax after small business credit of $560 = $840 -$280. Finally, calculate the SBT under the alternate tax. This equals ABI ($30,000) multiplied by 2.0%, which equals $600.

The taxpayers' tax equals $560, (the least of the tax before credit ($840), tax after small business credit ($560) and tax after alternate credit ($600)). In addition to example 3, taxpayers in examples 5, 7 and 9 claimed a Small Business Credit.

Exhibit 21
SBT Small Business Credit:
Illustrative Examples

No.	Michigan Tax Base	Base After Reductions	Adjusted Business Income	Tax Before Credit	Standard Small Business Credit	Alternate Credit	Tax After Credit	Tax as a % of Adjusted Business Income
1	$100,000	$30,000	$50,000	$630	$0	$0	$630	1.26 %
2	100,000	50,000	50,000	1,050	0	50	1,000	2.00
3	100,000	40,000	30,000	840	280	240	560	1.87
4	1,000,000	700,000	50,000	14,700	13,067	13,700	1,000	2.00
5	1,000,000	300,000	200,000	6,300	3,500	2,300	2,800	1.40
6	1,000,000	500,000	450,000	10,500	0	1,500	9,000	2.00
7	2,000,000	700,000	50,000	14,700	13,883	13,700	817	1.63
8	2,000,000	1,000,000	400,000	21,000	11,667	13,000	8,000	2.00
9	3,000,000	700,000	100,000	14,700	13,611	12,700	1,089	1.09
10	3,000,000	1,500,000	200,000	31,500	26,833	27,500	4,000	2.00

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. All the above examples assume that taxpayer's gross receipts are below $9 million and that the firm does not receive an investment tax credit (ITC).

Source: Tax Analysis Division, Michigan Department of Treasury.

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 upon which option reduces their liability more. In Exhibit 21, taxpayers in examples 2, 4, 6, 8 and 10 paid using the alternate tax method.

In 2000-2001, 52,437 firms claimed the SBC or used the alternate tax rate method, reducing their tax liability by $157.9 million (see Exhibit 22, page 50). Smaller firms in the services, 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 2000-2001, 57,349 firms claimed a total of $79.3 million in unincorporated/S corporation credits.

Public Utility and Public Contribution Credits

The public utility credit is equal to 5 percent of the state utility tax imposed on certain public utility property up to a maximum of the total SBT liability. In 2000-2001, 51 firms (most in the communications and utilities industry) claimed public utility credits totaling $6.5 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 2000-2001, 1,653 firms claimed $2.0 million in public contribution credits.

Miscellaneous Credits

The SBT allowed many other minor credits in 2000-2001. In 2000-2001, the enterprise zone credit totaled approximately $0.8 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.

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. Apprenticeship credits totaled approximately $100,000. Public Act 273 of 2003 increased the apprenticeship credit to $4,000 for tool and die companies.

Exhibit 22
Other Major Tax Credits, 2000-2001

Business Sector	Small Business Credit/ Alternate Tax Rate		Unincorporated/ S Corp. Credit		Public Contributions/ Public Utility Credits	
	Number of Firms	Amount	Number of Firms	Amount	Number of Firms	Amount
Agriculture, Forestry, and Fishing	1,272	$3,301,328	1,082	$602,927	19	$6,618
Mining	143	615,975	140	325,884	n.a.	n.a.
Construction	7,610	20,808,773	7,175	8,134,764	146	180,228
Manufacturing	4,085	18,663,009	4,539	14,752,536	382	704,929
Other Durable Manufacturers	1,455	6,460,798	1,716	3,886,336	122	216,997
Non-Durable Manufacturers	966	3,646,929	1,032	4,213,809	115	240,659
Primary Metals	130	859,242	155	730,422	n.a.	n.a.
Fabricated Metals	678	3,401,817	759	2,894,656	67	109,748
Machinery--Except Electrical	738	3,780,681	697	1,824,597	57	88,184
Transportation Equipment	118	513,543	180	1,202,716	21	49,341
Transportation	1,433	5,253,022	1,263	1,509,463	34	34,232
Communications and Utilities	337	1,220,279	385	1,349,460	57	6,485,582
Wholesale Trade	1,243	3,284,752	1,632	3,369,417	95	88,608
Retail Trade	16,780	36,334,270	13,921	13,903,468	332	287,760
Finance, Insurance, and Real Estate	3,614	11,748,065	6,335	5,584,386	184	236,210
Services	14,226	52,747,646	17,139	25,903,950	410	392,957
Not Elsewhere Classified/Misc.	1,694	3,925,805	3,738	3,878,947	20	19,243
All Businesses	52,437	$157,902,922	57,349	$79,315,202	1,704	$8,479,498

Note: There were 9,876 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.

Per Rule 205.1003, "n.a." was used to protect the confidentiality of firms in this business classification. These firms were included in the column total.

