The MBT- Changing Business Taxes in Michigan

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Setting the Stage

- Single Business Tax (SBT) - a consumption value added tax consisting of income plus compensation plus depreciation plus interest paid with other deductions and adjustments.
- Originally scheduled to expire at the end of 2009.
- Repealed at the end of 2007 by initiative petition adopted by the Legislature in 2006.

Why the SBT was Unpopular

- Taxed businesses previously not subject to tax.
- Unique (except New Hampshire).
- Wasn't based on ability to pay.
- Additive base labeled it as a tax on items such as compensation and health care.
- 30-year whipping boy of business.
- No defenders in legislature.

Earliest Proposals

- In 2005 Governor proposed simplified SBT with a lower rate and increased tax on corporate profits and a 35% personal property tax reduction for manufacturing and R & D.
- In 2006 Governor proposed three part tax with assets, gross receipts and income part of the base; 46% personal property tax reduction for manufacturing and commercial; revenue neutrality.

Other Business Tax Plans

- **Michigan Chamber** – Tax base is gross receipts and business income
- **Detroit Chamber** – Tax is gross receipts license fee with $1 million cap.

Things that Mattered along the Way

- **Substantial credits for economic activity in the state (compensation, capital investment and R&D).**
- **Reducing the personal property tax.**
- **Not having some taxpayers pay for others' credits.**
- **Tax pyramiding.**
- **Winners and losers.**

Things that Mattered Along the Way

- Not being different from other states.
- Not being like the SBT.
- Revenue neutrality.
- A tax cut for business.
- Maximizing the number of large taxpayers who paid.

Things Discovered

- An overall tax cut does not mean a tax cut for everyone.
- Multiple bases tend to mitigate liability shifts.
- Two taxes are more trouble than one.
- Those who don’t benefit from credits and exemptions will pay more for those who do.
- Banks and insurers don’t fit well.

House Passed Package

- 6.95% business income tax.
- 0.488% net worth tax.
- Each raised half the revenue.
- Credits for compensation, R&D and capital investment in Michigan.
- 73% personal property tax reduction for manufacturing.
- 46% personal property tax cut for commercial.
- Overall revenue neutrality.
- Unitary filing (Finnegan).

Senate Passed Package

- 0.54% tax on gross receipts minus tangible personal property purchases from other firms applies to firms in excess of $15 million gross receipts.
- 1.5% business income tax.
- 25% personal property tax credit for manufacturing and commercial.
- $250-$300 million headquarters credit.
- $600 million tax cut.
- Unitary filing (*Joyce).*

The Differences Reconciled

- House approach to credits.
- Personal property tax reductions closer to House levels.
- Senate modified gross receipts base.
- Expanded small business treatment, closer to Senate approach.
- Revenue neutrality.
- Unitary with *Finnegan* rule.

Michigan’s New Business Tax

New Tax Base

- Business Income Tax – 4.95% rate.
  - Base includes non-corporate entities.

- Modified Gross Receipts- 0.8% rate.
  - Base is gross receipts less purchases from other firms.
  - Purchases from other firms includes inventory, depreciable property, materials and supplies, and construction payments to a subcontractor.

Special Provisions for Small Businesses

- Firms with less than $350,000 in apportioned gross receipts exempt.
- Phased-in for $350,000 to $700,000 in apportioned gross receipts, eliminating the “cliff effect.”
- Qualifying firms pay an alternate rate of 1.8% on adjusted business income.
- To qualify for the alternate rate, officer compensation cannot exceed $180,000.
- Gross receipts threshold of $20 million.
- Entrepreneurial credit to promote hiring and investment in Michigan.

Personal Property Tax Reductions

- Combination of credits and exemptions reduce manufacturing personal property taxes by 65%.
- Exemptions reduce commercial by 23%.
- Schools held harmless through school formula; portion of tax earmarked to school aid fund.
- Local government revenues not affected.

Major Credits

- Compensation Credit: 0.37% of Michigan compensation.
- Investment Tax Credit: 2.9% of Michigan investment.
- Research and Development Credit: 1.9% of Michigan research and development expenses.

Credit Limits

- Sum of compensation credit and investment tax credit cannot exceed 65% of MBT liability before credits.
- Sum of all three credits cannot exceed 75% of MBT liability before credits. No carryforwards.

