AN INFORMATION REPORT

The Michigan Single Business Tax:

A Different Approach to State Business Taxation

ADVISORY COMMISSION ON INTERGOVERNMENTAL RELATIONS

Washington, DC 20575
MARCH 1978

M-114

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Preface

An important role of the Commission is to identify and highlight significant innovations in state and local finance.

Clearly Michigan's recent action of replacing its multifarious business tax structure with a type of value added tax (VAT) falls into this category and is worthy of close attention.

Michigan's action is also worthy of attention because it can be viewed as one state's attempt to answer the question of how business should be taxed and is an important step in the effort to develop a uniform, rational business tax policy for state and local government.

The Commission has devoted considerable attention to outlining the attributes of a high-quality state and local tax system. While considerable progress has been made in defining a high-quality personal tax system, the complex nature of business taxation has prevented much progress in answering the question—what are the attributes of a high-quality state business tax system? This report does not attempt to answer that question but it does suggest certain business tax principles that appear to be worthy of consideration by state and local governments.

This report was originally to be limited to a discussion of the Michigan experience with the value added tax, but in examining the Michigan experience it became evident that several of the principles embodied in the Michigan VAT were of sufficient importance to merit additional attention. As a result, the report was expanded to include a section on the principles of state business taxation. The expansion of the report was also partly a result of the current ACIR work on state economic growth and tax competition among the states. The type of business tax structure used by state and local governments has clear implications for tax competition and state economic growth. This report briefly discusses the linkage between the type of tax structure used by a state and tax competition among the states. As a result this report can be viewed as the first volume of the forthcoming series on these important topics. A subsequent volume will discuss in detail state and local tax incentives and their effect on industrial location and state economic growth.

The Commission is not recommending that state and local governments adopt the type of business tax structure enacted in Michigan nor is the Commission endorsing the value added tax. Because of the differing conditions in each state it is not clear that this would be a wise choice in every case. In this report as in all of the Commission activities, the major purpose is to provide information on the Michigan experience which in this case will be of assistance to those governments that wish to evaluate the value added tax as a possible revenue source. And in view of recent proposals to repeal the federal corporate income tax and tax all corporate income to the individual, state and local governments may have an added incentive to evaluate the value added tax as a possible replacement for the corporate income tax.

Robert E. Merriam
Chairman

Acknowledgments

This report was authored by Robert J. Kleine, senior resident in public finance, on leave from the Michigan Department of Management and Budget.

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Full responsibility for the content and accuracy of this report rests, of course, with the Commission staff.

Wayne F. Anderson
Executive Director

John Shannon
Assistant Director
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Chapter I

State Value Added Taxation: An Innovation in Michigan

In August 1975, Michigan embarked on a new experiment in state business taxation with the enactment of the single business tax (SBT), a value added type tax. The tax was so named because it largely replaced Michigan's more traditional types of business taxes—income, corporate franchise, inventory taxes.[1] The VAT[2] is based, in large part, on the "benefits received" rather than "ability-to-pay" concept of taxation. Ability-to-pay business taxes use such measures as corporate profits and income of individuals from partnerships, proprietorships and professions. The value added tax is a levy on the value a business firm adds to goods and services it purchases from other firms. The firm adds this value by handling or processing these purchases with its labor force, machinery, buildings and capital. Value added is the difference between a firm's sales and its purchases during an accounting period or alternatively, the sum of its wages, profits, rent, interest and royalties. Because it is based on the output of the firm the VAT is generally viewed as a good measure of the value of government services consumed by the firm.

Value added taxation has generated considerable controversy in this country in recent years. In this respect, the Michigan VAT is no exception. Its significance for present purposes is that it represents the first comprehensive effort by a state to tax all forms of business on a uniform basis.[3] In the past Michigan, like

most other states, has had a fragmented, uncoordinated business tax structure.

In 1937, Mabel Walker, executive secretary of the Tax Institute of America, summarized the state of business tax theory as follows:

> The subject of business taxation is in an unsettled state, theoretically as well as politically. There is no consensus among tax authorities concerning how business should be taxed, as there is, for example, in connection with personal taxation. The underlying principle is still in dispute. Economists have not agreed whether a system of business taxation should be based on the principle of benefits received or ability to pay. There is even greater uncertainty concerning how either of these principles could be most satisfactorily used in taxing business.[4]

Business taxation remains in an unsettled state and there is still no consensus about how business should be taxed, in part because the purpose of business taxation has not been clearly defined. Each of the states and local governments levy many different types of business taxes at varying rates. Unlike the federal government which has consistently relied on the corporate income tax, state and local governments have relied, to varying degrees, on income, franchise, intangibles, business property, gross receipts, and sales taxes (on business purchases) among others. The result is not only confusion and added expenses for business but situations that give rise to unhealthy tax competition among states and localities.

The adoption of the VAT in Michigan can be viewed as one state's attempt to answer, the question of how business should be taxed. Proponents of the VAT claim that the tax contains all the ingredients needed for a good business tax structure and is a major contribution to the effort to develop a uniform, rational business tax policy for state and local government. Its opponents claim that the Michigan VAT is an expedient measure enacted largely because of political considerations, not because of its overwhelming theoretical or practical superiority to other forms of taxation.

The contrasts between the typical state business tax structure and the Michigan value added tax are summarized in *Figure I*.

A STATE VAT VERSUS A NATIONAL VAT

Before the Michigan VAT is discussed, a distinction must be drawn between the use of a VAT at the national level and at the subnational level, as there are significant differences.

The business enterprise is the vehicle through which individuals in their roles as consumers or as suppliers of land, labor, or capital derive the benefits of economic activity. As an intermediary in the economic process, the business enterprise is a particularly efficient and/or expedient instrument for collecting taxes. Although it is widely understood that business taxes are borne by individuals as consumers, workers, or shareholders, political realities dictate that taxes be imposed on the enterprise. In the long run, business taxes reduce income available for private consumption or investment no less than do personal income taxes.

These general concepts hold for both national and subnational business taxes. A major difference for purposes of tax policy exists, however, because of the politically defined jurisdiction of state and local governments; these governments operate in "open" economies. A state or local government has no authority to erect tariffs or other barriers to trade, or to control the movement of labor and capital across its borders. The result is high mobility of the factors of production, which reduces the independence subnational governments can exercise in the formulation of tax policies.

An obvious implication of economic "openness" in combination with geographically restricted tax jurisdiction is that nonresident individuals owning a resident business enterprise cannot be taxed directly on their income or wealth (other than real property). In addition, resident individuals can engage in spending beyond the political boundaries of their state and avoid direct payments of sales and consumption taxes.

Another budgetary implication of economic "openness" is the overspill or externality of benefits from state and local expenditures. As a result, even if the benefits and corresponding cost of programs could be apportioned to identifiable recipients, the authority for requiring payments is limited by political boundaries.

An "open" economy also presents the op-

Figure I

Comparison of the Michigan Value Added Tax Approach to The Typical State Business Tax Structure

Issues	Typical State Structure	Michigan Value Added Tax
Composition	Complex—relies on many tax bases such as corporate, partnership, and sole proprietorship income, capital value, business inventory.	Simpler—replaces income, capital value, and franchise bases with the value added.[1]
Philosophy	Emphasis on net profits of business firm, therefore related to *ability to pay.*	Emphasis on business activity (use of capital and labor), therefore more closely related to *benefits received.*
Uniformity of Treatment of Business Firms	Scores poorly because the tax liability of the firm often depends on the form of business organization, i.e., whether or not the firm is incorporated.	Scores well on uniformity—businesses are taxed on basis of economic size rather than form of business organization.
Uniformity of Treatment of Capital and Labor	Taxes fall more heavily on capital than on labor—net profits, inventories, and net worth taxes in particular. Income of corporation is taxed not only when earned but also when distributed to shareholders.	No bias against capital because the impact of the tax is on capital and labor in proportion to their contribution to the value added to the product.
Incentive for increased Capital Investment	Not available unless provided by special treatment such as accelerated depreciation or investment credit.	No inherent discrimination against capital. One benefit—may reduce pressure to grant special concessions.
Stability of Revenue	Heavy reliance on income tax base results in sensitivity of collections to changes in the economy. To taxpayers this appears as an advantage, because lower profits result in lower tax liability.	Inclusion in the tax base of compensation to labor results in more stability in tax liability. To taxpayers this appears as a disadvantage, because taxes must be paid even if no profits are earned.

[1]Local real estate and personal property taxes on machinery and equipment are still paid by Michigan businesses.
Source: Compiled by ACIR staff.

portunity for exporting taxes to nonresidents. Examples are severance taxes on resources consumed in other states and sales and excise taxes paid by tourists. If tax exporting is carried to an extreme it can raise questions of interstate equity and the efficiency of resource use.

Because of these differences, the national government has more flexibility in taxing business than does state and local government and need not be restricted in its choice of a system of business taxation. Because the national economy is essentially a "closed" economy, factor mobility and overspills are not crucial factors in the development of national tax policy. On the other hand, employing the business enterprise as a tax collecting enterprise is the only method available for state and local governments to assess individuals, wherever they may reside, for the benefits of public service provided initially to the business enterprise. It can be logically argued from an economic efficiency standpoint then that the services of government should be treated like the services of labor and capital and their costs incorporated into the pricing structure.[5]

The VAT has the advantage of overcoming the major problems in business taxation that confront subnational governments, as indicated in the comments of Prof. Papke.

> While the federal TVA [VAT] is nothing more than a disguised retail sales tax, a TVA [VAT] imposed by an individual state, operating in an open economic system, is the only device by which a state can reach all incomes arising within its borders or the value of all goods and services provided therein. A TVA [VAT] is based on the dollar value of the contribution of the business enterprise to the output of goods and services in the state. The advantage of a TVA [VAT] levied at the subnational level is that it relates a business's tax liability directly to its use of economic resources—capital, labor, land, and entrepreneurial skills. The logic or rationale of the tax rests squarely on the benefits received principle of taxation—government services are essential to the operation of any business enterprise, regardless of profitability, and a part of these public service costs should properly be included in the cost of doing business.
>
> The subnational TVA [VAT] reaches incomes before they are distributed in the form of wages, interest, rents and profits and goods before they are exported. In short, it addresses itself directly to the problem of the inaccessibility of state tax bases, especially as it relates to subnational business taxation.[6]

The ACIR first looked at value added taxation when it was asked by President Nixon in 1972 to report on a proposal that would have used the proceeds of a national value added tax to provide property tax relief and to ameliorate fiscal disparities among school districts within each state. When the Commission concluded that there was no need for the national government to undertake school finance and property tax relief initiatives, it refrained from making any recommendation with respect to the value added tax.[7] The ACIR did, however, issue an information report in 1973, the *Value Added Tax and Alternative Sources of Federal Revenue*, which described the advantages and disadvantages of value added taxation and contrasted these with the advantages and disadvantages of other proposals to increase federal revenues. But the Commission does not have a recommendation for or against either a national or state value added tax.

FOOTNOTES

[1]The taxes replaced were the corporate income tax, corporate franchise tax, personal property tax on inventories, business intangible tax, financial institutions' tax, insurance company privilege fee, and savings and loan company privilege tax. These taxes raised an estimated $800 million a year in revenue, the amount expected to be raised by the VAT.

[2]The Michigan SBT will be referred to as the VAT throughout this report.

[3]Michigan enacted a type of value added tax in 1953 (repealed in 1967), but it was a supplement to the business tax structure rather than a replacement for other business taxes. Hawaii employed the value added concept in 1932 with the passage of the business excise tax: the tax was repealed in 1935. In 1970, the West Virginia legislature adopted a value added tax bill, which was very close to the "pure" VAT concept, however the bill was subsequently vetoed by the Governor.

[4]Mabel Walker, *How Shall Business Be Taxed*, New York, Tax Policy League, Inc., 1937, p. v.

[5]Robert D. Ebel and James A. Papke, "A Closer Look at the Value Added Tax: Propositions and Implications," National Tax Association: *Proceedings of Sixtieth Annual Conference*, 1967, pp. 157-158.

[6]James A. Papke, Discussion, Proceedings of the National Tax Association Seminar on "Balancing Our Federal-State-Local Fiscal System," *National Tax Journal*, Vol. 24, No. 3, Sept. 1971.

[7]ACIR, *Financing Schools and Property Tax Relief—A State Responsibility*, Report A-40, January 1973, p. 9.

Chapter II

Measuring Value Added

As explained in the introduction, value added is equivalent to the payments business makes for the use of labor and capital equipment—the sum of payroll, interest, and rental payments reflect the activity of the firm's employees, the services rendered by individual creditors and lessors of the firm, and the reward to the owners for risk-bearing. For the economy as a whole, the value added tax is a tax on the total income or the total product of the economy.

Three types of value added tax can be distinguished—gross product, net income, and consumption. The various types of value added taxes are so called because they closely conform to the gross product, net income, and consumption accounts, respectively, in the national income accounts. The essential distinction among these variants is their treatment of capital goods. Under the gross product type of tax, neither the cost nor the depreciation on capital goods purchased enters into the calculation of the tax base. The income type also does not permit the firm to deduct the cost of a capital asset at time of purchase but the firm is allowed to deduct annual depreciation on their capital assets when calculating the tax base. Under the consumption type, a firm that purchases capital assets may deduct their full cost in the year of purchase but no deduction of depreciation on the asset is allowed thereafter. The consumption type of value added tax pro-

vides the most neutral treatment of capital assets.[1]

The Michigan VAT is a modified consumption type of value added tax.

TO ADD OR TO SUBTRACT, THAT IS THE QUESTION

A value added tax can be calculated by an additive or subtraction method. Under the additive approach the base is built up by adding up the payments to the factors of production—profits, wages, rent and interest paid to individuals. Payments made to other firms are deducted to avoid double taxation of value added. Under the subtraction method components that *do not* measure value added, such as *cost of* goods sold (less labor costs) are subtracted from gross receipts to determine the taxable base (*Figure II*). The advantages of the additive method are listed below.

- □The main advantage of the additive method is simplicity. The concepts of profits and wages are already used by businessmen and conform with conventional accounting practices.

- □The additive method identifies the components of value added. It makes explicit what is taxed, i.e., profits, wages, interest, etc.