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. Public Act 248 of 2003 expanded the definition of eligible business. Public Acts 249-251 extended MEGA's authority to award credits until December 31, 2009. While MEGA credits totaled $20.4 million for 2000, MEGA has awarded credits of $2.5 billion. MEGA estimates that the new investments will generate about 3½ times that amount in net new tax revenue.

A credit is available for 100 percent of the tax attributable to business activity in a renaissance zone. As of 2000, there were 11 renaissance zones in portions of 30 townships and cities. By 2004, there were 40 renaissance zones located in parts of 122 cities and townships. Renaissance SBT credits totaled approximately $5.7 million in tax year 2000. The Michigan Strategic Fund (MSF) may designate one of the five MSF renaissance zones as an alternative energy zone. The strategic fund is to designate one of the five MSF renaissance zones as a pharmaceutical renaissance zone. Public Act 622 of 2002 revised the methods for calculating renaissance zone credits so that the credits better reflect eligible business activity for each credit. Public Act 266 of 2003 allows for the creation of up to 20 tool and die renaissance zones.

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 provided a revised brownfield credit for projects approved by the state before 2003, with a greater maximum credit, and allowed credit for investment on blighted and functionally obsolete property in qualified local governmental units. Public Act 726 of 2002 extended the brownfield project approval deadline from January 1, 2003 to January 1, 2008. Brownfield credits totaled approximately $4.3 million in tax year 1999.

Under an alternative energy credit, eligible taxpayers may claim both a nonrefundable SBT credit, based on the increase in qualified business activity, and a refundable credit, based on the taxpayer's qualified payroll amount.

Taxpayers engaged in pharmaceutical research for tax years may claim a credit for 6.5 percent of the taxpayer's increased qualified pharmaceutical research expenses compared with their average qualified expenses from the same activity in the three preceding years.

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 2000-2001 (68.6 percent, see Exhibit 23, page 53). Corporations paying most SBT were in the manufacturing, services, and retail trade sectors. Individuals paid $33.0 million of the total SBT liability (1.6 percent) while S corporations accounted for $380.1 million (18.0 percent). Firms using other forms of business organization (fiduciary, professional corporations, partnerships, and limited liability companies) paid $249.4 million (11.8 percent) of 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 24 and 25, pages 54 and 55). As shown, effective tax rates were usually, but not always, significantly below the 2000-2001 nominal rate of 2.1 percent. For all firms, the average effective SBT rate was 1.3 percent. Values ranged from a high of 1.8 percent for wholesale trade firms with MTBs over $50 million to a low of 0.13 percent for firms in the retail trade 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 24). Exhibit 25 shows this trend as well. It compares overall effective tax rates with the effective tax rates for the manufacturing sector and the service providing sectors.[14] The effective tax rates for all three decline as the MTB decreases. This pattern held for all business sectors.

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[14]The service providing sector includes transportation; communications and utilities; wholesale trade; retail trade; finance, insurance, and real estate; and services sectors.

Exhibit 23
Single Business Tax by Type of Firm, 2000-2001

Business Sector	Individuals Number of Firms	Individuals Liability	S Corporations Number of Firms	S Corporations Liability	Corporations Number of Firms	Corporations Liability	Other* Number of Firms	Other* Liability
Ag., For., and Fishing	395	$873,303	865	$2,765,001	664	$4,370,229	329	$1,786,185
Mining	43	70,121	150	772,171	214	3,587,241	99	1,540,169
Construction	2,223	3,137,560	6,031	54,437,011	6,173	63,703,429	1,215	7,254,014
Other Durable Man.	169	164,007	1,671	24,130,318	3,436	133,340,089	373	4,000,798
Non-Durable Man.	115	259,029	1,011	19,228,425	2,166	147,616,279	204	14,795,433
Primary Metals	n.a.	n.a.	158	3,830,035	364	30,834,177	26	1,028,076
Fabricated Metals	38	74,237	801	20,650,759	1,359	43,712,954	65	1,496,890
Machinery--Exc. Electrical	42	50,563	696	11,766,604	1,388	52,389,851	115	1,491,716
Transportation Equipment	n.a.	n.a.	179	4,563,590	481	115,895,465	49	3,475,729
Transportation	335	313,711	1,441	7,258,070	1,908	37,172,757	350	4,341,432
Communications and Utilities	53	96,181	399	2,986,486	867	129,467,476	203	7,308,308
Wholesale Trade	188	440,472	1,648	20,596,430	3,223	81,784,465	290	4,421,289
Retail Trade	3,894	3,809,050	14,673	85,089,364	13,592	202,585,037	2,587	15,444,825
Finance, Ins., and Real Estate	1,789	4,976,539	3,031	14,310,487	3,115	99,666,391	8,627	25,678,193
Services	4,834	16,143,774	13,593	96,678,431	15,067	260,164,523	10,919	138,931,514
Not Elsewhere Class./Misc.	1,124	2,518,882	2,130	11,041,401	2,582	37,723,234	2,977	16,405,353
All Businesses	15,260	$32,965,164	48,477	$380,104,583	56,599	$1,444,013,597	28,428	$249,399,924

* Includes fiduciary companies, professional corporations, partnerships and limited liability companies.
Per Rule 205.1003, "n.a." was used to protect the confidentiality of firms in this business classification. These firms were included in the column total.

