Taxes on Businesses

BACKGROUND

According to a 1995 study (latest available data) by the Institute on Taxation and Economic Policy (Washington), 42 percent of Michigan's state and local taxes are collected from business, slightly more than the national average of roughly 41 percent; Michigan ranks 34th highest among the 50 states. The major levies affecting Michigan businesses are

- the single business tax (SBT),
- real and personal property taxes (state and local),
- the unemployment insurance (UI) tax,
- vehicle fuel and registration taxes,
- the sales tax (although this is a consumer rather than a business levy, an estimated 25–30 percent is paid by business), and
- workers' disability compensation insurance (although this is not a tax, it is a major business cost imposed by government).

It is unlikely that the final incidence of these costs falls on business: A large share is passed on to consumers, employees, or shareholders in the form of higher prices, lower salaries, or lower profit.

Since 1991 business taxes in Michigan have been reduced significantly. The Senate Fiscal Agency estimates that in fiscal year 2000–01, tax savings to business will total about $1.5 billion, including $850 million in SBT relief. The next most likely candidate for major reduction is the personal property tax on machinery and equipment.

All the levies are discussed below except the sales tax and vehicle fuel/registration taxes, which are discussed elsewhere in this book.

Single Business Tax

The SBT, easily Michigan's most important business tax, is a levy on the value a business adds to its product during production, whether the product is automobiles or legal services. The main components of the added value are labor, interest paid, depreciation, and profit. An SBT deduction is allowed for capital investment, and special relief is provided for firms that are labor intensive or have gross receipts below a certain level; complete exemption is allowed for very small businesses.

The current rate (tax year 2002) is 1.9 percent. The original rate was 2.35 percent, which was reduced to 2.3 percent in 1994. In 1999 legislation was enacted that reduces the rate 0.1 percent each year until the tax is eliminated.

The SBT took effect in 1976 as a replacement for seven business taxes, of which the largest three were the corporate income tax, personal property tax on inventory, and corporate franchise tax. Not only has the SBT added stability to the Michigan tax structure, but it has exhibited reasonably good growth potential: Collections rose from about $800 million in the levy's first full year (FY 1976–77) to about $2.2 billion in FY 2000–

GLOSSARY

Base
In taxation, the dollar value on which a tax is levied.

Capital acquisition deduction (CAD)
Single business tax deduction allowed for purchase of real and personal property.

Effective rate
Tax rate after credits, exemptions, and deductions are applied.

Final incidence
In regard to taxes, the person or entity that cannot shift all or part of the levy's cost elsewhere.

Mill
A monetary unit equal to 1/1000 of a dollar; "millage" is the tax rate on property—the number of mills assessed against the property's taxable value.

Personal property
Generally, items not attached to real estate; e.g., equipment, computers, furniture, tools.

Real property
Generally, land and items permanently attached to it—e.g., land, buildings, fixtures.

Unemployment insurance
Provides money to workers to replace some of their lost wages if they become unemployed.

Value added
The value a business adds to its product (or service) during production; the main components are labor, interest paid, depreciation, and profit.

Workers' disability compensation
Replaces wages and extends medical/rehabilitation benefits to workers injured on the job.

01. The latter figure is down from about $2.5 billion in the prior year due to the 0.1 percent rate reduction and the weak Michigan economy.

Single business tax receipts comprised about 9 percent of all state tax revenue when the levy went into effect, rose to a high of 17.5 percent in 1988, and now are back to 9 percent. The exhibit shows the distribution of SBT revenue by industry class for FY 1997–98 (latest data available). Manufacturing provides the largest part of SBT revenue, roughly 39 percent, but in the last decade its share has declined from about 55 percent. In comparison, the services sector's share rose from about 10 percent to 18 percent.

In theory, a value-added tax should extract a contribution from all firms, regardless of organization, size, or business type. In practice, however, more than half the businesses in Michigan do not have an SBT liability largely because of an exemption for small firms and the deduction for capital investment; about 75 percent of the tax is paid by 5 percent of the firms. The SBT's actual effective rate (after credits, exemptions, and deductions are applied) is 1.57 percent; it rises from 0.2 percent for the smallest firms to 1.98 percent for businesses with a tax base exceeding $100 million. (These calculations are based on FY 1997–98 data and do not reflect subsequent revisions to the SBT, but the changes probably have not substantially altered the tax's effective rate.)