- □Some economists believe the additive method lessens the inflationary impact of a tax substitution.[2] One of the main criticisms of the value added tax has been that it is inflationary. The argument is that businessmen view it as a substitute for a sales tax, and would pass it directly forward to the consumer in the form of higher prices.[3] If the tax were viewed as a substitute for profits taxation, it is less likely that the tax would be passed directly forward to the consumer. With the additive method, the change would more likely be viewed as a switch from one form of profits taxation to another.

- □The additive method is more appropriate for taxing financial institutions.[4] Calculating the value added of financial institutions under the subtractive method could be done, but it might create inequities. For a nonfinancial firm interest paid is included in value

Figure II

Alternative Calculations for Consumption Type Value Added Tax

Additive Method	**Subtraction Method**	**Michigan VAT**[1]
Compensation Paid	Gross Receipts	Federal Taxable Income
Rent Paid	Less: Purchases from Other Firms or Costs of Goods Sold (other than labor and interest costs)	Plus: Compensation Paid
Interest Paid		Interest Paid
Dividends Paid	Less: Capital Purchases	Dividends Paid
Income Tax Paid	Equals: Taxable Value Added Base	Income Taxes and Michigan VAT Paid
Depreciation		[2]Depreciation (100% on assets acquired after 1/1/76, varying percentage on other depreciation)
Net Profits		Less: Interest Received
Less: Capital purchases		Dividends Received
Rent Received		Capital Purchases
Interest Received		Various Exclusions and Deductions
Dividends Received		
Equals: Taxable Value Added Base		Equals: Taxable Value Added Base

[1]This is an illustrative example and does not include all additions to, and subtractions from the tax base.

[2]Depreciation must be added to the base because it is deducted from federal taxable income, and failure to add it back would allow a double deduction for capital investment.

added because it is a payment to capital, but for a financial institution interest paid is similar to the cost of goods sold, which is not a part of value added. The additive approach allows the treatment of interest to be reversed, that is, interest paid is deducted from the base and interest received is added to the base. The major problem with this approach is that interest paid by a financial institution to a nonfinancial business will escape taxation.

PURITY VERSUS PRACTICALITY

The single business tax as introduced was almost a pure consumption type value added tax. The major concession was that rent paid was allowed as a deduction from the tax base and rent received was included in the base. This departure from the normal value added treatment of rent was adopted to prevent a windfall gain for a few companies, particularly real estate management firms, and to avoid placing a penalty on many companies that prefer to lease rather than buy property and equipment.

In addition to the exclusion of rent paid from the tax base, several other adjustments were made in the original bill in order to develop support for the proposal.

1. Depreciation charges on assets existing prior to the January 1976, effective date were excluded from the base. This exclusion was allowed to avoid penalizing those firms that made investments prior to January 1, 1976, and were not eligible to obtain the capital acquisition deduction.

2. Net operating loss carryforwards from the Michigan corporate income tax were allowed as a deduction from the VAT. This deduction was allowed because many businesses argued that it would be unfair for them to lose the tax benefits of losses when the corporate income tax was repealed.

3. The capital acquisition writeoff was not allowed for real property located outside the State of Michigan. This was done in order to encourage investment in Michigan. These types of investments may be depreciated in lieu of the immediate writeoff.

4. The standard three-factor formula (payroll, property, sales) was used to apportion the tax base of multistate taxpayers. Value added theory would dictate that the tax be calculated on an "origin" basis and implies use of the two-factor formula—property and payroll.[5]

5. A $15,000 small business deduction was allowed. A partial exemption was allowed if the tax base was between $15,000 and $60,000. The purpose of this exemption was to avoid the costs of collecting taxes from small, part-time businesses and to shelter small, low-profit businesses from taxation.

None of these adjustments constituted a serious departure from the value added concept. They were intended to simplify compliance with the law, reduce administrative costs and enhance the competitive position of Michigan relative to other states.

THE VAT COMPUTATION AS ENACTED

Value added in the Michigan tax is measured on the income side by summing payments to the factors of production—labor and capital. The actual calculation made by the taxpayer begins with business income, federal taxable income (*Figure III*). From this amount, deductions are allowed for dividends, interest and royalties received, and capital purchases eligible for federal depreciation. The additions to the tax base are payments for interest, royalties, labor (including fringe benefits) and depreciation. A deduction is allowed for 28% of all depreciation on assets acquired prior to January 1, 1976, and on assets located, or deemed to be located outside of Michigan acquired after January 1, 1976. This deduction increases to 50% in 1977 and to 60% in subsequent years.

The result is a tax base, which includes payments for interest, royalties, labor, and capital plus rent received. A number of exemptions and special deductions are allowed from this base, as follows:

1. Labor Intensity—Total compensation is limited to 65% of the gross tax base. Any excess percentage is allowed as a percentage deduction from the adjusted tax base (defined in Chap. 2, Sec. 31(2) of the act). For example, if compensation is 85% of the gross

Figure III

How to Compute the Michigan Value Added Tax

Add: Total Compensation = Salaries and wages (W-2), F.I.C.A. payments, unemployment insurance tax, worker's compensation premium, health insurance premium, pension, profit sharing cost.

SUBTOTAL

Add: Taxable income from federal return

Add: Net interest (paid less received)

Add: All depreciation taken on federal return for assets purchased before 1/1/76
All depreciation taken on federal return for assets purchased after 1/1/76

SUBTOTAL: GROSS TAX BASE

Subtract: 28% of depreciation on federal return for assets purchased before 1/7/76[1]

Subtract: Full value of real and personal property capital acquisitions

SUBTOTAL: ADJUSTED GROSS TAX BASE
Apportion by three-factor formula to determine Michigan tax base

SUBTOTAL: MICHIGAN TAX BASE

Subtract: Small business/low-profit exclusion, if eligible

SUBTOTAL: ADJUSTED TAX BASE

Subtract: Gross receipts limitation, if eligible

Subtract: Labor intensity deduction, if eligible[2]

TOTAL TAX BASE

MULTIPLY BY TAX RATE .0235

TAX LIABILITY

[1]Applies to 1976 tax year, deduction increases to 50% in 1977 and 60% in subsequent years.

[2]Calculated on the gross tax base above.

tax base, 20% of the adjusted tax base is allowed as a deduction. (Deduction cannot exceed 35% of adjusted tax base.)

2. Small Business—A business with income of $34,000 or less is allowed a $34,000 exemption ($36,000 in 1977 and subsequent years) from the tax base. This exemption is reduced $2 for each $1 that net income exceeds $34.000 and phases out at $51,000. An additional exemption of up to $40,000 is provided for partnerships.

3. Gross Receipts Limitation—The adjusted tax base of business is limited to 50% of gross receipts. If the tax base exceeds 50%, the excess can be deducted from the adjusted tax base. For example, if a firm's gross receipts are $200,000 and the calculated tax base is $120,000, the amount in excess of 50% of $200,000, in this case $20,000, can be deducted from the final tax base. (Firms using the gross receipts limitation are not eligible for other exemptions and deductions.)

4. Capital Acquisition Deduction—All businesses subject to the tax are allowed to deduct 100% of all new real property investments made in Michigan in the year in which the expense is incurred. The personal property investment deduction is calculated on the basis of a two-factor—property and payroll—apportionment formula.

5. Income Tax Credit—A sliding scale credit (tied to business income) of 10% to 20% of the SBT liability is allowed as a deduction from the personal income tax for noncorporate businesses. (This provision is included in the income tax act.)

6. Other Credits—(a) A credit is allowed for educational contributions (this is carried over from the corporate income tax), (b) certain utilities are allowed a 5% credit for state property taxes paid, (c) owners of farmland are allowed a credit for property taxes paid under certain conditions (this is carried over from the corporate income tax).

Under the Michigan VAT certain businesses were singled out for special treatment.

1. Rental Housing—Taxpayers whose interest and depreciation exceed 70% of the tax base are allowed to limit their tax base to 35% of gross receipts. This provision does not specifically mention real estate, but real estate builders and developers are about the only businesses that meet this criterion.

2. Food Retailers and Private Security Guards—A taxpayer meeting the requirements for these classifications is allowed to use a 35% labor intensity deduction factor rather than the 65% factor used by all other taxpayers.

3. Transportation Companies—Taxpayers in this classification are allowed to use a tax base equal to 30% of the computed base. However, these taxpayers are subject to a minimum tax equal to their average tax liability from 1971 to 1975.

4. Construction and Engineering—These firms are allowed to deduct 50% of all compensation on work bid prior to September 1, 1975.

5. Insurance Companies—The portion of the payroll of domestic insurers that constitutes insurance sales commissions paid to employees and salaries of employees primarily concerned with the adjustment of claims are not included as part of taxable compensation. (Foreign—out-of-state—insurance companies continue to pay the insurance premiums tax and are excluded from the VAT.)

6. Financial Institutions—The tax base of a business, 90% of whose assets are intangible personal property or 90% of whose gross income is dividends, interest, or other charges resulting from the use of money and credit, is calculated by reversing the normal treatment of interest, that is, interest received is added to the tax base and interest paid is deducted. (For an explanation of this different treatment, see *page 6.*)

These deductions and special exemptions added by the legislature reduced the yield of the VAT by over $200 million and required a 0.35% increase in the rate and less generous treatment of depreciation on assets acquired prior to the enactment of the tax (See *Table 1.*).

Table 1

Estimated Cost of VAT Exclusions and Deductions (1976)

(in millions)

General	
Capital Acquisition Deduction	$160.0
Labor Intensity Deduction	106.0
Small Business Exemption	65.0
Gross Receipts Limitation	12.0
Two-Factor Allocation Formula for Personal Property Investment	9.0
Net Operating Loss Carryforward	6.0
Income Tax Credit	10.0
Special	
Construction and Engineering Firms	14.0
Transportation Companies	9.0
Food Retailers	4.0
Private Security Guards	0.6
TOTAL COST	$395.6
Cost of Exclusions and Deductions Added to Original Bill	$205.0

Source: Michigan Department of Management and Budget, Office of Revenue and Tax Analysis.

In almost every case these special provisions were enacted because the businesses affected were able to convince the legislature that the change from the old to the new system would subject them to a burdensome tax increase unless they were granted special relief. The legislature was particularly concerned about small, low-profit businesses. The legislature was also concerned about unincorporated businesses paying both the VAT and the personal income tax. This concern was partly responsible for the enactment of the income tax credit for a portion of the VAT paid. The gross receipts limitation was enacted in order to limit the tax burden on professionals and the labor intensity deduction was aimed at firms with a high labor content, particularly service firms—a major concern in a strong labor state. The special treatment for individual industries was due largely to strong lobbying by these industries and their ability to convince the legislature that they were being treated unfairly by the VAT because of their special circumstances.

For example, the construction industry claimed that many of their projects were covered by bids that were based on a different tax system and they would be unable to recover the costs of higher taxes. The transportation industry made the case that they were regulated and they would be unable to pass along the higher costs of the tax system for several years because of regulatory lag. The food retailers claimed that they operated on a very low profit margin and were being unfairly burdened by the new tax system, and as a result would have to pass the increased taxes to the consumer in the form of higher food prices.

The effect of most of these special provisions was to complicate the law, provide discriminatory treatment in a number of areas, particularly in the case of food retailers, transportation companies and security guards, and to move the Michigan VAT away from the pure VAT concept and closer to the Michigan BAT.

The VAT is levied on all entities doing business in Michigan at a rate of 2.35% and is a tax "upon the privilege of doing business and not upon income." It is not a tax on gross receipts. The three-factor allocation formula—property, payroll, and sales—is used to apportion to Michigan the tax base of a multistate business. For example, if a multistate business has 50% of its payroll and property in Michigan and 10% of its sales in Michigan, the allocation factor would be 36.7% (50% + 50% + 10% ÷ 3).

This summary does not cover all the special provisions allowed or adjustments to the tax base. For more specific information refer to the act which is included in *Appendix A5* and the sample calculation in *Appendix A1*.

VAT VERSUS CORPORATE INCOME TAX

The evaluation of the value added tax as a state revenue source must be based on a comparison of the VAT with other types of taxes that may be replaced or raised in lieu of its enactment. Because the corporate income tax is the most widely used general business tax at the state level a comparison between it and the VAT has the greatest relevance.

No definitive statements can be made about how the two taxes differ in terms of their effects unless certain assumptions are made about whether these taxes are absorbed by the owners of capital or passed along to consumers. Many economists hold the view that the value added tax is shifted forward to the ultimate consumer through a rise in the price of consumption goods and the corporate profits tax is absorbed in the short run and shifted forward to the consumer, at least in part, in the long run. However, there are many factors that determine to what degree a tax will be shifted and it is impossible to make definitive statements about the final incidence of value added and corporate profits taxes.[6]

The discussion which follows is largely restricted to a national VAT—the effects of the Michigan VAT are discussed in *Part III*.

In every case the specific assumptions are crucial to the predicted effects on prices, efficiency and capital investment.

Price Effect

A major argument used against the VAT at the national level is that it would be inflationary. This argument is based on the assumption that the value added tax is passed along to the consumer while the corporate income tax is absorbed by the owners of capital. If this is the case, a tax on the factors of production is replaced by a tax on consumption. The result would be that prices would rise and the reward to the owners of capital would be increased. This could trigger a series of wage demands as workers tried to maintain their real wages, which in turn would result in another round of price increases.

If it is assumed that both taxes are absorbed by business, overall price levels will also be unaffected. In this case the VAT becomes a tax principally on wages and profits. The tax falls on two factors of production, labor and capital, in contrast to the corporate income tax which falls only on profits (capital) in its immediate impact. The result is that the rewards to both factors are reduced, but relative to the previous position, capital will be better off and labor worse off, since the tax burden is spread over two factors rather than one.

A third possibility is that in which the VAT is absorbed and the profits tax passed along. This situation will result in a decline in prices. However, because a tax on wages and profits reduces money income, the pattern of real gains and losses would depend on the household mix

of incomes from wages and dividends and the change in consumption patterns induced by the fall in prices.

If it is assumed, however, that both the VAT and the profits tax are passed forward the effect on prices will be negligible. There will be a change in relative prices favoring high-profit firms. The impact on the cost of living will depend on household consumption patterns for the goods whose relative prices have been changed.