Source: Tax Analysis Division, Michigan Department of Treasury.

Exhibit 24
Ratio of Tax Liability to Michigan Tax Base, 2000-2001

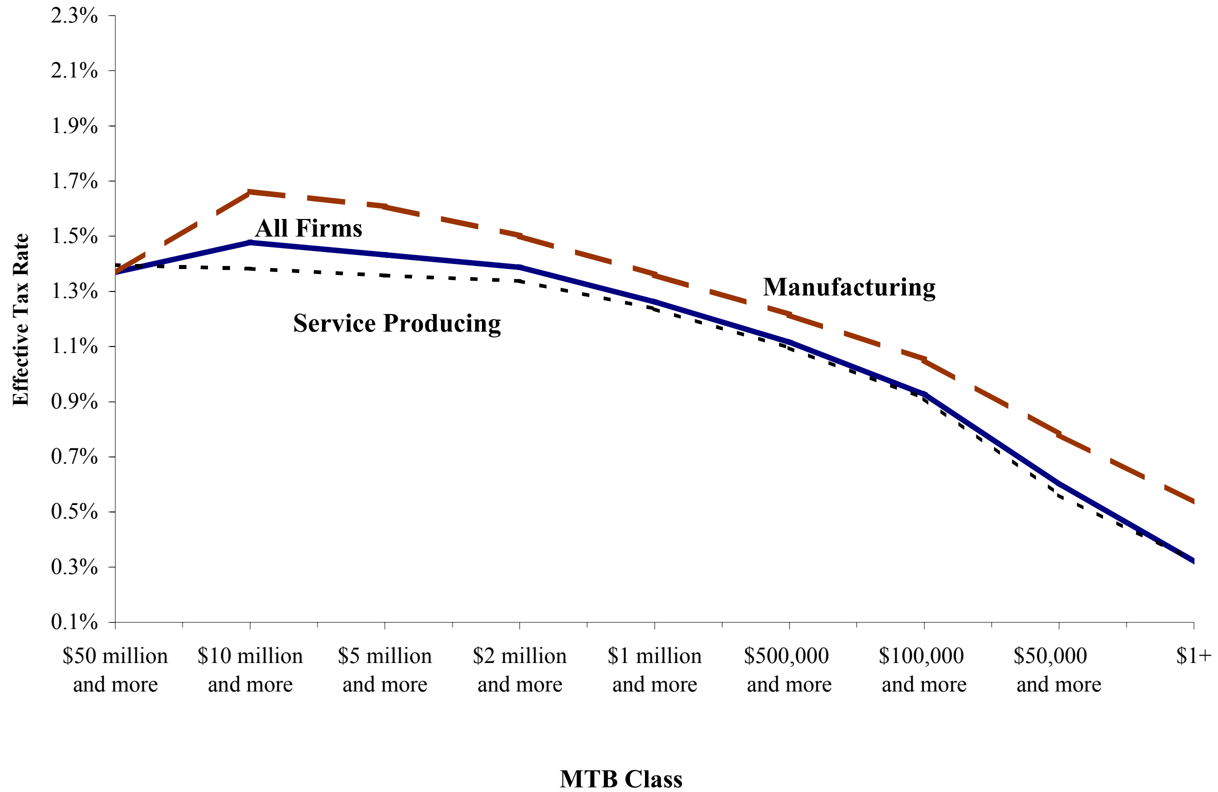
Business Sector	All Businesses	$50,000,000- and more	$10,000,000- $49,999,999	$5,000,000- $9,999,999	$2,000,000- $4,999,999	$1,000,000- $1,999,999	$500,000- $999,999	$100,000- $499,999	$50,000- $99,999	$1- $49,999
Agriculture, For., and Fishing	1.10%	n.a.	n.a.	n.a.	1.21%	1.24%	1.05%	0.80%	0.41%	0.23%
Mining	1.29%	n.a.	n.a.	1.36%	1.20%	1.17%	1.05%	0.62%	0.56%	0.22%
Construction	1.28%	n.a.	1.46%	1.47%	1.42%	1.25%	1.12%	0.89%	0.65%	0.17%
Other Durable Manufacturers	1.55%	1.70%	1.66%	1.60%	1.52%	1.38%	1.25%	1.10%	0.81%	0.48%
Non-Durable Manufacturers	1.65%	1.72%	1.72%	1.66%	1.57%	1.48%	1.25%	1.08%	0.74%	0.39%
Primary Metals	1.51%	n.a.	1.47%	1.63%	1.56%	1.19%	1.19%	1.02%	0.98%	0.43%
Fabricated Metals	1.50%	n.a.	1.70%	1.57%	1.43%	1.32%	1.18%	0.98%	0.55%	0.45%
Machinery--Exc. Electrical	1.49%	n.a.	1.56%	1.56%	1.46%	1.28%	1.12%	0.95%	0.95%	0.30%
Transportation Equipment	1.15%	1.02%	1.63%	1.61%	1.44%	1.37%	1.35%	1.04%	0.73%	0.62%
Transportation	1.33%	n.a.	1.45%	1.39%	1.41%	1.23%	1.03%	0.80%	0.62%	0.34%
Communications and Utilities	1.45%	1.54%	1.20%	1.28%	1.31%	1.12%	1.15%	0.88%	0.78%	0.54%
Wholesale Trade	1.62%	1.82%	1.66%	1.67%	1.64%	1.60%	1.40%	1.25%	0.93%	0.42%
Retail Trade	1.39%	1.63%	1.62%	1.59%	1.51%	1.38%	1.13%	0.83%	0.52%	0.13%
Finance, Ins.,and Real Estate	1.05%	1.14%	1.18%	1.24%	1.17%	0.93%	0.83%	0.74%	0.46%	0.34%
Services	1.19%	1.20%	1.31%	1.20%	1.23%	1.19%	1.13%	0.99%	0.60%	0.24%
Not Elsewhere Classified/Misc.	1.15%	0.80%	1.30%	1.27%	1.41%	1.21%	1.14%	1.06%	0.92%	0.45%
All Businesses	1.32%	1.37%	1.48%	1.43%	1.39%	1.26%	1.12%	0.93%	0.60%	0.32%