Distribution of Single Business Tax Collections, by Industry (quarterly payments only), FY 1997–98

Industry	*Tax Liability (thousands)*	*Percentage of Total*
Forestry, fishing, and agriculture	$8,552	0.4%
Mining	9,740	0.4
Construction	102,725	4.4
Manufacturing	913,136	39.4
Nondurable goods	208,111	0.9
Transportation equipment	295,436	12.8
Other durable goods	409,588	17.6
Transportation	46,297	2.0
Communication and utilities	168,688	7.3
Wholesale trade	109,191	4.7
Retail trade	312,384	13.5
Finance, insurance, and real estate	176,524	7.6
Services	425,279	18.4
Other	42,701	1.8
TOTAL	$2,315,219	100.0%

SOURCE: Michigan Department of Treasury (July 2001), The Michigan Single Business Tax, 1997–98.
NOTE: 1997–98 data are the latest available.

Over the years there have been many important revisions to the SBT. One concerns the capital acquisition deduction (CAD)—the SBT deduction allowed for purchase of real and personal property—and is being challenged in court. To make the CAD more fair to firms doing business in Michigan but headquartered in other states, multistate SBT payers are permitted to apportion their deduction using the same formula they use to apportion their tax base. This is a three-factor formula involving the portions of a firm's payroll, property, and sales that are located in Michigan. For tax years after 1998, the in-state sales factor increased to 90 percent (up from 80 percent) and the Michigan payroll and property factors each fell to 5 percent (down from 10 percent). The change has been challenged by an Illinois corporation that contends that the Michigan CAD burdens out-of-state businesses and discriminates against interstate commerce. The state court of claims agreed, but the appeals court ruled in 2001 that the CAD is not designed to punish multistate taxpayers and it has not harmed those who choose to increase their Michigan presence. The case is expected to be appealed to the Michigan Supreme Court. If ruled unconstitutional, the tax will revert to the old CAD calculation and the sales-payroll-property apportionment formula will return to 70-15-15 percent.

The most recent and far-reaching SBT change was enacted in 1999, reducing the rate 0.1 percent each year until 2021, when the tax is completely eliminated. The legislation does include a provision that suspends the phaseout if the balance in the Budget Stabilization Fund falls below $250 million, which may be the case by the end of FY 2002–03.

Property Tax

The property tax is Michigan's oldest form of taxation, dating back to 1893. State government and all local governments levy taxes on the value of real and personal property owned by commercial operations; in addition, the state levies a tax on utility property, which equates to the statewide average property tax rate for commercial, industrial, and utility property (50.82 mills in 2000). All other business property, classified as commercial or industrial, is taxed at varying rates by local government units.

In 2000, for all jurisdictions, taxes on real property will generate about $8 billion and on personal property about $1.7 billion. Of total business property taxes, about two-thirds are levied on real property and one-third on personal property.

Real Property

The school finance reform legislation of 1993 and 1994 (Proposal A) changed the manner in which residential and business properties are taxed. Prior to the reforms, both were taxed in the same way, but at varying rates, by local government units. Under the new system,

- a 6-mill statewide education tax on all property is levied for the state School Aid Fund, and
- an 18-mill school operating levy on business property is levied for local school districts.

As a result of the reform, the average tax rate for all property in 2000 was 39.32 mills, down from 56.64 mills in 1993, the last year under the old system. The average tax rate on business property in 2000 was 50.82 mills; on nonbusiness property the average was 32.8 mills. In 2000 business paid just under $4 billion in property taxes—roughly 42 percent of all property tax paid in the state. In 1993 business had paid about 28 percent of all property taxes.

All property, other than utility, is assessed by its local government and equalized by the county and the state. The annual assessment increase on each parcel is limited to the inflation rate or 5 percent, whichever is less (in 2001, assessments were limited to a 3.2 percent increase). When property is sold, it is reassessed at current market value. Local governments thus must keep track of two values for each parcel: the taxable value and the assessed value. The assessment cap is more beneficial to residential than business property, because the former generally increases more in value.

Personal Property

Personal property generally is defined as property not permanently affixed to land: e.g., equipment, furniture, tools, computers. In Michigan, only businesses pay the personal property tax (PPT). From 1985 to 2000, personal property taxes grew from $668 million to about $1.7 billion—an increase of over 150 percent (about 57 percent when adjusted for inflation).