Proponents of the Michigan VAT, used the assumption that both the VAT and the profits tax are passed forward although this may not be entirely correct. They argued that the VAT, being an additive type tax and administered in the same manner as the profits tax, will be treated by business in the same manner as the profits tax. However, because a value added tax liability is more easily determined in advance than a profits tax and because many of the firms paying the value added tax, such as professionals, are in relatively noncompetitive markets the value added tax is more likely to be shifted forward to the consumer than the corporate profits tax. In addition, many local market businesses such as service and construction firms, retailers, and professionals do not have out-of-state competition and as they are all taxed relatively equally they will be in a position to pass the tax forward to consumers.

Ebel, in his analysis of the Michigan business activities tax, assumed that, for various reasons, the BAT would be largely shifted forward by construction firms, utilities, wholesale trade firms, retailers, and, within the manufacturing sector, transportation equipment, stone, glass, and clay, primary metals and electrical machinery industries. These industries accounted for more than 60% of total BAT collections.[7]

Brazer holds the view that in the long run the Michigan VAT will be borne largely by immobile elements among the factors of production, just as were the repealed taxes.[8] The implication is that the VAT will have no discernible effect on the Michigan economy.

In a 1968 study Henry Aaron attempted to estimate the price effects, under various shifting assumptions, that would result from replacing the corporate income tax with a value added tax. The results of the study indicated that the impact would differ sharply from industry to industry. In some industries, the shift would require substantial adjustments. Agriculture, in particular, would be penalized under most shifting assumptions. Under the most plausible uniform shifting assumptions, six industries other than agriculture would face major adjustment problems. The taxes of those industries would be increased and they would face the need to raise prices and/or lower payments to one or more factors of production. The industries are (1) transportation and warehousing, (2) oil and gas, (3) hotels and services, (4) construction, (5) lumber and wood products, and (6) auto repair services. Eight other industries would enjoy major reductions in tax liabilities and the ability to lower prices and/or raise payments to one or more factors of production. The industries are (1) utilities, (2) communications, (3) automobiles, (4) aircraft and other transport equipment, (5) chemicals, plastics, drugs and paints, (6) radio and TV broadcasting, (7) tobacco, and (8) ordnance.* (The table including these estimates is included in the footnote on the next page.)

Although the Michigan VAT replaced seven other taxes in addition to the corporate income tax, Aaron's findings are consistent with the estimated impact of the new tax on Michigan industries. Labor intensive agriculture, services and construction have experienced particularly large increases and transportation would have also experienced a large increase except for a special provision in the act. Those firms receiving tax reductions are not as clear, but Aaron's estimates appear to be reasonably accurate.

Identification of the direction and extent of general business tax shifting requires creating a control situation in which all economic factors other than the tax remain unchanged. In a theoretical world, a multiplicity of variables must be taken into account, such as behavioral assumptions regarding the firm's goal, tax policies of competing states, market structure, the firm's cost conditions over time, degree of money illusion, government spending, technology, degree of specialization of inputs and price elasticities.

In partial terms, it is virtually impossible to isolate the effects of a tax change. At best, cer-

(See footnote on next page.)

tain major factors that influence the direction and extent of shifting of business taxes in the state economy can be identified and, in conjunction with a discussion of the nature of the particular type of tax employed, some general conclusions drawn about tax shifting.[9]

Efficiency

A supposed major advantage of the VAT relative to the corporate income tax is that it is more conducive to the efficient use of resources. This claim is usually supported by two arguments. The first is simple and widely accepted. The second is more complex and often rebutted.

There is general agreement that the corporate profits tax acts as a disincentive to the efficient use of resources because efficiency increases profits which in turn increase the tax liability. The tax is also considered by some to encourage wasteful spending because increased ex-

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(Footnote from previous page.)

*Absolute Change in Tax Liability and Percentage Change in Tax Liability As a Result of Replacing the Corporate Income Tax With a Value Added Tax (by industry)

Industry	Change in Tax Liability as a Fraction of Gross Domestic Output	Change in Tax Liability as a Percentage of Initial Tax Liability
1. Agriculture	.0280	1,524.1
2. Transport	.0206	135.1
3. Oil and gas	.0157	222.4
4. Services	.0263	330.8
5. Construction	.0193	346.3
6. Lumber	.0099	97.4
7. Amusements	.0138	80.1
8. Trade	.0180	74.9
9. Auto repair	.0228	394.8
10. Food	–.0027	–15.5
11. Leather	.0050	26.5
12. Furniture	.0021	9.5
13. Textiles	.0015	8.5
14. Metal products	.0007	3.0
15. Metal mining	.0021	7.9
16. Coal	–.0015	– 4.7
17. Metals	–.0028	–11.7
18. Rubber	–.0009	– 3.3
19. Miscellaneous manufacturing	–.0057	–19.5
20. Home appliances	–.0058	–18.4
21. Printing	–.0040	–13.1
22. Machinery	–.0150	–36.5
23. Paper	–.0148	–41.4
24. Instruments	–.0218	–44.7
25. Finance	–.0329	–47.3
26. Ordnance	–.0188	–51.8
27. Tobacco	–.0352	–58.1
28. Radio and TV	–.0405	–57.9
29. Chemicals	–.0331	–60.3
30. Automobiles	–.0350	–65.2
31. Communications	–.0640	–59.0
32. Utilities	–.0624	–72.0

Henry Aaron, "Differential Price Effects of a Value Added Tax," *National Tax Journal*, Vol. XXI, No. 2, June 1968, pp. 162-175.

The results depend almost entirely on the size of the value added tax necessary to replace the corporate income tax. The shifting assumption used is the classic assumption that the corporate income tax is not shifted, while the value added tax is fully shifted. Aaron indicated that there did not appear to be sufficient grounds on which to reach a best guess of the average shifting parameters or the difference between industries.

penses reduce a corporation's tax bill.[10] Admittedly this argument is less important at the state level because of the relatively low rates levied by most states.

The value added tax is not generally subject to this criticism because profits are taxed at a much lower rate and on an equal basis with other factors. A related argument is that a heavy profits tax could discourage capital investment because profits are a major source of investment funds. The VAT would reduce the tax on profits, thereby freeing more funds for job creating capital investments.

The more complex explanation of the efficiency theory, assumes that the value added tax is absorbed by business. The VAT then becomes a tax on *wages* and profits, at least in its immediate impact—final incidence is difficult to determine. The tax on wages will theoretically encourage the best use of labor. With a corporate income tax, a company that earns no profit pays no tax although the company may continue to employ a large number of persons. If profits are viewed as a measure of efficiency it could be argued that a company employing many people, and using large amounts of raw materials but earning no profits, is inefficient. These resources could be put to better use in companies earning a profit. Thus, a VAT which creates a tax liability even when no profits are earned encourages the company to economize on labor and to make profits from which it can meet its tax liability. On the other hand it could also be argued that the VAT has a negative impact by placing a burden on a new business before it has had a chance to earn a profit.

A secondary encouragement to efficiency comes from modern plants earning higher profits relative to sales than older plants. The replacement of a corporate income tax with the VAT would reduce the tax liability for the modern plant and increase it for the older plant. Since older plants are generally more labor intensive, and have higher overall costs, the company would be encouraged to transfer labor from the old plant to the new plant, thereby improving efficiency and productivity.

The supporters of the VAT generally argue that the economy can only gain from increased efficiency. Unemployment might be slightly higher in the short run but in the long run business would be more competitive, demand would increase, and new jobs would be created. Greater efficiency and higher productivity can produce only one outcome in the long run—a higher standard of living.

The benefits of a tax structure that encourages efficiency are clear to an economist, but the legislators who must pass final judgment on a value added tax are not economists. In Michigan there were few legislators who voted for or against the VAT based on a clear economic perception of the long run economic effects of a value added tax.

Capital Investment

A major claim made for the value added tax in Michigan was that it would provide an incentive for increased capital investment in the state. The rationale used to support this claim was that the reduction of the tax burden on capital would make capital investment in Michigan more profitable, thereby encouraging more investment. However, this outcome would occur only under certain conditions. Again a comparison of the VAT with the corporate profits tax is used to illustrate the potential outcomes.

If both taxes are fully passed forward to the consumer, there will be no differential effect on investment policies.

If both taxes are absorbed, the tax on profits is replaced by a tax on wages and profits. Prices are unchanged but the real returns to capital increase and those to labor fall. The result is an increase in the relative cost of labor. If these costs cannot be passed forward, the relative cost of labor and capital will shift in favor of capital, thereby providing greater incentive for investment.

If the VAT is absorbed and the profits tax passed forward, the tax on capital would increase as profits would bear a tax they had previously passed forward. The result would be to reduce the reward to capital and discourage investment.

The economic logic used in Michigan was actually somewhat faulty. The proponents of the VAT assumed that the profits tax and the value added tax were passed forward to the consumer, at least in the long run. If this were the case, the switch from a corporate profits tax to a VAT could provide no incentive for in-

creased investment, unless the two taxes are unshifted in the short run, in which case a short-term incentive for higher investment would be provided.

Revenue Stability

A major selling point for the VAT in Michigan, particularly with the legislature, was the gain in revenue stability achieved by exchanging the traditional business tax structure for a value added tax. Unlike the revenues from a corporate income tax, revenues from a VAT are unlikely to fluctuate greatly over the course of a business cycle.

Consumer purchases rise and fall as the economy swings between recession and expansion, but these changes are much more pronounced in states like Michigan whose economy is sensitive to the business cycle.[11]

Regressivity

The critics of value added taxation argue that it is a regressive tax in that it falls on the consumer in the same manner as a sales tax. As a result the VAT would bear heavier on low-income families because they spend a larger percentage of their income on taxable items than do high-income families. It can be argued, however, that the VAT is not passed forward to the consumer, or not shifted forward any more than any other business tax.

The proponents of the VAT also argue that the present federal tax structure is so progressive that an increase in the tax burden on those with high income would be counter-productive as it would reduce their incentive to increase their earnings. They also argue that the expenditures financed by a VAT are distributed in favor of low-income families thereby mitigating the regressive effects of the tax. Three frequently recommended remedies for the supposed regressivity of the tax are income tax credits, revisions in welfare programs, or multiple tax rates with lower rates on necessities.[12]

Administration

A final issue that should be mentioned is whether the VAT is easier to comply with or administer than other forms of taxation. Some experts argue that a VAT is more complex and expensive both for the tax administrator and the taxpayer. These arguments, however, generally apply to the European-type VAT. There is little question that the Michigan VAT as originally introduced was less complex than the European-type VAT. The final version of the Michigan VAT may be somewhat more complex, but, based on the first year's experience, it has created no more serious administrative problems than those normally experienced with a new tax. (See *Appendix A3* for detailed discussion of the administrative aspects of the Michigan VAT.)

Whether high compliance costs are perceived as a disadvantage of the tax will depend to a large degree on the type of tax structure a state currently employs and if the VAT is to be a replacement or supplemental tax.[13]

FOOTNOTES

[1]ACIR, *The Value Added Tax and Alternative Sources of Federal Revenue*, Report M-78, Washington, DC, U.S. Government Printing Office, 1973, pp. 19-21. Also see pp. 51-52 for examples of how the various types of value added taxes are calculated using both the addition and subtraction methods.

[2]Alan A. Tait, *Value Added Tax*, London, McGraw-Hill, 1972, p. 10.

[3]Very few of the critics of the Michigan VAT claimed that it was a sales tax.

[4]This was not a primary consideration in the selection of the additive method, but it did allow financial institutions to be equitably taxed under the Michigan VAT, an objective of some importance to the proponents of the tax.

[5]In an open economy, taxing income where it is received and spent, as do income and sales taxes, fails to tax goods and services sold outside the taxing jurisdiction and also fails to tax business income earned by nonresidents. A tax on value added is levied at the source of production, at the origin, whether that production is intended for sale in another state or country. If calculated on an origin basis, the value added tax provides a close tie with benefits received because industries can be directly taxed for the services provided by the governmental unit in which they are located. This aspect of value added taxation is particularly advantageous in Michigan, as the state is a large exporter of goods and services.

[6]For a discussion of the question of tax shifting, see Tait, *op. cit.*, pp. 72-84, 94-101.
Richard W. Lindholm, *Value Added Tax and Other Tax Reforms*, Chicago, Nelson-Hall, 1976, pp. 103-109.

Clara K. Sullivan, *The Tax on Value Added*, New York, Columbia University Press, 1965, pp. 263-271.

Richard A. Musgrave and Peggy B. Musgrave, *Public Finance in Theory and Practice*, New York, McGraw-Hill, 1973, pp. 396-410.

[7]Robert D. Ebel, *The Michigan Business Activities Tax*, East Lansing, MSU Business Studies, p. 139. The tax shifting issue is discussed on pp. 134-139.

[8]Harvey E. Brazer, "Michigan's Single Business Tax—Theory and Background," a paper presented to the NTA-TIA Annual Conference on Taxation, Phoenix, November 16, 1976, p. 21.

[9]For a discussion of these factors, see Robert D. Ebel, *An Evaluation of a Value Added Tax for the State of Hawaii*, Honolulu, Economic Research Center, University of Hawaii, 1973, pp. 69-72.

[10]See Musgrave, *op. cit.*, pp. 453 and 458.

[11]See Robert B. Bretzfelder, "Sensitivity of State and Regional Income to National Business Cycles," *Survey of Current Business; U.S. Department of Commerce*, April 1973, pp. 22-27. This article provides evidence indicating that the Michigan economy is more sensitive to changes in the business cycle than any other state economy.

[12]See Cambridge Research Institute, *What You Should Know About the Value Added Tax*, Homewood, IL, Dow Jones Irwin, Inc., 1973, pp. 84-85.

[13]See Sullivan, *op. cit.*, pp. 215-262 for a discussion of the administration of the value added tax.

Chapter III

The Michigan VAT: History, Rationale and Experience

THE BUSINESS ACTIVITIES TAX

The Michigan VAT represents a return to the philosophy of business taxation which was in effect in Michigan from 1953 to 1967. In these years, Michigan imposed the business activities tax (BAT), also a form of value added tax. Aside from the different types of exemptions allowed, the major difference between the VAT and the BAT is in the treatment of capital investment and depreciation. The VAT allows a complete writeoff for capital investment in the first year and requires that depreciation be specifically included in the base. The BAT allowed no capital investment writeoff and did not include depreciation in the tax base. (The initial act did not allow depreciation, but a 1955 amendment allowed a deduction for depreciation on real property.) (See *Figure IV* for comparison of the Michigan VAT and BAT.)