Notes: Does not include gross receipts short method filers or simplified return filers.

Per Rule 205.1003, "n.a." was used to protect the confidentiality of firms in this MTB category. These firms were included in column and row averages.

Source: Tax Analysis Division, Michigan Department of Treasury.

Exhibit 25
Effective Rates, 2000-2001



Source: Tax Analysis Division, Michigan Department of Treasury.

Compared to tax year 1999, the overall tax year 2000 effective rate fell as a result of the 0.1 percentage point reduction in the nominal SBT rate. For firms with MTB of $100 million or more, the ITC provided the largest effective reduction in their MTB (19.7 percent). Firms with MTBs between $50 million and $100 million used the gross receipts reduction and excess compensation reduction more frequently to reduce their tax bases (13.7 and 8.2 percent, respectively). Firms with MTBs between $5 million and $50 million relied on the gross receipts reduction or the excess compensation reduction. Firms with MTBs between $100,000 and $5 million relied heavily on the small business credit and the excess compensation reduction. Very small firms relied on the statutory exemption to reduce most of their MTB. See Exhibit 26.

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.

Exhibit 26
Tax Adjustments as a Percent of Michigan Tax Base, 2000-2001

Michigan Tax Base Class			Net Capital Acquisition Deduction*	Business Loss Deduction	Statutory Exemption*	Gross Receipts Reduction	Excess Compensation Reduction	Investment Tax Credit**	Small Business Credit**	Other Credits***
$100,000,000	-	and over	-3.82 %	n.a.	0.00 %	8.19 %	5.50 %	19.74 %	0.00 %	2.08 %
$50,000,000	-	$99,999,999	-1.19	n.a.	0.01	13.66	8.18	6.53	0.00	1.88
$10,000,000	-	$49,999,999	-0.93	3.94	0.03	9.47	10.23	4.05	0.00	3.03
$5,000,000	-	$9,999,999	-1.02	3.46	0.08	7.85	11.61	2.63	1.95	3.75
$2,000,000	-	$4,999,999	-1.21	3.64	0.17	7.80	13.03	2.21	3.45	3.70
$1,000,000	-	$1,999,999	-1.38	4.83	0.39	7.71	13.21	2.31	7.92	3.22
$500,000	-	$999,999	-1.84	6.17	0.89	7.59	12.04	2.63	12.93	3.19
$100,000	-	$499,999	-2.16	7.88	5.18	6.14	8.47	4.39	17.80	3.41
$50,000	-	$99,999	-5.46	12.41	36.81	1.23	6.49	5.85	10.34	2.88
$1	-	$49,999	-18.30	19.38	71.41	2.63	2.58	-1.09	9.92	2.23
		Total	-2.06 %	4.38 %	1.08 %	8.70 %	10.23 %	7.07 %	4.95 %	3.16 %

* Effective deductions and exemptions only.

