
Michigan League for Human Services



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Michigan's Single Business Tax: Should it Be Replaced or Reformed?

In 1975 the Michigan legislature adopted Public Act 228, the Single Business Tax (SBT) Act, which replaced seven existing taxes on business income, property, inventories, etc. The primary motivation behind this major reform, which was spearheaded by then Management and Budget Director Gerald Miller with strong support from Governor William Milliken, was the recognition that the existing tax structure resulted in dramatic fluctuations in related revenue in direct relation to the business cycle. The truism that, “when the economy catches a cold, Michigan gets pneumonia,” was again illustrated in the recession of 1974-1975, as corporate income taxes declined by over 34 percent from their 1973 level. This dramatic revenue decline occurred just as the demand for government services to address economic dislocations was at its peak. The SBT was seen as a strategy intended to insulate state revenues from the cyclical swings typical of a durable goods based economy and assure the availability of the resources needed to address and counter the effects of an economic downturn.

Twenty-eight years after its adoption, Michigan’s Single Business Tax remains the only major value-added tax (VAT) in the United States. As discussed in the Michigan Department of Treasury’s July 2002 analysis of the Single Business Tax, value-added taxation is a completely different approach to raising tax revenue because it uses the value firms add to products, the sales price less the cost of materials, as the tax base. The report further notes that the value add within a specified jurisdiction, such as a state, provides a good measure of business activity and thus of government services a firm consumes over the tax year. The value-added tax is, therefore, a major departure from the concept that taxes should be based on net profits to the equity theory that businesses should pay for “services consumed” or “benefits received.” This shift was viewed as leveling the playing field for all forms of business, and as a move away from a tax theory that effectively penalized businesses for being profitable.

In addition to the revenue stability and equity arguments noted above, the authors of Michigan’s SBT contended that it would simplify and reduce the cost of business tax preparation and processing by consolidating the administration of the seven pre-existing taxes into one office within the Michigan Department of Treasury. Providing businesses with a centralized, coordinated entity responsible for the timely and consistent development of policies and forms, responses to tax payer inquiries, and processing of returns was assumed to be a benefit both to the state and its business community.

Another benefit of the Single Business Tax, which became evident as most other states saw revenues from business taxes decline precipitously during the economic boom of the 1990s, was its relative insusceptibility to the offshore and out-of-state gamesmanship increasingly played by companies like Enron and WorldCom in the last decade. As originally enacted, the SBT was based evenly in one-third increments on a company’s sales, property value and payroll in the State of Michigan. This basis for taxation made the transfer or hiding

of business profits irrelevant, and was responsible, at least in part, for one of the most stable business revenue climates in the United States since its inception.

Michigan has, however, undertaken its own gamesmanship. Beginning in 1991 the weighting of the SBT has shifted rapidly away from the payroll and property factors to in-state sales. By 1999 fully 90 percent of the tax was based on sales while payroll and property values each contributed 5 percent to the base. This had the effect of dramatically shifting the tax burden to out-of-state businesses selling products here. Because this strategy gives out-of-state companies a significant incentive to produce goods in Michigan, it certainly must be viewed as a government strategy to promote investment and job growth. The July 2002 Department of Treasury report notes, however, that at least ten other states have also adjusted their business tax strategies to more heavily tax out-of-state companies. It is also worth noting that Michigan's dramatic shift to sales as the basis for the SBT substantially undermines the goal of revenue stability. While property values and employment levels tend to lag behind the business cycle, sales can fluctuate quite significantly in the short-run, resulting in unanticipated revenue fluctuations.

Another major objective of the Single Business Tax that has been significantly compromised in the years since its passage is the goal of simplification. The related tax code has been amended almost annually since its creation and the exclusions, credits, and disregards now total approximately one-third of the potential tax base. While most of these amendments were intended to address various perceived inequities, or as noted above, support in-state businesses and encourage business growth, they also added to the perception that the Single Business Tax has become hopelessly and needlessly complex.