The BAT was repealed in 1967 for two basic reasons. (1) It was felt that the adoption of a personal income tax should be complemented by a corporate income tax. Organized labor would have been unlikely to support a personal income tax without a companion tax on business. (2) Many small and service-type businesses were strongly opposed to the BAT because it was not based on "ability to pay." Many businesses objected to paying taxes in loss years and were able to develop considerable opposition to the tax. George Romney, then Governor of Michigan, played an impor-

Figure IV

Comparison of Michigan Single Tax and Business Activities Tax

	BAT (final version)	VAT
Rate	0.75% for all businesses except utilities 0.20% for utilities	2.35% for all businesses
Base	Gross business receipts less cost of merchandise (excluding labor and overhead costs), supplies, rents, interest paid, taxes (other than income), utilities, depreciation of real property and all other outlays treated by *IRS Code* as ordinary business expenses	Business income (federal taxable income) plus compensation (including fringe benefits), depreciation, royalties paid and interest paid less interest and royalties received and capital expenses eligible for federal depreciation
Deductions	Small Business—$12,500 Gross receipts—50%[1] Labor intensity—50%[2]	Small business—$34,00 first year, $36,000 in subsequent years[3] Gross receipts—50%[3] Labor intensity—65%[3]
Special Provisions	Net income credit—Variable tax credit based on ratio of 1% of firm's adjusted receipts to net income. Credit ranged from 1% to 25%	Special treatment is provided for real estate firms, food retailers, security guard companies, construction and engineering firms, transportation firms and insurance companies.[3] Credits are provided for property taxes paid by farmers and certain utilities. A credit is also available to all companies for educational contributions.[4]
Allocation	Three-factor formula (payroll, property, and sales) Special allocation provisions for transportation	Three-factor formula Special allocation provisions for transportation
Administrative Procedures	Businesses with gross receipts of $25,000 or less were not required to file a return. Tax paid in quarterly installments or in advance for entire year. Annual return required.	Businesses with gross receipts of $34,000 or less not required to file return. Tax paid in quarterly installments. Annual return required.
Exemptions	Government and charitable organizations, financial institutions.	Government and charitable organizations.

[1]If total amount of itemized deductions was less than 50% of gross receipts, a business was permitted to take a standard deduction of a flat 50% of gross receipts.

[2]If a firm's payroll exceeded 50% of gross receipts, a deduction of 10% of these receipts or one-half the excess of payroll over 50%, whichever was smaller, was permitted in addition to the minimum standard deduction. Total allowable deductions were a maximum of 60% of gross receipts.

[3]Refer to *page 8* for explanation.

[4]Noncorporate businesses are eligible for a credit against the personal income tax which slides from 10% to 20% depending on the level of business income.

Source: Compiled by ACIR staff from Ebel, *The Michigan Business Activities Tax*, and the *Michigan Single Business Tax Act* (PA 228 of 1975).

tant role in the repeal of the BAT. Governor Romney, who was one of the prime movers behind the income tax proposal, was strongly opposed to the BAT and urged its repeal as part of the tax reform program. His opposition to the tax dated back to his days as president of American Motors, a low-profit company that fared better under an income tax than a value added tax.

Although it might be perceived that Michigan's previous experience with value added taxation made the enactment of the VAT easier, this was not the case. The opponents of the VAT pointed to repeal of the BAT as evidence that a value added tax would not be a beneficial addition to the tax structure.

THE WEDDING OF AN IDEA AND A NEED

The current version of the Michigan value added tax was first proposed in 1972 as a replacement for the school portion of the business property tax[1] and was revived in the fall of 1974 when the Governor was seeking means to cover an impending deficit of about $200 million in the FY 1974-75 budget.

The Governor presented the VAT proposal to the legislature in his January 1975 state-of-the-state address. The proposal was greeted with considerable skepticism by the business community and the legislature. However, because of the economic and fiscal situation, the legislature agreed to give the proposal a hearing although few legislators thought the proposal had any chance for passage.

The business community was split on the proposal, but those in favor of the VAT wielded enough influence to insure that the tax would be given a fair hearing by business. The VAT was generally favored by high-profit manufacturers, retailers, financial institutions, and utilities, mainly because their taxes would be reduced by the enactment of the VAT. Many multinational businesses favored the VAT because its adoption solved two major problems that they were concerned about. First, the apportionment of foreign dividends for income tax purposes, which is a major issue with multinational companies, would not be a problem under the VAT concept, as dividends received are not taxed. Second, these firms were also concerned about worldwide consolidation for tax purposes, which was not specifically required by the Michigan VAT act. (Some businessmen hold the view that the VAT has helped Michigan's image with multinational businesses.)

The revival of the value added concept of taxation in Michigan after such a short hiatus can be attributed to two main factors.

First, the experience with the corporate income tax was not very favorable. Michigan depends heavily on durable goods industries whose profits traditionally have fluctuated with the business cycle. This volatility, which created serious fiscal problems in Michigan, was partly responsible for the increase in income tax rates in 1971. For example, in FY 1968-69 the yield of the corporate income tax was $247 million (adjusted for rate change). In FY 1970-71 the yield was only $149 million. The following fiscal year (1971-72) the yield of the tax increased sharply, to a level of $270 million. Fluctuations in the corporate income tax collections also caused problems during periods of economic recovery by creating large surpluses that were sometimes hastily spent, thereby raising the expenditure base and in turn creating problems during the next downturn in the economy. Adding to the unpredictability of corporate income tax collections were frequent changes in accounting procedures and federal tax laws, such as accelerated depreciation and exemptions for Domestic International Sales Corporations (DISC). These changes generally tended to reduce the yield of the tax.

The second reason for the revival of the value added concept was the condition of the Michigan economy and the concern about the poor business climate; the proponents of the VAT claimed it would promote capital investment and create new jobs. Michigan has been plagued by high unemployment throughout the 1970s. In 1974 the unemployment rate averaged 8.5% and rose as high as 10.9% in December 1974. During the 1970-75 period the Michigan unemployment rate averaged 8.2%, 39% above the U.S. average of 5.9%.

In addition to the obvious weaknesses in the economy, Michigan was developing a reputation as a bad place for business. A number of surveys indicated that many businessmen ranked Michigan very low as a state in which to expand or locate a new business.[2] In some

instances the results of these surveys were questionable and the negative publicity about Michigan overdone, but many people in Michigan, including legislators and state government officials, began to become very concerned about the Michigan business climate. An unfavorable tax structure was cited as a negative factor by many businessmen, although by no means was it listed as the major factor. These negative attitudes were generally based on a comparison of Michigan tax levels with other states and not on any concern about equity or the economic effects of business taxes. However, much of the debate about Michigan's poor business climate focused on the tax structure because it was one of the few factors that policymakers could realistically change. Certain aspects of the tax structure were especially unpopular with various segments of the business community. The personal property tax on inventories was considered unfair by most retailers and, in fact, Michigan had granted relief from this tax in 1974 by allowing a phased credit against the corporate income tax that was scheduled to increase to 75% by 1981. The financial institutions tax was unpopular with some bankers who wished to be taxed in the same manner as other businesses rather than on a separate basis. The corporate income tax had also generated considerable litigation because of disagreements over taxation of foreign dividends and worldwide consolidation.

The corporate franchise tax was particularly unpopular with major corporations. Michigan was one of the few states with a substantial corporate franchise tax, a tax that had generated more litigation than almost any other.[3]

The proponents of the value added concept of taxation were able to convince many legislators that the Michigan business tax structure had held back economic expansion and that a drastic revision was needed in order to encourage greater employment opportunities in Michigan.

The combination of general dissatisfaction with several business tax measures and concern about the Michigan business tax climate produced a receptive atmosphere for reforms in the business tax structure. The support of those businesses that did not like particular aspects of the tax structure was important to the passage of the VAT.

THE CASE FOR THE VAT

The supporters of the new tax claimed it would have a number of beneficial effects.

Promote Capital Investment and Create New Jobs

They argued that the VAT with its capital acquisition deduction would lessen the heavy tax burden on capital, increasing the return on capital investment, thereby making investment in Michigan more attractive, and in turn create new jobs. This objective was given primary emphasis by the proponents of business tax reform because of the concern about employment opportunities and the genuine belief that this was the major advantage of the switch to the value added tax.

Eliminate the Short-Term Budget Deficit

The $180 million cash flow gain generated by the overlap of the new tax with the old tax structure would balance the budget and negate the need for sharp expenditure cuts or permanent tax increases.

This "windfall" resulted from the fact that the corporate franchise tax, which was to be replaced, was paid on an annual basis while the value added tax was to be paid on a quarterly basis. In addition, the personal property tax on inventories, which was to be repealed, was a local tax, and although local units were to be reimbursed, the first payment would not be required until FY 1976-77. (The first payment to local units from the VAT was made at the same time that they would have received the revenue from the property tax on inventories.)[4]

Many skeptics in the legislature and the business community claimed that the gain in revenue was the major objective motivating the Governor's proposed business tax reform. There is little question that this was an important consideration, as the Michigan Constitution prohibits a deficit. However, those who proposed the VAT considered this objective important only to the extent that it could be used as leverage to obtain passage of the tax reform program. The creation of a more favorable tax climate for business and a more equitable and neutral tax structure were the main objectives of the authors of the VAT.

Provide Long-Term Tax Stability

The instability of the business tax structure, particularly the corporate income tax, had precipitated two budget crises in Michigan, in FY 1970-71 and 1974-75. Therefore the proponents of the VAT believed the corporate income tax to be an inappropriate tax for a state with such a volatile economy. The VAT is much more stable than the corporate income tax, largely because about 75% of the base consists of compensation, which is not subject to wide swings from year to year.[5] *Table 2* compares the stability of the VAT with the old tax structure. The greater stability of the VAT was particularly evident in 1971, a recession year, when Michigan business taxes declined 15% compared with an estimated 3.9% decline had the VAT been in use. It should be noted that *Table 2* was based on the VAT as originally proposed. The final version is likely to be somewhat more unstable.

The stability objective had particular appeal to many legislators who accepted the premise that a stable state tax structure would reduce the need for sharp expenditure cuts during economic downturns.

A sharp decline in revenues in a state contributes to an uneven and inefficient delivery of public services. Thus, revenue stability is a pearl of great prize, particularly in those states such as Michigan that have a constitutional prohibition against deficit financing.

The stability objective was presented to the business community as a means of slowing the upward spiral in tax rates. The past two tax increases in Michigan could be attributed in large part to the sharp decline in revenue

Table 2

Stability of Michigan Value Added Tax Compared with Stability of Old Tax Structure

		1969-74				
Existing Taxes	**1969**	**1970**	**1971**	**1972**	**1973**	**1974**
Financial Institutions	$ 9.0	$ 13.3	$ 16.9	$ 14.0	$ 13.4	$ 17.1
Corporation Income	344.3	312.0	176.4	331.6	368.9	366.1
Corporate Franchise	113.4	122.6	132.9	140.0	152.3	156.5
Intangibles (Portion)	22.5	24.3	27.3	26.8	30.2	28.8
Savings and Loan Privilege	.3	.3	.3	.4	.5	.6
Insurance Privilege	.9	1.0	1.0	1.1	.9	1.2
Inventory (calendar year estimate)	192.3	206.7	223.3	231.2	238.9	253.0
Individual Income Tax on Unincorporated Businesses	2.6	2.8	2.0	3.3	3.6	4.0
TOTAL	$685.3	$683.0	$580.1	$748.4	$808.7	$827.3
Index*	1.000	0.997	0.847	1.092	1.180	1.210
Annual Rate of Change	— — —	(0.3)	(15.0)	28.9	8.1	2.5
Value Added Tax Base (in millions)	$27,890.2	$28,519.6	$27,409.4	$31,913.9	$36,202.3	$37,863.2
Index*	1.000	1.023	0.983	1.144	1.298	1.358
Annual Rate of Change	— — —	2.3	(3.9)	16.4	13.5	4.6

Note: The receipts from existing taxes are adjusted to the 1974 rate and base. The Michigan value added tax base is shown on a "going year" basis after prior depreciation and operating losses have been used up.

* Index computed using 1969 as base year.

( ) Indicates negative rate of change.

Source: Michigan Department of Management and Budget, Office of Revenue and Tax Analysis.

growth during a recessionary period. If the severity of these declines could be reduced, it was argued that the need for tax increases would be reduced. Some business officials viewed stability as an important consideration, because it would reduce the periodic proclivity of the legislature to look for business taxes to increase when revenues were needed. (In Michigan some businessmen were particularly concerned about the possibility of losing the industrial processing exemption from the sales tax.)

The Michigan VAT could have a countercyclical impact because of the capital acquisition deduction. In a recessionary period, the deduction will decline as capital investment falls, moderating any decline in revenue. In a period of strong economic growth, the capital deduction will rise, causing revenue to fall or increase less rapidly. This countercyclical effect is offset to a certain degree by the labor intensity factor. In a recession as profits fall, the labor intensity deduction will increase and revenues will decline. During a recovery period as profits rise, the deduction will decline and revenues will increase.

All things considered, the VAT as originally proposed would have been more stable than is the final version. Because of the revisions in the tax, specifically the labor intensity deduction, and the fact that the corporate franchise tax and the inventory property tax were quite stable, it is questionable whether the VAT will exhibit a significantly greater degree of stability than the old tax structure. The revenue going to the Michigan general fund should be more stable, however, as the corporate income tax constituted a large share of the state taxes replaced by the VAT—the inventory tax was a local tax.

In any event it is likely that any state (with a corporate income tax) adopting a VAT as a replacement for, or in lieu of, an increase in existing taxes could increase the stability of its revenue structure. This feature has little appeal to most businesses but could be a strong selling point to the legislature, particularly in states that are seriously affected by cyclical changes in the economy.

The opponents of the VAT countered the stability objective by arguing that the state should be required to reduce expenditures to match revenues during times of recession just as businesses are required to do. Many businessmen felt that they should not be required to suffer because of the state's poor fiscal planning. They suggested that the state should set aside money during good times to provide a cushion for economic downturns. Proponents of the VAT pointed out that it was politically impossible to keep the legislature from spending a surplus, making a more even flow of revenues the only feasible solution to the problem.

