Citizens Research Council of Michigan

Evolution of Business Taxes in Michigan

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Reinvigorating Public Service in Michigan, 2011 and Beyond
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Business Taxation in Brief

Potential Reasons For Taxing Business

- Pay for services consumed by business
- Increase progressivity of tax structure (assumes owners bear most of burden – not workers or consumers)
- Export a portion of tax
- Hidden burden (political reason not a policy reason)

Potential Reasons for Not Taxing Business

- Tax may lead to reduced investment and economic growth
- Equity or tax burden issues

What was the MBT Trying to Do?

- **Export tax/reduce disincentives for MI based activity**
  - 100% sales factor
  - Unitary filing
  - Generous credits for MI based activity (MI compensation, MI investment, MI R&D)
- **Reduce investment disincentives**
  - Personal prop tax relief (school taxes & refundable credit)
  - Investment credit
- **Increase importance of profits in tax base**

Why Was MBT So Unpopular?

- Tax complex and unique among states
- Initial revenue neutral swap with SBT meant many businesses saw a tax increase
- Addition of surcharge represented a large tax increase over the SBT (~30%)
- Noncorporate entities (partnerships, LLCs, etc.) paid both MBT and IIT (also present w/ SBT)
- Targeted tax incentives (MEGA, battery, film, etc.) created equity issues (also present w/ SBT)

MBT to Corporate Tax

- Flat 6% rate on C corps only (non corp exempt)
- Repeal all credits (accept certain legacy credits and one small business credit)
- Retain legacy credits already promised (MEGA, battery, etc.) totaling ~$500M per year
- Replace revenues with income tax increases
- FY2103 MBT net of legacy credits estimated to be $1,991M, corp tax net of legacy credits $343M (83% reduction in tax)

Full Year Estimate of Business Tax Change (millions of $)

	FY2013 Estimate
MBT Revenues	$1,990.6
6% Corporate Income Tax	$799.1
Financial Institutions Tax	$43.9
Legacy Credits	($500.0)
Net Corporate Tax Revenues	$343.0
Net Tax Change	**($1,647.6)**

Source: House Fiscal Agency

Income Tax Changes

- Eliminate scheduled rate reduction from 4.35% to 3.9% (rate will fall to 4.25%)
- Repeal nonrefundable credits: city income tax; public contribution; etc.)
- Reduce EITC from 20% to 6%
- Reduce HPTC: reduce income cap; set max house value; change factor for seniors
- Reduce public and private pension reductions
- Phase-out personal exemption for high income
- Net individual income tax increase $1.4B (approx. 22% increase)

Full Year Estimate of Income Tax Change (millions of $)

	FY2013 Estimate
Freeze IIT Rate at 4.25%	$223.0
Repeal Nonrefundable credits	$104.5
Reduce EITC	$261.6
Reduce HPTC	$270.2
Reduce Pension Exemptions	$343.4
Phase out Personal Exemp.	$83.4
Other Changes	$137.6
Net Income Tax Change	**$1,423.7**

Source: House Fiscal Agency

Broad Tax Relief vs. Targeted Incentives

- Business taxation in general discourages investment
- Broad tax relief reduces disincentive by lowering tax on everyone: tax relief for those who would have invested anyway, those who aren't investing, and those who are only going to invest if the tax burden is lower
- Targeted tax relief: attempt to identify those where the tax prevents the investment and direct the tax relief there (e.g., the "but for" test in MEGA)

Broad Tax Relief vs. Targeted Incentives

- Targeted tax relief is significantly cheaper **but** it presumes government can identify those firms whose investment decisions will change based on the tax relief

- Targeted tax relief can raise equity issues – e.g. credit provided to a firm making a new investment to locate in Michigan, but not to the longstanding MI firm that made its investment in the past

- MBT to Corporate change moves philosophically from targeted relief to broad relief

Will It Help Economic Growth?

- Reduction in business tax improves return on investment in Michigan
- Lower tax, simpler structure will improve MI's reputation among businesses
- Repeal of PPT credit means large multistate mfrs with a lot of personal property pay more
- Increase in income tax reduces consumption, net tax cut reduces govt spending
- ? Net Impact unknown but likely small (but small differences compounded over time can make a big difference)

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