Business Income Tax Base

- Starting point: Federal taxable income from business activity.
- Applies to all entity types.
- S corps and partnerships include in taxable income any income or expense attributed to business activity reported separately to partners or shareholders.

Business Income Tax Base

- Deduct net earnings from self employment included in federal taxable income unless they are a return of capital.
- Add intangibles expenses included in federal taxable income made to related parties not part of the unitary group.

Gross Receipts Defined

The entire amount received by the taxpayer from any activity whether in intrastate, interstate, or foreign commerce carried on for gain to the taxpayer or others. Same as SBT except for new exclusions for a motor vehicle sales finance company, professional employer organization, and for floor plan assistance.

Modified Gross Receipts Tax Base

- The tax base is a taxpayer's gross receipts less, "purchases from other firms," before apportionment.
- "Purchases from other firms" means:
  - Inventory acquired during the tax year.
  - Depreciable assets acquired during the tax year.
  - Materials and supplies, including repair parts and fuel.
  - Compensation of personnel supplied to customers of a staffing company.
  - Payments by construction contractors to subcontractors.

Modified Gross Receipts Tax Base Exclusions

- Amounts received as an agent on behalf of the principal.
- Certain amounts realized from the sale of marketable instruments.
- Receipt of the loan principal by residential mortgage companies.
- Receipts by a professional employer organization of the cost of wages paid under the professional employer arrangement.
- Amounts received by auto dealers subsidizing interest expenses.

Business Income Tax Nexus Sales of Tangible Personal Property

- *Tangible personal property* (TPP) sales are subject to federal statutory jurisdictional standards (PL 86-272).
- Provides that mere solicitation of TPP sales is insufficient to establish nexus.
- PL 86-272 is not applicable to receipts on “services” or “intangibles,” which are subject to same nexus standard as for modified gross receipts.

Modified Gross Receipts Tax Nexus

- Taxpayer has a *physical presence* for more than 1 day per tax year,

OR

- Taxpayer *actively solicits* sales and has Michigan gross receipts of $350,000 or more. (The department must define *actively solicits* and it shall be applied prospectively.)

Unitary in the SBT

- "Taxpayer" includes a unitary business group.
- A unitary business group shall file a combined return.
  - Must include each U.S. person other than foreign operating entities.
  - All transactions between persons included in the unitary business group must be eliminated from the business income tax base, the modified gross receipts tax base, and the apportionment formula.
  - Insurance companies are excluded from the combined return.

Unitary Business Group Defined

A unitary business group is a group of U.S. persons other than a foreign operating entity, one of which:

- **Owns/controls, directly or indirectly, more than 50% of the ownership interest of the other U.S. persons; and**
- **Has business activities or operations that result in a *flow of value* between or among persons in the business group;**

OR

- **Has business activities or operations that are *integrated with, are dependent upon, or contribute to* each other.**

Cars & Boats

- **New motor vehicle and watercraft dealers may separately itemize the modified gross receipts tax on invoices to their customers and collect the tax in addition to the sales price.**
- **The amount remitted to Treasury for the tax cannot be less than the stated and collected amount.**
- **Note: Amounts separately itemized as modified gross receipts tax are subject to sales tax on taxable sales of motor vehicles and watercraft.**

Apportionment

- Single factor apportionment based on sales.
- Sales Factor Formula: Michigan sales/sales everywhere.
- When at least one person in the group has nexus, all Michigan sales by persons in the unitary group are included in the numerator.
- Sales are sourced to another state if that state has jurisdiction to tax even if that state does not do so.

Sourcing Sales of TPP, Electricity and Natural Gas

- Ultimate destination test is applied.
- Sourced to where property comes to rest regardless of shipping terms.
- Gas and electricity sourced based on where contract requires delivery.

Sourcing Receipts of Royalties and Intangibles

- Royalties and intangibles are sourced where the property is used by the purchaser.
- Multistate use apportioned MI use/use everywhere.
- Default-exclude from numerator and denominator
- Customer location is irrelevant.

Sourcing Receipts of Services

- Service income is sourced where recipient receives all of the benefit.
- Multistate use apportioned recipient’s MI benefit/benefit everywhere.
- “Cost of performance” sourcing no longer applicable.