Simplify the Payment and Administration of Business Taxes

Replacing seven taxes, several of which were difficult to administer, with one tax would reduce confusion, paperwork, and expense for the taxpayer and the tax collector.[6] (Detailed information on administrative aspects of the Michigan VAT is contained in *Appendix A3.*)

Improve the Equity of the Tax Structure by Taxing All Businesses on an Equal Basis

Proponents of tax reform argued that the current system was unfair because it discriminated against business on the basis of their form of organization. Many partnerships and unincorporated businesses escaped taxation while corporations conducting the same type of business were heavily taxed. The VAT was a fairer tax, it was argued, because it taxed businesses uniformly on the basis of their economic size and contribution to the economy, rather than on their form of organization or some other artificial basis.

Many owners of unincorporated businesses argued that as they were paying personal income taxes on their business income, they should not be required to pay additional taxes. The proponents pointed out that the returns to the owners of corporations, i.e., dividends, were taxed as both business and personal income; therefore, to create an equitable situation, unincorporated business should also pay personal and business taxes. The different treatment of retained earnings was recognized by a proposed exemption from VAT for the retained earnings of unincorporated businesses. However, when it became evident that this exemption would be administratively unwork-

able, a sliding scale credit against the personal income tax for the Michigan VAT paid was adopted as a proxy for retained earnings.

Remove Penalty for Business Efficiency

Proponents claimed that the corporate income tax penalized efficiency and subsidized inefficient firms. They argued the VAT would lower the tax on profits and provide greater incentives for efficient operations.

The double taxation of dividends was also eliminated, as the VAT does not tax dividends received.

Take Advantage of Possibility for Tax Exporting

A major advantage of the VAT is that the potential exists for "exporting" the tax to taxpayers outside the state. (A tax is exported to the extent that it is shifted forward or backward to residents outside the taxing jurisdiction.[7]) This is important to Michigan which is a major exporter of goods and services. However, this argument was not used to any great extent by the proponents of the Michigan VAT.

THE CASE AGAINST THE VAT

Opponents of VAT raised six major issues.

Ability to Pay

Many businessmen argued that the tax was not based on ability to pay and they could not afford to pay taxes in loss or low-profit years. This was the main argument against the tax and one that generated the most emotion.

Proponents of the VAT used several arguments to rebut this complaint.

□Many of the taxes scheduled to be repealed, such as the corporate franchise tax and personal property tax on inventories, had no relation to ability to pay. These taxes were also paid by businesses in a loss situation.

□Since all companies benefit from public services, a company should not be exempt from supporting these services just because they earn no profit in a particular year. (The Michigan State and Detroit Chambers of Commerce went on record in favor of all businesses making a reasonable contribution for government services received.)

□Net income or profit is an elusive figure. Many companies are able to use creative accounting techniques to reduce reported income. For this reason and others, net income is not always the best measure of a company's ability to pay. A company can report little or no income yet still earn a relatively high return on investment. Professional corporations were used during the Michigan debate on the VAT as an example of businesses that were able to largely escape income taxation by paying generous salaries to their employee-shareholders.

□The VAT was based to some extent on ability to pay as profits were included in the base. At a later stage in the debate, the labor intensity deduction was cited as a feature reflecting ability to pay.

Tax on Labor

As more than three-quarters of value added reflects labor input, the VAT looks to be largely a tax on labor. Opponents of the tax claimed that placing a tax on labor (compensation plus fringe benefits) would discourage businesses from increasing employment and depress economic growth rather than provide the stimulus for economic expansion claimed by the supporters of the tax. Many businesses were particularly upset about the inclusion of payroll taxes in the base. Worker's compensation and unemployment insurance are very emotional issues in Michigan and are viewed by many businessmen as major contributors to the poor business climate. Paying a tax on taxes already viewed as excessive was labeled unfair by some business officials.

Proponents of the tax argued that employment decisions were based on market considerations and that the addition of a relatively small tax on payrolls would have little negative impact on employment. Supporters argued that the VAT would be minor in comparison to other payroll taxes such as social security, unemployment insurance, workmen's compensation, etc. Supporters of the VAT also argued that capital investment was needed to create new jobs, and that if the VAT encouraged capital investment as expected, employment would increase.

Low Tax Rate

Some businessmen feared that since the VAT

Table 3

Comparison of Michigan VAT and Previous Tax Structure For Three Typical Firms (based on 1976 tax year)

	Manufacturing Firm	Unincorporated Retailer	Self-Employed Professional
Taxable Income	$ 323,110	$18,722	$ 96,507
Total Compensation	831,508	65,529	22,510
Net Interest Paid	28,123	1,962	456
Depreciation on Assets Purchased Prior to 1-1-76	207,393	3,899	N/A
Depreciation on Assets Purchased After 1-1-76	9,146	158	1,397
SUBTOTAL: **GROSS TAX BASE**	$1,399,280	$90,270	$120,870
Labor Intensity Reduction Factor	ineligible	7.3%	ineligible
Capital Acquisition Deduction	(91,457)	(1,567)	(15,888)
28% of Depreciation on Assets Purchased Prior to 1-1-76	(58,070)	(1,092)	N/A
SUBTOTAL: **TAX BASE**	$1,249,753	$87,611	$104,982
Small Business Deduction	ineligible	(34,000)	ineligible
SUBTOTAL: **ADJUSTED TAX BASE**	$1,249,753	$53,611	$104,982
Gross Receipts Limitation	ineligible	ineligible	ineligible*
Labor Intensity Deduction	ineligible	3,914	ineligible
NET TAX BASE	$1,249,753	$49,697	$104,982
x Tax Rate—2.35%			
TAX LIABILITY	$ 29,369	$ 1,168	$ 2,467
VAT Credit (personal income tax)	- - -	(234)	(227)
VAT LIABILITY AFTER CREDIT	$ 29,369	$ 934	$ 2,240
Individual Income Tax (family of four)	- - -	585	4,163
TOTAL TAX LIABILITY	$ 29,369	$ 1,519	$ 6,403
TAX LIABILITY UNDER PREVIOUS TAX SYSTEM			
Corporate Income	$ 22,331	$ 585	$ - - -
Franchise Fee	7,411	- - -	- - -
Intangibles Tax	592	- - -	- - -
Inventory Tax (net after credit)	11,036	226	- - -
Individual Income	- - -	- - -	4,163
TOTAL TAX UNDER PREVIOUS SYSTEM	$ 41,370	$ 811	$ 4,163
NET CHANGE	($ 12,001)	($ 708)	$ 2,240

N/A—Not Applicable *Generally the larger professional businesses will be eligible for the gross receipts limitation.

Note: These examples are taken from *Appendix A1* which includes nine examples of how the change in the tax system affects various types of firms.

as initially enacted was a low-rate tax, the legislature would find it attractive for raising revenue because a seemingly small increase would produce substantial revenue.

The supporters of the tax argued it would probably be more difficult to raise the rate because, for the first time, all businesses would be covered by one tax. Any attempt to raise the rate would meet with solid opposition from the business community, whereas, in the past, a proposed increase in business taxes often affected only one segment, usually profitable corporations. The argument was also made that any debate over a proposed tax increase would focus on the amount of dollar increase and not on the magnitude of the increase in the rate. A 0.2% increase might sound small to the legislature and the public, but $70 million was a large enough amount to attract anyone's attention.

Shift in Tax Burden

A major argument used against the VAT proposal was that it shifted the tax burden, generally from profitable manufacturing firms, banks and utilities, to professionals, service firms and low-profit firms of all types and resulted in unreasonably large tax increases for many businesses (see *Table 3*). In some cases, businesses, particularly service firms and professionals, would be paying several times as much as they paid under the previous tax system. This was a difficult issue to deal with and nearly resulted in the defeat of the bill.

Small Business

One of the major criticisms leveled against the Michigan value added tax was that it placed too heavy a burden on small business. This issue probably created the most emotion and had the greatest impact on the legislature. Many opponents of the Michigan VAT began to call the tax the "small business tax" (SBT). Available data, however, did not support the charge that small business was unfairly taxed by the VAT. Proponents of the VAT presented figures indicating that the VAT paid by small business as a percentage of gross receipts was only 60% of that paid on average by all businesses. Although the data also indicated many small businesses would pay twice as much as under the previous tax system, supporters of the VAT claimed that many small businesses had been undertaxed in the past and the new tax system provided a more equitable distribution of the tax burden among all types of businesses, large and small. Supporters also pointed out that the vast majority of businesses were exempted from the tax because of the small business exemption. (No specific figure was mentioned, but available data indicated that about two-thirds of the businesses were likely to be exempted from the tax because of the small business exemption.)

Proponents of the Michigan VAT heavily emphasized the dependence of small business on the large, basic manufacturing and resource companies. They pointed out that service and retail firms can only grow and prosper if the state's basic industries are healthy. The ripple effects from new jobs in manufacturing, construction and utilities will create higher sales and employment in the service and retail sectors. Although some of these firms may pay higher taxes in the short run, they will benefit in the long run because of increased sales and profits.

This argument is plausible if one assumes the value added tax will create higher investment. However, this logic was not accepted by most businesses faced with large tax increases. They were more concerned about short-term losses than promises of long-term gains.

The supporters of the VAT also argued that the capital acquisition deduction would help new businesses and in some cases shield them from taxation in the early years of their existence.

Small businessmen generally did not agree that they were favored by the tax system. Even if they did agree they would likely argue that a tax advantage is needed if they are to compete with big business. In Michigan small businessmen claimed that they had less access to credit, were more susceptible to downturns in the economy, and were less able to pay taxes in a poor year than big business. One businessman claimed that the VAT was one way to ensure that he stayed a *small* businessman.

Although the VAT was viewed as favoring large businesses at the expense of small businesses, the real issue was unincorporated businesses versus incorporated businesses and nonprofitable firms versus profitable firms. Generally speaking, more small firms than large

firms tend to be unincorporated and/or unprofitable. As a result, the opponents of the VAT seized on the small versus large issue.

This issue was partially neutralized in Michigan not because the proponents were able to offer convincing arguments about the long-run benefits to small business, but because the opponents were unable to offer any solid evidence that the VAT was unfair or burdensome to small business. The actual impact of the VAT on "small business" was probably greater than most legislators expected when they enacted the tax. In this instance it is possible that if more accurate information had been available, the chances for passage of the VAT would have been reduced.

This is not to say that the tax unfairly burdens small businesses. There are special relief provisions in the Michigan VAT law, but because small businesses were treated even more favorably under the old tax system their tax burden has increased substantially in many cases. (A number of very small businesses are paying less under the VAT than under the old system because of the small business exemption.)

Administration

A number of businessmen and legislators claimed the VAT was excessively complex and would result in increased paperwork and expense for business, particularly unincorporated business and partnerships which did not normally pay business taxes.

The Michigan Department of Treasury has estimated that, after a transition period, the administrative costs of the VAT will be less than those of the old tax system. The administrative costs of the Michigan VAT are expected to be about $1 million a year.

Other Arguments Against VAT

Surprisingly, the two main theoretical arguments generally used against a value added tax were given little attention in the Michigan debate.

The argument that in its final incidence the VAT is a regressive tax was almost completely ignored. This is an issue usually raised by labor unions and if it was relatively unimportant in a heavily unionized state like Michigan, it seems unlikely that it will be a major consideration in other states.

The argument that a value added tax is inflationary was used to some degree, but did not become a major issue. The proponents of the tax claimed that there would be a one-time increase of about 0.5% in the Michigan (Detroit) consumer price index (CPI), with the increase centered in the service sector of the economy. This forecast was not documented, but it went unchallenged by the critics of the tax. (There is no evidence that the VAT has had any effect on overall price levels in Michigan. The Detroit CPI increased 5.4% in 1976, compared with a 5.8% increase in the U.S. CPI.)

The question of whether or not the tax could be passed along to the consumer became an issue. Opponents claimed that the large increase in the tax for many businesses could threaten the very existence of these businesses. The supporters of the tax pointed out that the maximum increase in taxes was 1.175% of gross receipts (in its final version) and that this could be recouped by a small price increase; after allowance for federal deductibility, the maximum increase would be considerably less than 1% of gross receipts. It is argued that in recent years businesses had been able to raise prices an average of about 10% per year and that an additional 1% would not be that difficult to pass along to the consumer. This argument was not accepted by most businesses. Many businessmen claimed that they would be unable to pass along the higher tax to consumers and thus would be required to reduce employment or suffer reduced profits. Even those businessmen who were willing to admit that the tax could be shifted to the consumer were not appeased by this argument. They argued that businessmen do not like to raise prices and resented the attitude that the increase in their taxes was not a problem because the burden could be shifted to the consumer.

Economic analysis suggests that the ability to pass on either a tax increase or a reduction will depend on competitive conditions. In Michigan the general view was that businesses paying increased taxes would pass the increase on to consumers, while those receiving a tax reduction would not be likely to pass the savings along to the consumer.

The economic argument that increased prices would reduce the demand for the company's product was not used. However, some com-

panies pointed out that they competed with out-of-state firms and that they could not increase prices without being put at a competitive disadvantage. This problem was one aspect of the VAT that was of some concern to even the strongest supporters of the tax. The general feeling at the time was that if the tax passed, this potential problem would have to be closely monitored to insure that these types of companies were not unduly burdened by the VAT.

Many businessmen who were opposed to the VAT overlooked, or did not accept the argument that if the Michigan VAT were not adopted other business taxes would probably be raised. From this standpoint the VAT would not necessarily have placed a business at a competitive disadvantage. However, many businesses pay higher taxes under the VAT than they would have under any other option and these businesses could be placed at a disadvantage with out-of-state competitors. The firms voicing this complaint were generally suppliers of large corporations or companies in highly competitive markets.

REASONS FOR PASSAGE OF THE VAT

The Michigan VAT was enacted in August 1975 after numerous amendments that provided special relief for labor intensive firms, small businesses, professionals, and several specific industries such as food retailing and transportation. The rate initially proposed was 2%, but because of the many exemptions and special provisions added to the bill the rate was set finally at 2.35%.