** Claimed credits were divided by the tax rate (.021) to allow for a comparison to other deductions, exemptions and reductions.

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

Per Rule 205.1003, "n.a." was used to protect the confidentiality of firms in this MTB category.

These firms were included in column average.

Source: Tax Analysis Division, Michigan Department of Treasury.

Other Measures of Liability

To provide a clearer understanding of the magnitude of SBT liabilities, Exhibit 27 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 from the sales factor. However, Exhibit 27 does allow for a general comparison of SBT costs relative to other costs incurred by firms.

Exhibit 27
SBT Liability Statistics, 2000-2001

	All Businesses		Michigan-Only Businesses	
Business Sector	**Liability as a % of Apportioned Compensation***	**Liability as a % of Apportioned Gross Receipts****	**Liability as a % of Compensation***	**Liability as a % of Gross Receipts****
Agriculture, Forestry, and Fishing	1.51 %	0.40 %	1.32 %	0.36 %
Mining	2.06	0.18	1.76	0.39
Construction	1.58	0.35	1.54	0.35
Manufacturing	1.92	0.40	1.56	0.42
Other Durable Manufacturers	1.99	0.47	1.52	0.38
Non-Durable Manufacturers	2.41	0.43	1.66	0.42
Primary Metals	1.84	0.38	1.47	0.33
Fabricated Metals	1.98	0.53	1.62	0.51
Machinery, Except Electrical	1.83	0.48	1.55	0.51
Transportation Equipment	1.46	0.26	1.37	0.26
Transportation	1.77	0.47	1.35	0.28
Communications and Utilities	3.39	0.57	4.23	0.74
Wholesale Trade	2.37	0.21	1.87	0.21
Retail Trade	1.81	0.19	1.55	0.19
Finance, Ins., and Real Estate	1.79	0.22	1.93	0.32
Services	1.47	0.45	1.34	0.50
Not Elsewhere Classified/Misc.	2.01	0.34	1.72	0.32
All Businesses	1.81 %	0.33 %	1.64 %	0.34 %

* 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: Tax Analysis Division, Michigan Department of Treasury.

On average, in 2000-2001 the SBT equaled approximately 0.33 percent of sales and 1.81 percent of compensation. In other words, the SBT is substantially less than half a cent per dollar of sales and slightly less than 2.0 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 27. To address this concern, Exhibit 27 also presents similar measures for 100 percent Michigan firms. For these firms, the SBT is 0.34 percent of sales and 1.64 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, the compensation result is 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 from corporations other than S corporations. Exhibit 28 (page 60) presents the total liability of corporate SBT payers for 1977 through 2000 and the total taxable income derived from professional and other corporations that paid the Michigan SBT in each year, which is the tax base of a standard CIT. The SBT rate has varied from 2.35 percent to 2.1 percent over this period and the current rate is 1.9 percent. The corporate SBT revenues have been adjusted to a constant 1.9% rate. Dividing the adjusted corporate SBT liability by the total taxable income of corporations for each year provides a rate that varies from as low as 5.3 percent in 1977, up to 12.7 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 today from corporations based on history from 1977 until 2000 would be 7.19 percent. This rate is not much higher than the CIT rates imposed by many other states (see Exhibit 29, page 61).

There are three reasons why this rate is lower than the CIT rates published in previous reports. First, the 7.19 percent rate does not replace 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. Second, the CIT rates published in previous reports were calculated to replace the SBT at rates up to 2.35%, not the current 1.9% rate. Third, previous estimates assumed that all business losses were eventually used to offset positive income. In fact, U.S. Department of Treasury data suggest that up to half of losses are never used to offset positive income. This analysis uses only positive business income and reduces that income by five percent to reflect subsequent years' net operating losses carried back against that income. The revenue neutral rate is likely higher than the 7.19 percent estimate because the nexus standard applied to the SBT is broader than the one applied to a state corporate income tax. Thus, certain corporations may be taxable under the SBT but would not be taxable under a corporate income tax.[15]

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[15]For SBT nexus standard, see page 19.

When simply comparing the FY 2002 corporation tax burden among all 50 states on a per-person basis and as a percent of personal income, Michigan ranks eighth and ninth highest, respectively. This ranking reduces SBT revenue by 31.4 percent, the portion of tax paid by unincorporated firms and S corporations.

The Council on State Taxation (COST) has published a more sophisticated study (Exhibit 30) that provides a more comprehensive method of comparing state business tax burdens than the cursory corporation tax burden comparison. Unlike that comparison, the COST study includes gross receipts based taxes such as Washington's Business and Occupation tax and other business taxes not specifically levied on corporations. The COST study takes into account businesses' share of sales and use tax. The simpler comparison does not. Finally, the COST study looks at both state *and* local taxes. The simpler comparison looks only at state taxes. Therefore, the COST study provides a more accurate analysis of the tax burdens that face a business operating in any particular state.

