



Michigan League FOR Human Services

July 6, 2007

Agreement Reached on Single Business Tax Replacement

FY2008 Budget Discussions To Resume After One Week Recess

As the legislature prepared to begin a one week Fourth of July recess, final agreement was reached on the specifics of the Michigan Business Tax (MBT), a re-write of the tax code intended to fully replace the \$1.9 billion in revenues currently linked to existing business property taxes and the soon-to-expire Single Business Tax (SBT). After more than a year of hearings and debate on a series of alternative proposals, the Legislature adopted a revenue-neutral tax plan under which an estimated 72 percent of Michigan businesses should see an overall tax decrease, with the big three auto makers and other large manufacturers receiving the most significant tax relief. At least partially offsetting state revenue losses associated with these tax reductions were rate increases of approximately 17 percent for insurance companies and other financial services industry businesses. During the debate over the details of the Michigan Business Tax it was also suggested that a significant portion of the related tax burden would be shifted to out-of-state businesses, although the actual value of such a shift remains the subject of speculation and possible legal action.

As part of the final Michigan Business Tax agreement, negotiators settled on a replacement that relies primarily on a gross receipts tax of .8 percent applied to the difference between a company's sales receipts and their production costs (value added), and about one-third on a 4.95 percent business income tax. While the new Michigan Business Tax shares two notable similarities with the expiring Single Business Tax (it is in large measure a value added tax and it remains unique among the fifty states), the base on which business taxes will be calculated will no longer include payroll—that component of the expiring SBT having been criticized as a disincentive for businesses considering moving to or expanding in Michigan.

A significant factor in reaching a final agreement on the new tax was the resolution of concerns raised by building contractors that their tax liability could quadruple if they were prevented from deducting subcontractor and tangible property costs from their gross receipts. Similarly, advocates for limited liability partnerships raised concerns that under the proposal they would be precluded from deducting compensation payments for their partners. In the final bill, language was added to address both of these issues.

1115 SOUTH PENNSYLVANIA AVENUE • SUITE 202 • LANSING, MICHIGAN 48912

517.487.5436/PHONE • 517.371.4546/FAX • WWW.MILHS.ORG

A UNITED WAY AGENCY

In addition to the gross receipt and income tax rates cited above, the MBT agreement details a series of major tax credits related to property, compensation and capital assets that are intended to reward and promote investment in Michigan. To offset the negative impact those credits would have on the tax base and revenues of local units of government, a portion of MBT proceeds are earmarked as replacement revenue in an effort to hold those entities harmless.

The Michigan Business Tax agreement also establishes a revenue growth limit over the first three years of its existence. In the first year any revenues in excess of the base plus 5 percent would be split, with half being returned to contributing businesses and half deposited in the state's now depleted Budget Stabilization Fund. In the second and third years the limit would be pegged at 1 percent plus the percentage growth in the state's personal income. In the fourth and subsequent years no limit on revenue growth was specified.

Regarding a series of other concerns raised in the month since the tentative agreement was announced, officials indicated that appropriate technical fixes would be enacted in time to be effective with MBT implementation in January.

No contingency plans were specified in the agreement to address the budgetary shortfall that would result should revenues from the new Michigan Business Tax come in below expectations.

FY2008 Revenue and Budget Negotiations

As the final details of the Single Business Tax replacement package were being hammered out, the House appropriations committees responsible for Department of Community Health and the Department of Corrections budgets completed their work and forwarded their recommendations to the Senate. These budget recommendations were developed, however, without benefit of a spending target linked to expected FY2008 state revenues. Negotiations over how the state will resolve a FY2008 deficit estimated to total at least \$1.6 billion have been slowed at least in part by the ongoing debate over the SBT replacement. With that issue resolved, the issue of future revenues and/or reductions will take center stage as the legislature returns from an abbreviated summer recess to address what many believe is the worst fiscal crisis Michigan has faced in over half a century.