Although there were a number of factors involved, the main reason the VAT passed was because of the economic and fiscal climate. The VAT did not pass because the legislature and the business community were convinced of the virtues of value added taxation. The legislature did not really want to make such a radical change in the business tax structure but the budget had to be balanced and every other alternative seemed worse than the VAT. The economic climate created a receptive atmosphere for the claims that the VAT would promote capital investment and create new jobs. Even those who were skeptical of such claims, such as the labor unions, were concerned enough about the economy to at least tacitly accept such claims.

An additional factor working in favor of the VAT was that many businessmen believed a tax increase to be inevitable and found the VAT to be less objectionable than an increase in the corporate income or franchise tax or the loss of the industrial processing exemption from the sales tax.

In the final analysis the Michigan VAT was passed for political and budgetary reasons, but the advantages of value added taxation provided the strong economic justification (promotion of capital investment and revenue stability) needed to enact such a radical change in the Michigan business tax structure.

ESTIMATED TAX IMPACT ON BUSINESS

The business community, with few exceptions, opposed or supported the VAT almost solely on the basis of their estimate of the effect of the new tax on their tax liability (*Table 3*). Generally, all unincorporated businesses and partnerships, except those covered by the small business exemption, were opposed to the tax because they were then paying little, if any, business taxes. Most agricultural businesses were exempt from the tax because of their small size. However, many of the larger agribusinesses pay higher taxes under the VAT than under the previous tax system. These large businesses did not generally oppose the tax because the higher tax imposed by the VAT was, in most cases, more than offset by an increase in the maximum rebate allowed under the state property tax relief program.

Figure V summarizes the general impact of the tax on various types of businesses and *Appendix A2* presents industry-by-industry estimates of the impact of the Michigan VAT on tax liabilities. The estimates in *Appendix A2* are based on two early versions of the VAT and not on the final version, but the figures are reasonably reliable as an indicator of those industries that received a tax reduction and those that experienced a tax increase.

MICHIGAN'S BRIEF VAT EXPERIENCE

The VAT has been in effect only since January 1, 1976, and little data as to its impact is available. In conjunction with other measures,

Figure V

Comparative Tax Burden Under Old Tax Structure and Michigan VAT (by type of business)

Higher Taxes	Lower Taxes
Construction	Manufacturing (capital intensive)
Professional Services	Finance
Repair Services	Utilities
Business Services	Mining
Low-Inventory Retailers	High-Inventory Retailers
Labor Intensive Farming (e.g., fruit)	Wholesale Trade
Food Services	Mechanized Farming (e.g., dairy)
Hotel, Motel	
Insurance (casualty)	
Transportation Services*	
Manufacturing (low profit, labor intensive)	

*Because of a special provision in the act *(see page 9)*, many transportation firms received a tax reduction under the new tax system.

the VAT did allow Michigan to balance the FY 1975-76 budget without a permanent tax increase; although the first-year collections generated by the new tax were slightly less than expected.

It is too early to determine whether the VAT will achieve the goal of stimulating capital investment. The impact of the VAT on prices is also unclear although there is no evidence that the VAT affected the overall level of prices in 1976. However, there is some evidence that medical costs were increased in response to the new tax, which fell relatively heavily on members of the medical profession in private practice; the Detroit CPI for medical care increased 11.6% in 1976 compared to a 9.6% increase for the U.S. CPI. The difference is suspiciously close to the VAT rate. (Physicians, in most cases, were not previously subject to business taxes.)

The most significant development since the passage of the tax is the intense opposition expressed by certain segments of the business community; professionals, service firms, low-profit firms, and construction companies. This opposition was generated by the large increase in the state tax liability that many of these companies incurred under the VAT. In some cases the magnitude of these increases was larger than the business community or the legislature expected. In response to the vociferous complaints about the new tax, the Governor appointed a task force of 36 businessmen, an economics professor, and exofficio members from the legislative and executive branches, and charged them with examining the impact of the VAT and recommending any changes that may be needed to correct inequities.

MICHIGAN TASK FORCE HEARINGS AND RECOMMENDATIONS

The task force held a series of public hearings around the state during November and December 1976. A summary of the testimony at the hearing will provide a better understanding of current business attitudes toward the Michigan VAT.

The largest part of the testimony was against either portions of the tax or the tax as a whole. It is interesting to note that many speakers who were against specific portions of the tax were not against the concept of the VAT per se. Specific areas of concern were the inclusion of workers' compensation, unemployment compensation, and FICA in the labor portion of the base, treatment of interest, and the requirement that a firm be liable for the tax even when the business had sustained an operating loss during the tax year.

Both those who were against the tax in toto or against only a portion of the law generally urged that tax criteria should be based on the ability to pay as measured by some definition of profitability.

Apparently, there is no great concern whether this measure is based on net accounting profit or a broader, more inclusive gross profit definition.

While a wide variety of industries were represented at the hearings, certain industrial sectors made up the majority of those testifying. Farmers, especially at the hearings in Benton Harbor-St. Joseph and Grand Rapids, were highly critical of the tax. Many crops require labor intensive harvesting methods to preserve premium quality. Moreover, many farmers have high interest expenses. Many farmers

held the viewpoint that neither the capital acquisition deduction nor the increase in the property tax circuit breaker provided an adequate compensation for the added costs of the VAT.

A second group, protesting the inclusion of interest in the tax base, were automobile dealers. This group incurs a heavy interest expense in financing their inventory. Because auto dealers had been exempt from the inventory property tax, the VAT added a new tax burden without any apparent countervailing benefits.

Independent insurance agents comprised a third group of critics of VAT. Their problem stemmed from the fact that they were unable to control their prices and, therefore, could not pass on the additional costs due to the VAT. Moreover, they could not avoid the tax by paying wages as commissions like the larger insurance companies could do.

Professionals, including doctors, lawyers and accountants, comprised a fourth group with major representation at the VAT hearings. Most of this group were subject to a business tax for the first time and were protesting the new tax burden. Several witnesses asserted that VAT and malpractice insurance would force doctors to leave the state.

Other witnesses represented:

Small manufacturing firms, who because they are generally more labor intensive than the norm, could not take advantage of the capital acquisition deduction.

Construction firms, who because they are generally heavily labor intensive and have recently been operating on low profit margins and also, because they make heavy workers' compensation and unemployment insurance payments, urged that these items, with FICA, be removed from the tax.

Service industries, especially restaurants, which, again because they are labor intensive, feel put upon by the VAT. Included in this group were dry cleaning/linen supply firms, which, in addition to being labor intensive, are also protesting the decision to consider their supplies of linens, etc., as personal property subject to the property tax rather than inventory which would be tax exempt.

Most witnesses represented their own firms which ranged in size from small, one and two-person operations to several rather large firms. The majority were at the smaller end, however. In addition, many speakers represented professional and trade associations.

Several conclusions can be drawn from the hearings even though the speakers in all likelihood over-represent the disaffected portion of the Michigan business community. First, the basic idea of business taxation is clearly acceptable to the business community. That the VAT is the proper vehicle is less universally accepted. However, many who testified against the VAT were not against the tax in theory; they objected to specific features of the tax or to the redistribution of tax burden caused by the tax. Finally, it may be concluded that the pattern of tax burden is occurring in approximately the way expected prior to the passage of the tax, but that shifts are occurring in greater magnitude than originally anticipated.

As a result of the public hearing and an in-depth study of the Michigan VAT, the task force reached the following conclusions.

1. The single business tax (VAT) system is tending toward meeting the original goals of greater equity, simplicity, revenue stability, and creation of an economic climate conducive to business investment and expansion in Michigan. However, the magnitude of the shifts of tax burden is greater than anticipated and inequities have resulted that require remedy.[8]

2. In order to provide a more equitable tax, the principle of "ability to pay" should be incorporated to a greater degree into the single business tax system.

3. Any proposals for amendment to the tax must address the question of providing relief in an equitable and consistent manner throughout the whole of the business community of the state, rather than attempting to address the peculiar problems of particular types of business or industry.

4. Several groups of taxpayers have vigorously opposed the tax, thus pointing out the public perception that the single business tax has fallen short of meeting its original goals.

5. Although the task force has attempted to

evaluate the impact of the tax on all sectors of the business community, it is apparent that those businesses which favor the present tax system have not communicated with the task force. A notable exception is the banking community, which was very responsive to the efforts of the task force.[9]

The task force had some difficulty in agreeing on recommendations for changes in the VAT and the lieutenant governor, who was the chairman, expressed disappointment that the task force members were unable to overcome their self-interests and effectively discharge their responsibilities.

In response to the conclusions, the task force made the following recommendations for modifying the Michigan single business tax.

1. Create an alternative calculation for low-profit businesses, especially small businesses. This calculation would be based on income the proprietor, partners or operators extract from the business. This tax base would be adjusted to permit the sheltering of a certain portion of a business's income and the tax rate would be a multiple of the single business tax rate. This option would be limited to businesses with gross receipts of less than $100,000.

This proposal was recommended because the task force was impressed with the appeal of many businesses for taxation based on "ability to pay." The task force stated that this proposal would preserve legislative and executive intent to include a wider array of taxpayers while protecting the small business sector from devastating tax liabilities.

2. Permit taxpayers using the gross receipts alternative (tax base limited to 50% of gross receipts) to take a credit against the single business tax liability. At present a credit against personal income taxes is permitted only in the case of taxpayers using the additive method of calculating the VAT.

3. Provide relief to labor intensive businesses. The specific recommendation is to remove certain payroll taxes from the single business tax base.

4. Serious consideration should be given to weighting the profit component of the base (federal taxable income) more heavily than other components in order to recover revenues which will be lost if the recommendations for relief are enacted and to tie the single business tax more closely to "ability to pay." (The task force did not formally approve this concept, but it was presented to the Governor by the task force chairman.)

5. Set aside a portion of general fund surpluses in a budget stabilization fund. This fund would be a mechanism to minimize the imbalances between expenditures and revenue and, thus, promote the goal of stability in Michigan's fiscal system.

6. Simplify the reporting process by introducing a short form tax return that could be used by certain classes of taxpayers with uncomplicated returns. In addition, create a set of guidelines to help determine the most advantageous calculation procedure.

7. Encourage gubernatorial and legislative action on the recommendations outlined above. The task force has received vigorous appeals for relief from certain portions of the business community. Those appeals have communicated a sense of urgency that remedies be enacted promptly.

The Governor has made several recommendations for changes in the VAT retroactive to January 1, 1977, based upon the task force report.

1. Provide tax relief for small, low-profit business by allowing an alternative method of calculation based on the gross profit[10] of the business would be allowed. The full benefits of this provision would be available to any business with less than $40,000 in gross profit and would be phased out at $50,000. The tax would be 5% of gross profits, with an exemption of the first $15,000 in gross profits. This alternative method would be available only to companies with gross receipts of less than $5 million.

2. Provide relief to labor intensive business by removing workers' compensation and unemployment compensation taxes from the tax base.

3. The personal income tax credit currently

available to unincorporated businesses that do not use the gross receipts limitation should be extended to all unincorporated businesses.

4. The revenues foregone as a result of these changes should be restored by weighting the profit component of the tax.

Although they rest on strong practical grounds, many of these proposed changes would move the Michigan VAT further away from a pure VAT. The strong opposition to paying taxes in a no profit situation and to the substantially higher tax burdens incurred by many firms has forced the Governor and the legislature to give serious consideration to these proposed changes.[11]

A number of legislators have already introduced amendments to the act, and in one instance, a bill that would repeal the VAT, in response to the complaints about the tax from business constituents. It is now certain that there will be amendments to the VAT designed to provide more relief for small, labor intensive and low-profit businesses. However, repeal is highly unlikely for several reasons. First, the tax still has the support of the Governor and the legislative leadership, although they are concerned about certain aspects of the VAT. Secondly, a large segment of the business community supports the tax, although they have generally not defended it publicly. Third, reverting to the old system would create serious fiscal and administrative problems for the state, Finally, such an abrupt reversal of policy would violate the fiscal certainty criterion and seriously damage Michigan's business climate.

The VAT is not under fire because it is an unfair or unwise tax, but because it abruptly redistributed business tax burdens.

DISTRIBUTION BY INDUSTRY OF MICHIGAN VAT PAYMENTS 1976

The first-year payments from the Michigan VAT were somewhat less than originally estimated, but the industry distribution was in line with expectations. *Table 4* includes estimates of the number of returns, the estimated annual liability and the capital acquisition deduction by industry class. These figures are preliminary data drawn from quarterly estimates for the July 1976-June 1977 period. They are reasonably accurate as a measure of the distribution of VAT payments among the various industry groups, but the actual amounts will likely be higher when final figures are available. This is because firms have a tendency to underestimate their annual liability and because the first year's liability was reduced by credits for loss carryforwards from the corporate income tax and overpayments of corporate income taxes.

As expected the manufacturing sector provided the largest share of the revenue from the Michigan VAT—55.5%; almost 30% was contributed by the transportation equipment industry alone. Almost two-thirds of the returns were filed by retail trade and service firms, but they contributed only 28.3% of the total receipts.

The capital acquisition deduction totaled $4.5 billion, considerably less than the original estimate of $6.8 billion. However, it is likely that the final figure will be closer to the original estimate.

A comparison of the distribution of receipts from Michigan's two value added-type taxes contained in *Table 5* indicates that the distribution of receipts by industry class is not much different for the Michigan VAT than it was for the BAT. The decline in the manufacturing share can be largely explained by the relative decline of the importance of manufacturing in the Michigan economy. Slight differences are also created by the fact that financial institutions were not taxed by the Michigan BAT. The increase in the contribution from the communications, transportation and utilities sector is largely because utilities were taxed at a much lower rate under the BAT than other businesses. The construction industry pays a smaller share of the VAT than of the BAT, in part, because of the special labor deduction provided to the industry. Some of the differences in the distribution in payments between the Michigan VAT and BAT are due simply to the fact that the industrial mix of the economy shifted between 1965 and 1976 *(Table 5)*.