Another perception of the Single Business Tax is that it unfairly burdens small businesses in Michigan. However, the 2002 Department of Treasury report notes that only 36 percent of Michigan businesses typically have an SBT liability and that in 1999 over 91 percent of SBT tax revenues came from the 18 percent of businesses with a liability of over \$10,000. An effort to further reduce the burden of the SBT tax on small businesses resulted in an increase in the filing threshold from \$250,000 to \$350,000 in gross receipts beginning in FY2003.

In July 1999 the legislature acted to phase-out Michigan's Single Business Tax in 0.1 percent increments over a twenty-three year period retroactive to January of that year. From FY1999 through FY2003, as the SBT tax rate was reduced from 2.3 percent to 1.9 percent, the Senate Fiscal Agency indicates that related revenues declined by \$1.425 billion, equivalent to over 45 percent of the estimated \$3.15 billion in revenue shortfalls the State of Michigan incurred from FY2001 through FY2003. In addition to the phase-out formula, Public Act 115 of 1999 also contained a provision that required the pausing of the SBT phase-out if the state's Budget Stabilization Fund balance fell below \$250 million.

In FY2003 it was determined that revenues had deteriorated so significantly that the state's Budget Stabilization Fund would fall below the \$250 million phase-out trigger and further rate reductions were paused. At the same time, however, legislation was enacted that would eliminate the Single Business Tax in its entirety in FY2009. While no circuit breaker permitting the retention of the Single Business Tax in a fiscal crisis was included in this legislation, there was general agreement that an alternative tax package of some kind would be needed to replace at least a portion of the 10 percent of total state revenues and 25 percent of General Fund revenues (approximately \$2.0 billion) currently provided by the SBT.

Since adoption of the SBT sunset legislation, discussions regarding amendments that would further reduce the burden of the SBT on business in the interim have been ongoing. Of particular note is a proposal

under consideration by the Senate Finance Committee that would allow the deductibility of company sponsored health care insurance from the SBT tax base. While the stated purpose of such a deduction is to encourage businesses to provide insurance packages to their employees, Department of Treasury data suggests that the estimated \$126 million in annualized tax reductions would benefit primarily large corporations already providing their employees with insurance coverage.

While there is considerable support within the business community for eliminating the SBT, there is not necessarily unanimity. In an article entitled The SBT: A Tax Whose Time Has Gone, or Has It?, printed in the March 2003 edition of *Michigan Forward*, a Michigan Chamber of Commerce periodical, Steven E. Grob, C.P.A. and a member of the Dykema Gossett Taxation and Estates Practice Group, indicates in a Member Viewpoint column that the Single Business Tax has performed as advertised. He notes that the SBT was intended to “provide a fairly predictable source of revenue for the state that would not be subject to extreme fluctuations of economic cycles”, and in that regard it “has delivered exactly what it was intended to do. Revenue projections have been accurate to within a few percentage points per year.” This is in sharp contrast to the taxes that it replaced, which were particularly susceptible to economic fluctuations. As noted in the Michigan Department of Treasury’s report on the SBT, business tax revenues either rose or fell by over 15 percent in each of the five years immediately preceding its adoption. With regard to the issue of complexity, Mr. Grob notes that the seven taxes that it replaced “were viewed to be complex and unduly burdensome.” He indicates that the original SBT Act “was intricate and a multitude of subsequent amendments make it a challenge to understand.” In conclusion, he notes, “everyone hates taxes and the SBT has become the rallying cry for tax reform. However, as people begin to take a hard look at the alternatives, it’s unclear that a consensus of opinion will emerge as to the appropriate replacement tax or taxes, and with hindsight the imperfect SBT may not look all that bad.”

For Michigan citizens facing the possible loss of an additional \$1 billion in state funded services and a like amount of programming supported with matching federal funds, on top of the \$2 billion in reductions instituted since FY2002, a modified or alternative tax is of critical importance. The question state leaders must answer between now and FY2009 is to what extent they can or should rely on the state’s businesses to contribute to the costs of government services consumed by those businesses, their employees and dependents. During this period of significantly increasing international and state versus state competition for a limited number of well paying manufacturing and service sector jobs, the answer to that question requires a careful weighing of business, government and citizen interests.