The COST study finds Michigan's total state/local business tax burden tied for 15th lowest as a percent of private sector gross state product and ranked 16th lowest as a percent of personal income. Because business taxes other than corporate taxes comprise a larger share of most other states' business taxes, Michigan's total state/local business tax ranking is more favorable than Michigan's corporate tax ranking.

Exhibit 28
Comparing SBT With a Corporate Income Tax
(Corporations Only *)

Year **	Total Liability at 1.9% Rate	Total Taxable Income ***	CIT Rate
1977	$647,577,792	$12,168,649,001	5.32 %
1978	700,856,150	11,977,996,752	5.85
1979	730,562,728	12,880,516,215	5.67
1980	661,271,388	11,989,232,307	5.52
1981	731,729,229	12,648,764,583	5.78
1982	719,181,057	11,109,790,807	6.47
1983	845,932,967	12,814,803,591	6.60
1984	1,004,004,863	18,848,672,953	5.33
1985	1,066,578,413	18,817,638,411	5.67
1986	n.a.	n.a.	n.a.
1987	1,117,922,999	19,438,638,420	5.75
1988	1,171,743,826	19,408,109,349	6.04
1989	1,130,192,778	15,722,391,974	7.19
1990	1,079,489,135	13,576,515,600	7.95
1991	1,045,750,823	10,315,374,744	10.14
1992	1,325,205,302	10,446,537,766	12.69
1993	1,228,941,591	11,696,248,261	10.51
1994	1,401,418,102	17,162,481,983	8.17
1995	1,339,599,197	16,790,720,391	7.98
1996	1,342,092,834	17,251,073,219	7.78
1997	1,472,360,306	17,963,112,428	8.20
1998	1,505,380,573	19,188,102,281	7.85
1999	1,391,886,296	17,908,093,758	7.77
2000	1,365,382,193	17,939,140,819	7.61
Average	$1,088,046,110	$15,133,156,766	7.19 %

* 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 times Apportionment factor, setting negative income to $0. Also, only Professional Corporations and Other Corporations were used to calculate the Taxable Income. **Does not include corporations with negative business income.**

Source: Tax Analysis Division, Michigan Department of Treasury.

Exhibit 29
States With a Corporate Income Tax:
TY 2004 Highest Marginal Rate for Each State*

State	Rate	State	Rate
Alabama	6.5 %	Mississippi	5.0 %
Alaska	9.4	Missouri	6.25
Arizona	6.968	Montana	6.75 (5)
Arkansas	6.5	Nebraska	7.81
California	8.84	New Hampshire	8.5 (6)
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	7.0
Hawaii	6.4	Ohio	8.5
Idaho	7.6	Oklahoma	6.0
Illinois	7.3 (1)	Oregon	6.6
Indiana	8.5	Pennsylvania	9.99
Iowa	12.0	Rhode Island	9.0
Kansas	4.0 (2)	South Carolina	5.0
Kentucky	8.25	Tennessee	6.5
Louisiana	8.0	Utah	5.0
Maine	8.93	Vermont	9.75
Maryland	7.0	Virginia	6.0
Massachusetts	9.5 (3)	West Virginia	9.0
Minnesota	9.8 (4)	Wisconsin	7.9

* As of January 1, 2004

(1) Includes a 2.5 percent personal property replacement tax.
(2) Plus a surtax of 3.35 percent taxable income in excess of $50,000.
(3) Includes a 14 percent surtax, as does the following: an additional tax of $7.00 per $1,000 on taxable tangible property (or net worth allocable to MA, for intangible property corporations).
(4) Plus a 5.8 percent tax on any Alternative Minimum Taxable Income over the base tax.
(5) A 7 percent tax on taxpayers using water's edge combination.
(6) Plus a 0.50 percent tax on the enterprise base (total compensation, interest, and dividends paid).

Source: RIA Checkpoint and Federation of Tax Administrators (for select notes).

Exhibit 30

State and Local Business Taxes as a Percent of Gross State Product (GSP) and Personal Income