The state levies 6 mills on personal property, the same as Proposal A established for real property. There are state and local taxes that are tied to the PPT (i.e., state utilities tax and industrial facilities tax). The local levy varies from place to place, depending on what has been approved by local voters. Thus, if in City A, 12 mills are levied on real property, 12 mills also are levied on the personal property of those who must pay it.

Reliance on PPT collections varies across the state. In some rural counties, less than $10 million is raised annually from it, while in some more populous counties the figure exceeds $3 billion. In some counties the PPT represents less than 5 percent of total taxable property value; in others it is significant—in Midland and Kalkaska counties, 35 percent and 22 percent, respectively (2001). The statewide average is about 12 percent.

Although Proposal A substantially reduced the PPT (the average nonhomestead, which includes business property, rate fell from 56.6 to 48.17 mills, about a 15 percent decline), most statewide business associations still list PPT repeal as a major legislative goal.

Thirty-five states levy a PPT and in most, the levy is similar to Michigan's. Ten, including Illinois, New York, and Pennsylvania, have no PPT. The remaining five levy a PPT but allow specific exemptions (e.g., for manufacturing equipment).

Workers' Disability and Unemployment Compensation

In early 2002 the governor signed an executive order (1) combining the Unemployment Agency and the Bureau of Workers' Compensation into a new Bureau of Workers' and Unemployment Compensation and (2) moving the new bureau—along with the Wage and Hour Division—into the Michigan Department of Consumer and Industry Services. The objective is to combine functions with a similar purpose into a single agency: Workers' compensation and unemployment assistance benefits exist to replace wages lost by workers, and the Wage and Hour Division collects wages and fringe benefits owed to workers.

Workers' Disability Compensation

Although workers' compensation is a major business cost, it is not a tax. The law requires that every employer subject to the federal Workers' Disability Compensation Act provide a way to assure that it can pay benefits to its workers injured on the job. Most companies buy insurance to protect them from workers' injury claims. With state permission, some financially sound employers are permitted to self-insure for this coverage by paying into a regulated pool.

The state's assigned-risk pool (a state-managed entity from which hard-to-insure companies may purchase coverage) cut its rates every year from 1996 to 2000, but in 2001 rates increased for the first time in several years largely because (1) a major insurance writer went out of business, (2) reinsurance rates increased sharply after the September 11 terrorist attacks, and (3) rates had been artificially low in the past few years due in part to recent rate cuts.

According to the Workers' Compensation Research Institute (Cambridge), Michigan's workers' compensation system is improving, as indicated by three measures.

- From 1992 to 2000, the annual average total benefits per worker fell more than 5 percent (adjusted for inflation).
- From 1992 to 2000, the number of lost-time claims per 100 workers (the claim rate) fell from 2.5 to about 1.5 percent.
- From 1991 to 2001, the interval from the time a dispute is filed to when a decision is handed down following a formal hearing fell from 18.1 to 12.6 months.

There are many ways to compare workers' compensation state by state. The National Academy of Social Insurance (Washington) has published 1999 state data showing that indemnity and medical benefits paid in Michigan amount to 0.9 percent of covered payroll. The national average is 1.05 percent, and Michigan ranks roughly in the middle of the pack: 28th among the 50 states.

Unemployment Compensation

Unemployment insurance (UI) is a form of social insurance, administered in Michigan by the state Unemployment Agency (UA). It is designed to provide money to help workers replace some of their lost wages after becoming unemployed. Unemployment insurance taxes are paid by almost all businesses that (1) employ one or more employees in any 20 given weeks in a calendar year or (2) in a calendar year paid $41,000 or more in payroll to employees covered by unemployment insurance.

Michigan's average weekly UI benefit in the 2d quarter of 2001 was $262, about 37 percent of the $710 statewide average weekly wage. Nationally, the average weekly benefit was $229 a week in 2000. Michigan ranks 8th in average wage and 31st in wage replacement.

Employers pay two unemployment taxes: federal and state. The Federal Unemployment Trust Account (FUTA) assesses an effective rate of 0.8 percent against the first $7,000 of each employee's wage. This money goes into the federal fund, which doesn't directly pay benefits to former workers but does assist the state with administrative and other costs associated with the program.

The state tax is levied on the first $9,500 of each covered employee's wages paid each calendar year, and the rate paid on that $9,500 is phased in over a business's first five years in operation. The taxes are deposited in the state Unemployment Insurance Trust Fund, which makes payments to workers who have become unemployed. Each employer has an "account"—that is, a record is kept on how much the firm has paid in and how much the trust fund has paid out in benefits to the firm's former workers.