A comparison of the industry distribution of Michigan VAT and BAT returns with the distribution of Michigan labor and proprietor's income is also presented in *Table 5*. The figures indicate that the industry distribution of Michigan VAT payments corresponds relatively

Table 4

ESTIMATED DISTRIBUTION OF 1976-77 SBT PAYMENTS
(unaudited returns)[1]

Industry	Number of Returns	Percentage of Total Returns	Estimated Annual Liability (000)	Percentage ot Total Liability	Average Liability	Capital Acquisition Deduction (000)	Average Deduction	Annual Liability as Percentage of Labor and Proprietors' Income (1975)
Agriculture	3,876	2.9	$ 1,625	0.2	$ 420	$ 1,135	$ 293	2.8
Mining	521	0.4	3,288	0.5	631	16,380	89,021	1.4
Construction	11,148	8.3	18,284	2.5	1,640	127,507	11,438	1.0
Manufacturing	12,925	9.6	407,267	55.5	31,510	1,991,514	154,082	2.3
Nondurable	3,017	2.2	57,959	7.9	19,211	509,003	168,712	—
Durable	9,908	7.4	349,308	47.6	35,255	1,482,511	149,628	—
—Primary Metals	671	0.5	32,529	4.5	48,478	227,113	338,469	—
—Fabricated Metals	1,984	1.5	23,796	3.3	11,994	66,696	33,617	—
—Machinery except Electrical	1,941	1.4	30,146	4.1	15,531	123,701	63,731	—
—Transportation Equipment	644	0.5	214,402	29.4	332,922	958,265	1,487,989	—
—Other Durable	4,668	3.5	48,435	6.6	10,376	106,736	22,865	—
Transportation	2,430	1.8	7,464	1.0	3,071	49,242	20,264	0.7
Communications and Utilities	724	0.5	32,196	4.4	44,470	1,244,442	1,718,843	2.6
Wholesale Trade	4,443	3.3	29,007	4.0	6,529	106,956	24,073	1.2
Retail Trade	45,301	33.7	138,312	18.9	3,053	433,801	9,576	3.3
Finance, Insurance and Real Estate	13,795	10.3	27,285	3.7	1,978	135,519	9,099	1.7
Services and Other	39,374	29.3	68,894	9.4	1,750	391,698	9,948	1.1
TOTAL	134,537	100.0	$733,622		$ 5,453	$4,498,194	$33,435	2.0

[1]These figures are based on quarterly estimates for the period from July 1976-June 1977.

Source: Compiled by ACIR staff from information provided by the Michigan Department of Treasury.

Table 5

COMPARISON OF DISTRIBUTION OF VAT AND BAT COLLECTIONS AND MICHIGAN INCOME (by industry)

	Percent Distribution of Estimated Michigan VAT Payments (1976-77)	Percent Distribution of Michigan BAT Payments (1965)	Percent Distribution of Total Michigan Labor and Proprietors' Income (less government and nonprofit organizations) 1975*	1965
Agrigulture	0.2	0.2	1.2	1.6
Mining	0.5	0.7	0.7	3.5
Construction	2.5	5.5	5.1	6.2
Manufacturing	55.5	62.8	49.2	53.5
Communications and Utilities	4.4	2.1	3.2	2.5
Transportation	1.0	—	3.0	3.4
Wholesale Trade	4.0	4.6	6.4	5.6
Retail Trade	18.9	14.4	11.4	11.2
Finance, Insurance and Real Estate	3.7	0	4.3	3.8
Services and Others	9.7	9.4	15.1	11.7

*A complete industry breakdown was not available for 1976. The available figures for 1976 are listed below:

Agriculture	— 0.9%	Finance, Insurance and Real Estate	— 4.0
Manufacturing	— 51.4	Transportation, Communications and Utilities	— 6.0
Mining	— 0.6		
Construction	— 4.6	Services and Others (Including nonprofit organizations)	— 16.1
Wholesale and Retail Trade	— 16.2		

Source: Compiled by ACIR staff from data supplied by the Michigan Department of Revenue; Robert D. Ebel, *The Michigan Business Activities Tax*, pp. 83; Bureau of Economic Analysis, U.S. Department of Commerce.

closely to the distribution of labor and proprietor's income. A comparison with the distribution of value added by industry would be more appropriate, but the data is not available. Labor and proprietor's income is a reasonable proxy, as compensation accounts for about 75% of the Michigan VAT base.

The major differences between the distribution of tax payments and income are in the retail trade and services categories. However, if the two categories are added together they account for 28.6% of total VAT payments and 26.5% of labor and proprietor's income, which indicates that there may be some industry classification problems with the tax data.

There is also a substantial difference in the agricultural category, which may reflect the fact that most farms are exempted from the VAT by the small business exemption, as well as the inappropriateness of labor and proprietors' income for measuring the agricultural tax base.

The construction and transportation industries together contributed only 3.5% of total tax payments although they represented 8% of labor and proprietor's income. This difference is a reflection of the special exemptions provided for these industries by the Michigan VAT law.

The last column in *Table 4* shows the estimated annual VAT liability for 1976-77 as a percent of 1975 labor and proprietor's income. These figures are only a rough approximation of the relative industry contributions—1975 data is used because the desired detail was not available for 1976. The difference between the figures for retail trade and services, again, appear to be a reflection of an industry classifi-

cation problem. Other differences are due to either special treatment provided by the Michigan VAT act, as in the case of the transportation and construction industry groups, or the fact that labor and proprietors' income is a better measure of the VAT base for some industries than for others. For example, the labor component of the tax base for the services industry is very high, while it is relatively low for the manufacturing and communications and utilities industries. This is the likely explanation for the large difference in the relative tax contributions of these industry groups.

This preliminary analysis of the distribution of Michigan VAT payments should be used with caution. It is provided to give the reader a general idea of how the tax burden of Michigan VAT is distributed. The data presented here could be substantially revised, although the distribution of tax payments is unlikely to change significantly.

CRITERIA FOR CONSIDERING A VAT

In view of Michigan's experience with value added taxation, the logical question is: Should other states adopt the value added tax? That question can only be answered individually be each state depending upon its general view of value added taxation and on its economic climate, fiscal situation, current business tax structure, industrial structure, public attitudes toward business, and legislative make-up. It is nonetheless possible to set our criteria which can be used to determine whether a state should even consider a value added tax. Listed below are the factors that must be considered.

□*View of Value Added Taxation:* Is the VAT viewed as an equitable, efficient tax?

□*Economic Climate:* Has employment growth been lagging behind regional and national growth rates?

□*Business Climate:* Does business have a negative attitude toward the state as a place for business location and expansion?

□*Current Tax Structure:* Does the tax structure treat like businesses differently? Is capital taxed heavily? Has the tax structure been subjected to criticism because it is complex or inequitable?

□*Industrial Make-Up:* Is the state's economy heavily dependent on manufacturing and resource (mining, oil, etc.) companies? (The VAT generally treats manufacturing firms more favorably as compared with the traditional business tax system.)

□*Fiscal Situation:* Is the State's revenue system subject to large swings depending on the vagaries of the economy? Is revenue growth inadequate to finance the level of services desired by the public?

□*Public and Legislative Attitude:* Are public attitudes and legislative influence well balanced as between different types and sizes of businesses? Does large business have substantial influence in the state? (A switch from the traditional business tax structure to a value added tax will generally be more favorable to large businesses than small businesses.)

If the answer to most or all of these questions is yes, a state probably should give consideration to replacing or supplementing its business tax structure with a value added tax. If most of the conditions listed above exist in a state, the benefits of value added taxation are likely to outweigh the disadvantages and there will probably be a reasonable chance of enacting such legislation.

For example, a state faced with a serious unemployment problem, a poor business climate, and an impending fiscal crisis is likely to be much more receptive to a radical change in its business tax structure than a state with above average employment growth and a large surplus in its treasury.

Strong advocates of the VAT might argue that the tax should be considered by a state regardless of business and fiscal conditions because value added taxation is simply more equitable, efficient and neutral than are other types of business taxation. It can be argued, however, that regardless of the advantages of the value added form of taxation it might be unwise for a state heavily dependent on service type activities such as tourism, to enact a tax that could place its major business sector at a competitive disadvantage with similar tourist-based businesses in other states.

Michigan's experience suggests that a sudden shift to the value added tax may be an unwise

policy for other states. This is particularly applicable in a situation where value added taxation is replacing other state taxes. If the tax is supplementing other business taxes, the redistribution of the state business tax burden will not be as abrupt, but some businesses will still be subject to substantially larger tax increases than if the rates of current taxes were increased.

Because the distributional impact of the value added tax is substantially different from that of traditional business taxes, a phase-in period would ease the transition. One alternative would be to retain the corporate income tax as a minimum tax initially and then phase it out over several years time. If there were particular concern about the impact of the VAT on low-profit firms, the corporate income tax could be retained as a minimum tax permanently. This is not always feasible, however, as was demonstrated in Michigan where the overriding fiscal considerations necessitated abrupt action. Under such circumstances a state must weigh the political and economic consequences of a sharp shift in the tax burden against the benefits of value added taxation.

Even if a phase-in period is used, it is unlikely that such a radical shift in state-local business tax policy can be achieved except under the conditions listed above. The Michigan situation was not so unique as to hold no relevance for other states, but the combination of circumstances required for enactment of the Michigan tax may not occur often. The Michigan success in implementing the new tax was largely the result of a fiscal crisis that limited the legislative options, a poor economic climate that created a receptive atmosphere, and widespread dissatisfaction with the business tax structure. The instability of the Michigan tax system and the manufacturing-oriented business structure were additional factors which made the VAT attractive to some businesses and legislators.

A value added tax probably cannot be enacted in a state only on the strength of economic arguments about its supposed merits as a form of taxation. The merits of the VAT, even if they were not in wide dispute, would not likely be enough to convince a legislature to make radical changes in a long-standing tax structure to achieve an uncertain outcome. From a practical viewpoint the value added tax can probably be enacted only on the basis of compelling arguments about its favorable impact on the economic and fiscal structure of the state. If there is little concern about the economic and fiscal situation in a state, proposing a value added tax is likely to be an unproductive exercise.

FOOTNOTES

[1]The constitutional amendment to replace the property tax as the source of school financing was defeated by the voters in November 1972.

[2]*The Fantus Survey*, Illinois Manufacturers Association, 1975. The business climate in Michigan was ranked 45th among the 50 states.

[3]The Michigan corporate franchise tax was levied on the net worth or capital surplus of the firm.

[4]The revenue lost because of the repeal of the personal property tax on inventories is returned to local units of governments in the first year on the basis of actual loss. In the second year the disbursement is increased 5% and in subsequent years the payments to locals are based on a set percentage of the VAT. The effect of this is to redistribute the inventory portion of the personal property tax from areas with a high growth in inventories to areas with a low growth rate. A local unit with a slow rate of economic growth, such as Detroit, will benefit from this change in tax policy.

[5]See Robert D. Ebel, *The Michigan Business Activities Tax*, East Lansing, MI, 1972, p. 60 for a discussion of the revenue stability of the Michigan BAT.

[6]*Ibid.*, pp. 127-128 for a discussion of the administrative advantages of the Michigan BAT. Also see Samuel J. McKim III, "Michigan Single Business Tax Seen as a VAT," *The Tax Executive*, pp. 25-58, October 1976, for a discussion of the administration of the Michigan VAT from a legal point of view.

[7]See Ebel, *op. cit.*, pp. 140-142 for a discussion of the exporting of the Michigan business activities tax. He states that, based on the percentage of out-of-state shipments, the following industries would have been the major vehicles for BAT exporting: agriculture, mining, food and kindred products, textile mills, furniture and fixtures, printing and publishing, chemicals and allied products, rubber and plastics, stone, clay, and glass, fabricated metals, machinery, except electrical, electrical machinery and miscellaneous manufacturing. Ebel refers to a study that estimated that in 1956 approximately 26% of the BAT payments were exported from Michigan.

[8]The only "inequities" that were documented are situations where a firm is paying much higher taxes than they paid under the old tax system.

[9]Governor's Advisory Task Force on Single Business Tax, *Final Report*, State of Michigan, Lansing, MI, March 1977, pp. 6-7.

[10]Defined as net profit plus income received by active owners, partners and corporate officers.

[11]Some businessmen have received a misleading impression of the impact of the tax because they have compared their 1975 liability under the old system with their 1976 liability under the new tax system. This comparison fails to take into account the fact that the liability under the old system would have also increased in 1976, substantially in some cases, because of the strong economic recovery.

Chapter IV

State and Local Business Tax Policy

One of the most difficult questions to answer in the field of state-local finance is: How should business be taxed? This question has never been adequately answered, although it has generated considerable interest and debate, particularly in recent years as state and local taxes have grown rapidly.[1]

A discussion of how business should be taxed would not be complete without a definition of business taxes.

John Due defines "taxes on business" as levies under which business firms, as distinct from individuals not engaged in business, are involved in any way. He divides business taxes into four categories.

1. Taxes paid by business firms directly to governments, without instructions that the amounts be collected from anyone else. There are two subclasses:

> **A.** General levies that apply both to business and individuals, such as the property tax.
> **B.** Levies applied specifically to business, such as corporate income or value added taxes.

2. Taxes paid by business firms to vendors who are expected to collect the tax from the purchasers. An example is the retail sales tax on business purchases.

3. Taxes paid to government by business

> firms that are regarded as tax collection agents for government. Examples are the retail sales tax and the income tax withheld from employees' wages.

Due concludes that there is little scientific basis for classifying taxes as "business" or "nonbusiness" taxes and that because of the confused and unascertainable distributional effects of certain business taxes, such as the property tax on business property, reliance on these taxes should be minimized if desired distributional goals are to be attained.[2]

Business taxes are naturally of great importance to the business community, but they have never generated great interest or emotion among the public except on those occasions when there is publicity about certain businesses receiving large tax breaks or avoiding taxes completely because of loopholes in the tax laws. This lack of concern is probably due primarily to the public's lack of understanding of the complex maze of business taxes levied by all levels of government and their more immediate concern with the taxes that fall on them directly. Economists have never been able to determine the final incidence of business taxes, but in the final analysis taxes must be borne by the consumer in the form of higher prices, the employee in the form of lower wages, the stockholder in the form of lower dividends or lower stock values, or the proprietor in the form of lower profits. Because the impact is indirect and obscure to most taxpayers, business taxes often have substantial political appeal. It is much easier for an elected official to levy a tax on some faceless enterprise than on the voters. Some policymakers see business taxes as a means of increasing taxes on the wealthy, but the final incidence of most business taxes probably bears more heavily on consumers and employees than on stockholders. This view is supported by Due.