COST Study, FY 2004

State	State and Local Business Taxes (billions)	Effective Tax Rate (Percent of Private Sector GSP	Rank	Personal Income (billions)	State and Local Business Taxes as a Percent of Personal Income	Rank
Alabama	4.4	4.0%	40	124.1	3.5%	49
Alaska	1.9	7.6%	2	22.0	8.6%	2
Arizona	7.4	4.7%	23	157.2	4.7%	21
Arkansas	2.8	4.2%	37	68.6	4.1%	38
California	57.1	4.5%	24	1,219.3	4.7%	23
Colorado	6.3	3.8%	42	161.4	3.9%	43
Connecticut	6.0	3.8%	42	153.8	3.9%	44
Delaware	1.6	3.5%	49	28.9	5.5%	9
Florida	24.3	5.0%	19	528.1	4.6%	27
Georgia	10.5	3.8%	42	257.9	4.1%	39
Hawaii	1.9	5.2%	16	39.1	4.9%	18
Idaho	1.4	4.2%	37	36.5	3.8%	45
Illinois	21.7	4.8%	22	425.7	5.1%	15
Indiana	8.4	4.3%	33	183.1	4.6%	28
Iowa	4.0	4.4%	31	86.7	4.6%	26
Kansas	4.2	5.3%	14	82.0	5.1%	13
Kentucky	4.6	4.2%	37	112.1	4.1%	37
Louisiana	7.2	6.0%	5	121.4	5.9%	5
Maine	2.0	5.8%	7	39.2	5.1%	14
Maryland	7.7	4.4%	31	212.1	3.6%	48
Massachusetts	10.5	3.9%	41	260.4	4.0%	40
Michigan	**14.0**	**4.3%**	**33**	**320.7**	**4.4%**	**35**
Minnesota	8.6	4.5%	24	177.3	4.9%	19
Mississippi	3.4	5.7%	9	69.5	4.9%	17
Missouri	6.5	3.8%	42	171.8	3.8%	46
Montana	1.1	5.4%	12	24.1	4.6%	31
Nebraska	2.9	5.2%	16	53.5	5.4%	11
Nevada	3.5	4.5%	24	74.6	4.7%	22
New Hampshire	2.3	5.1%	18	46.5	4.9%	16
New Jersey	15.4	4.3%	33	349.8	4.4%	34
New Mexico	2.7	5.9%	6	48.5	5.6%	8
New York	42.0	5.7%	9	703.6	6.0%	4
North Carolina	9.6	3.5%	49	242.6	4.0%	41
North Dakota	1.1	6.2%	4	19.1	5.8%	6
Ohio	16.0	4.5%	24	350.7	4.6%	32
Oklahoma	4.4	5.4%	12	96.2	4.6%	30
Oregon	3.9	3.7%	46	105.0	3.7%	47
Pennsylvania	18.2	4.5%	24	403.1	4.5%	33
Rhode Island	1.7	5.0%	19	35.3	4.8%	20
South Carolina	4.6	4.3%	33	111.0	4.1%	36
South Dakota	1.2	5.3%	14	22.9	5.2%	12
Tennessee	8.0	4.5%	24	171.9	4.7%	25
Texas	41.5	5.8%	7	666.3	6.2%	3
Utah	2.4	3.7%	46	61.4	3.9%	42
Vermont	0.9	5.0%	19	19.7	4.6%	29
Virginia	9.0	3.6%	48	255.9	3.5%	50
Washington	11.9	5.7%	9	208.1	5.7%	7
West Virginia	2.5	6.5%	3	45.6	5.5%	10
Wisconsin	8.0	4.5%	24	171.8	4.7%	24
Wyoming	1.7	9.1%	1	16.8	10.1%	1
United States	$445.2	4.7%		$9,362.8	4.8%	

Source: Council on State Taxation Special Report, *Total State and Local Business Taxes* , April 12, 2005.

APPENDIX

QUESTIONS AND ANSWERS

ON THE SBT

Tax Analysis Division
Michigan Department of Treasury
February 2006

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. A gross receipts reduction assures that no firm pays on a tax base greater than half of adjusted gross receipts. The SBT provides an Investment Tax Credit. In addition, the SBT excludes FICA, unemployment, and worker's compensation and a portion of health care payments 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 SBT 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. On January 1, 2002, the SBT rate was reduced to 1.9 percent. Because the BSF balance fell below $250 million by the end of FY 2002, the SBT rate remained unchanged at 1.9 percent in 2004. The rate will remain at 1.9 percent until the BSF fiscal year ending balance exceeds $250 million. Public Act 531 of 2002 repeals the SBT entirely for tax years beginning after December 31, 2009.

For tax year 2000-2001, the tax after deductions and credits actually averages about 1.3 percent of the firm's total Michigan tax base. Data suggest that the SBT averages about 0.33 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 2004, the SBT cannot exceed 0.95 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. Between 1995 and 2002, inclusive, businesses did not owe SBT and did not need to file an SBT return if their adjusted gross receipts were under $250,000. In tax year 2000, only 108,000 of the approximately 250,000 businesses doing business in Michigan owed any SBT. Beginning 2003, the gross receipts filing threshold increases to $350,000 from $250,000. With this increase, approximately 13,000 firms 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 70). The SBT calculates 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 was 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.

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 $5.0 million, use an ITC rate of 0.85 percent. Firms with adjusted gross receipts above $2.5 million up to $5.0 million use an ITC rate of 1.00 percent. Firms with adjusted gross receipts above $1.0 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.