- Generally, in the first four years of a business's liability, the tax rate varies according to the type of business it is and how much in benefits has been paid out in the firm's behalf (for further detail, readers are directed to *Michigan in Brief, 6th Edition*, at *www.michiganinbrief.org*).
- In the fifth and subsequent years, the firm's tax rate is based on the full amount of any unemployment benefits paid out and whether it has built any reserve in its account. For 2001 tax rates may range from 0.1 percent (for businesses that have had no layoffs in the last seven years and an adequate reserve in their account) to 8.1 percent (for firms with high layoffs and little or no reserve).

Public Act 25 of 1995 made several important changes in unemployment taxes and the changes resulted in UI taxes being reduced every year since. Although Michigan's jobless tax sometimes goes as high as 10 percent, rates normally range from 0.1–8.1 percent. In 2002 some 161,000 employers will receive a 10 percent across-the-board cut in their unemployment taxes and about 105,000 will qualify for reductions in the account-building component of their tax rate; each tax cut will save employers a total of about $100 million. The reductions will apply to employers who are "fully experience rated"—typically those who have been in business for at least five years. They will be incorporated into the 2002 tax rate notices that the UA will issue to employers in December.

The average employer tax rate as a percentage of taxable wages fell from a recent high of 4.46 percent in 1994 and an all-time high of 5.71 percent in 1985 to 2.78 percent in 1998 (latest data available). The balance in the UI Trust Fund, which needs to be substantial as a cushion against recession, was $2.9 billion as of June 30, 2001.

DISCUSSION

Single Business Tax

The SBT generates controversy mainly for two reasons: It (1) substantially increased the tax burden of many businesses that had been paying little or no tax, and (2) requires a tax payment even when no profit is earned. Some have argued that the SBT hurts small firms and that a business should not pay a tax unless it earns a profit. Others contend that because all firms use government services, all should make a contribution (as with the local property tax) regardless of whether a profit is reported, that a two-tier tax structure would be unfair, that moving to a profits tax would make the SBT more unstable, and that the tax burden on most small businesses is too minor to have a negative effect on them.

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Many observers believe the complete phaseout of the tax was an overreaction to claims that the tax is too complex, unfair to small business, and not based on ability to pay. They believe that many SBT critics lost sight of the levy's original purposes: to (1) simplify the tax system, (2) increase its stability, (3) provide a more neutral tax treatment for businesses, and (4) improve the investment climate.

Supporters of the tax point out that in large part the goals have been achieved, but they were compromised over the years by numerous changes in the tax. Currently, the major concerns are (1) the revenue loss due to the phase-out—about $130 million annually—and (2) the fact that when the tax is completely phased out, there will be no major state tax on business, which will shift the burden to the individual taxpayer.

Phase-out supporters argue that business taxes are passed on to the consumer, result in businesses paying lower wages, and result in owners earning lower profits. Some observers believe that a case can be made to simplify the tax and return it to its original purpose by eliminating most special provisions and lowering the rate rather than phasing the levy out.

Property Tax

Prior to passage of school finance reform and the reduction in property tax rates, Michigan's property tax burden was about one-third above the national average and 50 percent above the burden in the adjoining states of Ohio and Indiana, which caused many to view the tax as detrimental to economic development, particularly in southeast Michigan, where tax rates are higher than in most other regions of the state. Since the reforms, Michigan is at about the national average, although the tax on business still is modestly higher.

While real property tax is of less concern since the reforms, the business community still views the personal property tax on machinery and equipment as a large negative for the business climate.

Opponents of the PPT argue that it is a major reason that the cost to locate or expand a business in Michigan is higher than elsewhere, and business leaders see the tax as one of the top five anti-competitive provisions of Michigan law. Some analysts argue that since the nontax costs of production sometimes are higher in Michigan than elsewhere (labor costs usually are mentioned), to attract new jobs the tax burden for business actually should be lower than in competing states.

Opponents also argue that administrating the PPT is burdensome and unfair. Unlike the tax on real property, personal property is self-reported by each firm. Each year, every business must provide the local assessor with a form itemizing each piece of personal property and its age. The assessor then assigns a value, using depreciation schedules published by the state, to each item. This self-reporting, opponents argue, is time-consuming for businesses and leads to substantial underreporting.