Other Sourcing Provisions

- Securities brokerage service receipts (sourced to customer’s address)
- Regulated investment companies receipts (look to shareholders domicile/mailing address)
- Financing activities receipts (generally follow RAB 2002-14)

Other Sourcing Provisions (Con’t)

- Transportation receipts (generally sourced MI revenue miles/ revenue miles everywhere)
- Telecommunications receipts (has several sourcing rules)
- Telecommunications terms follow the streamlined sale and use tax agreement.

Sourcing in General

- New default sourcing rule:
  - Where the benefit to customer is received.
  - If benefit received is undeterminable to customer's location.

New Tax Base

- Insurance Companies – 1.25% tax rate
  - Base is Michigan gross direct premiums written.
  - Retaliatory tax is still in place.
- Financial Institutions – 0.235% tax rate
  - Base is value of net capital averaged over 5 years.
  - A financial institution is a bank, bank holding company, certain thrift institutions and savings and loans, and a business other than an insurance company owned by the bank that is part of the unitary group.

Severability Clause

If a final order of a court of competent jurisdiction determines that any provision of this act that provides a deduction, credit, or exemption with respect to employment, person, services, investments, or other activity in the state is unconstitutional or applies to a similar activity outside of the state, that provision shall be severed and the remaining provisions would remain in effect.

Basic Numbers

- SBT raises $1.9 billion, excluding insurance provision and retaliatory taxes.
- New structure finances $1.3 billion in personal property tax relief and economic activity credits on top of completely replacing SBT revenue.
- Revenue before credits is 1/3 business income and 2/3 modified gross receipts.

Balance Sheet for Michigan Business Tax

	Calendar Year 2008	Calendar Year 2009
SBT Repeal	($1,816.1)	($1,852.4)
MBT before credits	$3,445.6	$3,514.5
Investment Tax Credit	($312.8)	($319.1)
MI Comp Credit	($313.4)	($319.6)
R&D Credit	($72.6)	($74.1)
All Other Non-refundable	($324.7)	($331.3)
Total MBT After Non-refundable Credits	$2,422.1	$2,470.5
Total Personal Property Tax Relief	($636.2)	($643.6)
Net Change in Insurance Premiums Tax	$31.0	$31.9
Total Taxes	**$0.8**	**$6.4**

Revenue Estimating Issues

SBT returns include gross receipts, business income, and capital investment data.

- **Difficult to estimate modified gross receipts tax base. Working down from gross receipts provides very different answer from working up from SBT base,**

Revenue Estimating Issues (Con't)

- Difficult to estimate impact of nexus change.
- Difficult to estimate impact of unitary filing requirements.
- Difficult to estimate revenue loss from tax planning.

Revenue Estimating Issues (Con't)

- Unable to estimate portion of business income not from business activity.
- Unable to estimate impact of apportioning services based on benefits received.

MBT Revenue Limit

- Ensures that the MBT does not produce a significant revenue increase.
- If revenues exceed limit, one half refunded to taxpayers and one half deposited into the state rainy day fund.
  - FY 2008: if tax produces 5% or more than revenue neutral amount.
  - FYs 2009 and 2010: trigger increases by growth in personal income plus 1%.
  - Limit expires after 2010.

First Taxable Year Calculations for Fiscal Year Filers

- May elect one of the following:

  \- Annual method, reporting the taxpayer's full year multiplied by a ratio of the number of months in the tax year included under the MBT over 12.

  \- Actual method, reporting only those months included under the MBT.

Steps to Implement the MBT

- Treasury Tax Policy analyzes the operational impacts and develops policies and procedures
- Design of new forms begins
- Project control office established to create full project plan with IT vendor and DIT
- Tax calculator placed on web
- Training seminars developed and other communications are scheduled and launched

Steps to Implement the MBT

- Materials are prepared for U of M and MSU tax schools
- Materials prepared for MACPA and other preparer group presentations
- Web based training module available

MBT Timeline

- 1st estimated payments due – February 08
- New automation design complete – May 08
- Final build of MBT system – November 08
- Final testing and implementation – January 09

MBT Information

- **Comprehensive MBT Web site, www.michigan.gov/mbt.**
- **Tax estimator will be on Web site.**
- **Education outreach (training seminars, webinars, roundtables, press releases).**