For example, assume a Michigan firm has a tax base of $400,000. In the example, the firm's excess compensation deduction percentage equals 16 percent (see below). If the firm invests $20,000, then its investment tax credit equals $420 ($20,000 times 2.3 percent times (2.1 percent/2.3 percent) times (100% -16%) = $20,000 times 2.1 percent times 84 percent) in tax year 2000-2001. Thus, the firm's ITC equals $353, rounded to the nearest dollar. This example is shown on page 70.

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 1.1 percent in tax year 2000.

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 and compensation of $316,000. 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. The reduction then is $400,000*0.16, or $64,000, leaving a reduced base of $336,0000 and a tax liability (before credits) of $7,056. This example is shown on page 70.

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 10.2 percent in tax year 2000.

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, plus any loss carryovers or carrybacks.

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. The small business credit is applied to the calculated SBT after the investment tax credit.

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 55.6 percent, and the firm receives a 44.4 percent credit or $2,976. Hence, the SBT liability after the SBC is $6,703 minus $2,976, or $3,727, equal to 3.73 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 2 percent for tax years beginning after September 1994. In the case described above, the alternate tax liability for 1999 would be $2,000 ($100,000*2%). Because the alternate credit provides a lower tax liability, the taxpayer in this example would pay based on the alternate tax method and receive a $4,703 alternate credit.

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 approximately 50,000 firms qualifying for the SBC/alternate credit, 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. It remains to be seen whether this change will affect the level of investment in Michigan.

For Michigan only firms the ITC results in the same SBT as the CAD if and only if the firm's AGR is $1 million or less. For all Michigan only firms with AGR over $1 million, the ITC implies a smaller capital investment incentive than a CAD would.

For multistate firms of any size, the ITC may result in a tax that is higher, the same or less than with a national apportioned CAD. For a firm filing using the straight calculation method: (1) If the firm's share of investment in Michigan equals its apportionment factor divided by the ratio of its ITC rate and SBT rate, then the SBT under the ITC equals the SBT under a national apportioned CAD. (2) If the Michigan share is smaller, then the ITC yields a larger SBT than under a national apportioned CAD. (3) If the Michigan share is larger, then the ITC yields a smaller SBT than under a national apportioned CAD.

Thus, even if a multistate firm has an AGR over $5 million, if its share of Michigan investment is high enough (equal to the firm's apportionment factor divided by about 0.37), then its SBT under the ITC equals that under a nationally apportioned CAD. If the Michigan share is higher, then the firm's SBT is less than under a nationally apportioned CAD. If the Michigan share is lower, then the firm's SBT is more than under a nationally apportioned CAD. (Note: 0.37 approximately equals 0.85/2.30).

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. See page 16 for a history of SBT apportionment.

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 2.3 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:	Compensation. Wages, salaries and benefits, excluding FICA, Unemployment Insurance and Worker's Compensation. Federal Taxable Income. Net Interest Paid. Interest paid less interest received. Depreciation. As claimed on federal income tax return.
Equals:	Tax Base.
Multiplied by:	Apportionment Factor.** The weighting of the sales (90 percent), property (5 percent) and payroll (5 percent) factors. Payroll Factor. Proportion of total payroll in Michigan. Property Factor. Proportion of total property in Michigan. Sales Factor. Proportion of total sales in Michigan.
Equals:	Apportioned Tax Base or Michigan Tax Base.
Minus:	Capital Acquisition Deduction (CAD). 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)). Statutory Exemption. 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:	Excess Compensation Reduction. 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:	2.1 percent tax rate. (See pages 27, 28 and 65.)
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	+ 19,000
Tax Base	400,000
Adjusted Tax Base	400,000
Excess Compensation Reduction	- 64,000
Reduced Tax Base	336,000
Tax Rate**	x .0210
Tax Before Credits	7,056
Alternate Credit	- 5,056
Tax After Credit	$2,000

Excess Compensation Calculation

$316,000 / $400,000	=	79%
		- 63%
		16%
16% x $400,000	=	$64,000

Small Business Credit (SBC)

Profits	$ 30,000
Compensation to Owners	70,000
Adjusted Business Income (ABI)	$ 100,000

SBC = 100% - $100,000 / (45% x $400,000)
= 100% - 55.6%
= 44.4% x $6,703
= $2,976

Investment Tax Credit

Adjusted Gross Receipts $500,000
Investment in Michigan $20,000
Investment Tax Credit = $20,000 x.021
= $420 x (1-16%)
= $353

Tax After ITC = $7,056 - $353
= $6,703

Alternate Tax Credit - $4,703

Tax After Credit $2,000

Alternate Tax = 2.0% * ABI
= 2.0% * $100,000
= $2,000

Alternate Credit = $6,703 - $2,000
= $4,703

* 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 January 1, 2000, the tax rate is 2.1 percent.