The Michigan Chamber of Commerce's goal is to eliminate the PPT, and to that end, it supports

- enacting legislation to (1) annually exempt the first $25,000 in assessed and taxable value per jurisdiction, (2) remove such intangible costs as sales tax, freight, labor, and engineering charges from the tax base, (3) define buildings on leased land and certain leasehold improvements as "unsecured" real property, and (4) adequately fund the annual updating of all tangible PPT depreciation tables promulgated by the State Tax Commission;
- revising P.A. 328 of 1998 to allow all communities, not just distressed areas, to abate all new personal property taxes so as to spur economic development;
- providing relief for any taxpayer assessed in lieu of the general ad valorem (value-added) tax regime, either through higher or new SBT credits; and
- enacting legislation to end the discriminatory nature of the assessment and taxation of intangible property owned by telecommunication and railroad companies (only the tangible personal property of other property taxpayers is assessed and taxed).

Some analysts believe that eliminating, reducing, or reforming the PPT is easier said than done, and they point out that

- reducing or eliminating the tax would affect the revenue stream to Michigan government at all levels: city, county, township, school, and state;
- since the PPT base varies widely across the state, the effect of reducing or eliminating the tax would be much greater in some places than others;
- the tax is in large part a local tax that could be changed or eliminated by state law;
- it is very difficult to quantify the economic effect of reducing the PPT; and
- there is a long list of technical questions involved in reform.

Both opponents and proponents of changing or eliminating the PPT agree that it negatively affects economic development, but they disagree on how much and in what circumstances. Opponents do not believe that reducing/ eliminating the PPT will increase economic activity enough to offset the direct revenue loss.

Among the technical problems that would arise in PPT reform is the fact that personal property never has been tightly defined in state law. Although some categories of personal property are mentioned in statute, personal property generally is defined as all property that is "not real." Since in Michigan the tax rates on real and personal property always have been identical, this vagueness has not been too troublesome, but the statutory distinction between the two will become very important if personal property comes to be taxed at a lower rate than real property.

Currently, there are no specific proposals to reduce or modify the PPT. The state did revise the depreciation schedules in 1999, the first major revision since 1964, but some jurisdictions still are not using them for utility property. Based on the property's age and useful life, these schedules determine depreciation factors that then are multiplied by the property's original cost; this calculation establishes the item's taxable value. Many observers argue that the state's use of only a few schedules results in the actual value of personal property being misrepresented for many businesses.

A number of reform proposals have been offered in the past, and one or more of these could reemerge. Readers are directed to *Michigan in Brief, 6th edition,* at *www.michiganinbrief.org* for a list of these options.

Workers' Disability Compensation Costs

Despite recent cost declines, the business community still believes legislation is needed to reduce fraudulent and unwarranted claims. The Michigan Manufacturers Association reports that its membership surveys show that workers' compensation costs rank among the matters that most concern manufacturers.

Unemployment Compensation Tax

Unemployment insurance costs long have been viewed by the business community as a burden and a deterrent to economic development. Others see UI benefits as essential to keeping unemployed workers and their families from quickly falling into poverty. In 1998 UI taxes paid by Michigan businesses amounted to $103 per capita, 30 percent above the U.S. average of $79. Since 1996 unemployment taxes have been cut every year, for a total savings of about $1.2 billion, which has brought Michigan more in line with other states and reduced the negative effect that UI taxes have on the state's business climate.

These taxes pay for benefits: In 2001 the *average* weekly benefit paid in Michigan was $262 per capita, about 14 percent above the national average (down from 18 percent in 1995) and the highest in the Great Lakes region. Michigan's *maximum* weekly benefit of $300 is the lowest in the Great Lakes states, however, and 21st lowest among all the states.

The governor has recommended that UI benefits be increased for the first time since 1996. There is general agreement that the maximum weekly benefit should be increased from $300 to $415, but there is serious disagreement on one issue: Republicans want to establish a "waiting week," meaning that unemployed workers would not get benefits for the first week they are out of work. The waiting week, which 38 other states have, would reduce the amount Michigan businesses have to pay into the UI fund. Democrats and organized labor oppose the provision, arguing that a waiting week unnecessarily penalizes the unemployed. At this writing, a conference committee is working to resolve differences in legislation passed by the House and Senate to raise the weekly benefit.

See also K–12 Funding; Highway Funding and Safety; Taxes on Consumers.

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