> Despite their limitations, taxes on businesses especially those with obscure distributional effects, have great political appeal. Many persons appear to regard a tax on business as a levy on the enterprise, per se, and thus not falling on any human beings who are voters. This is of course nonsense; any tax must reduce the real income of some individuals, and analysis of distributional effects without regard to the persons whose incomes are affected is meaningless. Corporations do not have tax paying ability in and of themselves, but only as agents for people—owners, employees, customers, etc. Liberals seeking a higher portion of the tax on the wealthy frequently favor business taxes as a means of attaining this objective—yet the objective is in all likelihood rarely obtained by this means.[3]

BUSINESS TAXES AND LOCATION DECISIONS

Business is far from defenseless in the battle to hold down state and local taxes. In recent years the business community has done an excellent job of convincing many legislators and state officials that taxes can have a detrimental effect on economic growth. The highly fragmented business tax structure of the United States, in which each of the 50 states and innumerable local governments levy many different types of taxes at varying rates, not only creates confusion and expense for business but also encourages destructive competition among states and localities and impedes the rational development of an efficient and equitable tax structure.

Concern about the impact of taxes on interstate competition for business has acted to slow the growth in business taxes to a rate below that for individual taxes. For example, between 1960 and 1975 the yield of the corporate income tax, the major state business tax, increased 192% while that of the individual income tax rose by 298%.[4] Some of this difference can be accounted for by the greater elasticity of the individual income tax, but about half the difference is due to the states' greater reliance on individual taxes during the past 15 years. Concern about taxes and interstate competition is particularly acute in the midwest and northeastern states where businesses and jobs are growing more slowly than in the south and southwest. Taxes in the midwest and northeast are generally higher than in other parts of the country, and some businessmen, politicians and state officials have claimed a direct relationship between high taxes and the lack

of business growth. The per capita state and local tax burden in 1975 was $715.37 in New England, $823.46 in the mideast and $657.51 in the Great Lakes region. This compares with a tax burden of $489.51 per capita in the southeast and $531.83 in the southwest.[5]

The trend toward reduced reliance on business taxes is not of recent vintage. In its 1967 report, *State-Local Taxation and Industrial Location*, this Commission noted that:

> The increase in business tax collections from $5.7 billion in 1950 to $14.5 billion in 1964 (excluding employment taxes) represents nonetheless a slow but steady decline in the relative fiscal importance of this component of state and local taxes. It dropped from 36% to 30.4% during this 14-year period.
>
> State efforts to attract industry by improving the tax climate are largely responsible for this development. The transition has proceeded at a slow and steady pace, as dictated by fiscal and political realities. State tax policymakers pursue a policy of attracting industry by improving the tax climate with understandable caution. The majority of the electorate would not support the repeal of the $14.5 billion of business taxes for this objective or on the grounds that they are simply indirect or hidden sales taxes—particularly if it means corresponding increases in personal taxes. In short, most of the post-war activity on the business tax front can be described as an effort to maximize the attractiveness of the state's tax image while minimizing the loss of revenue and political support. The steady demand for more revenue places heavy constraints on the business tax reduction policy, while the keen desire to promote economic development virtually precludes any attempt to raise the general level of business taxation.[6]

In addition to holding the line on business tax increases, many state and local governments have enacted selective tax reductions and tax incentives designed to improve their business tax image. These incentives include property tax exemptions for new industry, industrial development bonds, tax concessions, and preferential writeoff provisions in the corporate income tax. There is little empirical evidence to date that tax incentives or tax levels in general have much effect on industrial location decisions, but they continue to be an important concern of state and local policymakers.[7] However, casual observation suggests that in situations where state-local taxes are well above those in surrounding areas (e.g., New York City, Massachusetts) these differentials can influence business location decisions.

The desire to maintain a favorable business climate and remain competitive with other states is a major factor in determining the level of business taxes but it does not completely explain why state and local governments select particular types of taxes, although it can be argued that state and local governments are susceptible to the "herd instinct." That is, they tend to adopt the types of taxes used by other jurisdictions and are reluctant to adopt a tax that is not widely used in other parts of the country.

BENEFITS RECEIVED AND ABILITY TO PAY CRITERION

There are two major criteria that can be used to select a tax base, ability to pay and benefits received. According to the ability to pay criterion as applied to business, net profits are the best measure of a firm's ability to pay taxes. This has been a key factor in the states' selection of business taxes as evidenced by the widespread use of the corporate income tax. Another important factor has been the federal government's use of the corporate income tax.

There are three major arguments against the ability to pay approach: (1) net income is an elusive tax base because of wide differences in accounting techniques, and even if uniformly determined it is not an adequate measure of the taxpaying ability of a firm; (2) net income provides no consistent relationship between taxes paid and government services provided; and (3) ability to pay is inherently a personal matter, related to "sacrifice" and "loss of utility." As applied to a firm,

the concept is meaningless, except as a way of describing the economic effect on the ability of the firm to survive and grow.

Ability to pay is, however, a popular concept with taxpayers and politicians. Many businessmen claim they do not mind paying taxes out of profits but if they do not make a profit they should not have to pay taxes. This argument carries weight with many policymakers.

In contrast to the ability to pay criterion, the benefits received criterion attempts to put government expenditures and revenues in the same equation. The basic argument used to justify this type of business taxation is that government provides business various beneficial services such as highways, and protection of persons and property. Business would have to purchase or provide these services themselves if they were not provided by government. In an economic sense, government services are a factor input in production just as are labor, land, capital and enterpreneurship. Business taxes should therefore be treated as any other business cost and incorporated into a firm's pricing structure. The corporate income tax and several other state and local taxes do not meet the benefits criterion as firms earning no profits do not pay a tax, although they consume public services to no less a degree than a profitable firm. The public services received by these "unprofitable" firms are being subsidized by other firms; it would be unthinkable for one business to subsidize, for example, the labor costs of another firm.

The extent to which business utilizes governmental services is not directly measurable. The most obvious proxy is a measure of overall business activity such as value added. While the relationship between value added and benefits received is indirect so is the relationship between corporate profits and ability to pay. In either instance business is expected to make a reasonable tax contribution but no attempt is made to provide any direct link between services and taxes.[8]

OTHER CRITERIA

There are a number of other factors that are given varying degrees of weight by state and local governments in developing business tax policy. These are enumerated below.

Distribution of Tax Burden. The distribution of business taxes among industries and among companies within industries is a primary concern of legislators and state and local officials. Decisions about a tax proposal are often made solely on the basis of information about the change in the tax liabilities of various companies and industries. For practical reasons (e.g., mobility of the industry, or the "marginal" industry which is a large employer) some jurisdictions often take a protective attitude toward certain industries. These jurisdictions would be unlikely to adopt taxes that fall heavily on these industries.

Some policymakers are concerned with a tax structure that achieves relative tax equality among all taxpayers. However, since most state and local tax systems exhibit a fairly high degree of tax inequality this concern is not very widespread.[9] State and local policymakers seem to be most concerned about shifts in the tax burden.

Revenue Productivity. State and local governments generally select those revenue sources that will produce adequate amounts of revenue at reasonable rates of taxation; rates that are not out of line with other jurisdictions and that will not have a significant impact on economic behavior; high rates will exacerbate the inherent structural inequities and weaknesses in a tax. Unfortunately, revenue needs and political considerations sometimes require that these guidelines be ignored.

Responsiveness to Economic Growth. This is a tax criterion that is often overlooked by policymakers, partly because of a lack of understanding. A nonresponsive or inelastic tax structure often results in fiscal problems that lead to frequent tax increases. Although this is a major weakness of most state-local tax structures it is given little weight in developing business tax policy.

Administrative Ease and Compliance. As state and local business taxes have proliferated, this has become a more important tax criterion. Multistate firms are often required to fill out thousands of tax forms and the cost involved is far from insignificant. A jurisdiction that emphasizes taxpayer convenience will have a positive image with the business community.

The growing trend toward state conformity to federal tax provisions clearly reflects recog-

nition of the need to promote the dual goals of taxpayer convenience and administrative simplication. The widespread use of the corporate income tax can be attributed, in large part, to state and local governments' concern with the administrative aspects of business taxation.[10]

Fiscal Certainty. This is often an important factor to business, but is usually given much less weight by state and local governments. The business decision to locate in a particular jurisdiction is a commitment based on the future economic climate. The more uncertain the future conditions of a state, the more unlikely that a favorable location decision will be made. Such factors as periodic state financial crises, frequent tax changes, and tax policy decisions based solely on political expediency will tend to create a bad business climate in a state. A stable and productive revenue structure will lessen the chances of fiscal crises and mitigate the need for frequent tax changes.

Ratio of Business to Nonbusiness Taxes. Legislators frequently follow a "rule of thumb" to test the reasonableness of public policy. In the business tax field, one rule of thumb is to maintain the ratio of business to nonbusiness taxes. Any tax proposal that causes a significant change in the historical ratio has difficulty in attracting public and legislative support.

In many states, the business share of total state-local taxes has declined in recent years, partly because of business tax concessions and partly because the individual income tax and the retail sales tax have been more responsive to economic growth. Nonetheless, the business-individual ratio remains an important factor in shaping state-local tax policies. It should be noted that this distinction is completely illusory as there is no way to determine the final incidence of business taxes and therefore who bears the tax burden cannot be determined.

"Exportability" of Taxes. Many states favor taxes that can be exported to nonresidents. For example, New Hampshire imposes low tax rates on cigarettes and liquor to make them attractive for purchase by tourists and residents of neighboring states. At one time the state levied a wage tax on nonresidents working in New Hampshire so as to capture the credit neighboring states allow their residents for a state income tax on wages and salaries earned in another state. The latter effort to "export" New Hampshire's tax burden was thwarted by the U.S. Supreme Court.

PRINCIPLES OF STATE BUSINESS TAXATION

Because of the confused and undeterminable distribution of business taxation and the conflicting interests involved, it is difficult to develop business tax objectives and principles that would be widely accepted. However, it can be argued that in business taxation it is no longer sufficient to rely on general principles applicable, largely, to taxes that fall directly on the individuals. Michigan's enactment of the single business tax—VAT—and the identification of the factors that shape state business tax policy provide a framework within which to discuss some of the attributes that state and local policymakers might wish to consider in developing a business tax structure.

A fundamental issue in business taxation is whether states would do better to strive for a uniformly applicable, comprehensive and nondiscriminatory business tax system (e.g., VAT) or whether they should seek "to get the most feathers with the least squawks"—that is to tax industries differentially and selectively based on the inelasticity of demand for their output or supply of their inputs or on the basis of their inability to relocate. The former approach may be more equitable, but the latter may be more efficient in maximizing revenue while minimizing legislative discord and the impact on the economy.

If uniformity and nondiscrimation are viewed as the appropriate objective, then the following principles of state business taxation embodied in the Michigan VAT have merit.

Broad based economic measure for tax—VAT rather than income tax

Ability to pay consideration

1. To insure that all businesses make some contribution for state government services, a broad based measure of the economic activity of the firm, such as value added, rather than profit, could well serve as the primary basis for state taxation of business firms; however, to protect no and low-profit firms (particularly small businesses) from the excessive tax burdens that can arise from the indiscriminate use of business activity or value added type taxes, appropriate safeguards to assure some consideration of ability to pay can be used.

Neutral as to form of business organization

2. To insure that business taxes are borne as equally as possible by all segments of the business community, the business tax system should not discriminate on the basis of the form of organization.

Expense all capital investment and dispense with special tax inducements

3. To provide equitable treatment in the design of tax policies aimed at encouraging economic development, the immediate "expensing" of business capital investments for all firms is prefereable to the granting of special tax concessions that often discriminate against existing firms.

Reduce number of business taxes

4. To minimize compliance and administrative costs for both taxpayers and tax administrators, avoid the use of an excessive variety of business taxes.

Stability

5. To provide a uniform flow of business tax receipts, use a measure of business activity that remains essentially unaffected by swings in the business cycle (e.g., value added rather than profits).

Reimburse local government

6. To protect local governments from revenue losses due to state-initiated changes in the business tax structure, the state should provide adequate reimbursement for the repeal of the local tax on business personalty or other modifications in the business tax structure that erode the local tax base.

TAXATION ON THE BASIS OF BENEFITS RECEIVED

A case can be advanced that a state business tax structure should achieve a balance between the benefits received and the ability to pay concepts of taxation. The business tax structure currently used by most state governments generally places a much greater weight on ability to pay than on benefits received. A case can also be made for sheltering low-profit firms from burdensome taxation. Nonetheless, it can be argued that all businesses should make some contribution toward the support of government services regardless of their level of profitability.

If a more equal contribution from all segments of the business community is desired, a state business tax structure might give more

weight to the benefits received concept. The criteria for the taxation of individuals recommended by the ACIR are all based on ability to pay but this is a very elusive concept for business. Business net income can be measured in many different ways that, it can be argued, often bear little relationship to a business's ability to pay taxes.[11] The benefits received concept, because of its close association with a measure of overall business activity, provides a closer link between government services provided and taxes paid and reduces the inequality of the business tax burden.

Ability to pay considerations should not be abandoned entirely in business taxation. Advocates of the benefits received concept of taxation might argue that while ability to pay considerations should not be a major factor, they should be given some recognition to insure that certain businesses are not unduly burdened by the tax structure. The Michigan approach has been to build in safeguards designed, largely, to protect small, low-profit businesses. Certain segments of the Michigan business community, however, are of the opinion that even greater safeguards are needed and it is likely that the Michigan VAT will be amended to provide greater relief for small and low-profit businesses.

NEUTRALITY TOWARD FORM OF BUSINESS ORGANIZATION

The current system of business taxation generally uses the form of business organization as one means of determining the type and level of taxation to be imposed on business. The result can be inequitable treatment among competing businesses. If neutrality is viewed as a desirable objective, business taxes should be borne as equally as possible by all segments of the business community and should not discriminate on the basis of form of organization, type of financing, capital-labor ratio, or degree of efficiency.

UNIFORM TREATMENT OF CAPITAL INVESTMENT

The typical state business tax structure often places a relatively heavy tax burden on capital accumulation, thereby dampening the incentive for business expansion. The principal state and local business taxes, the property and corporate income taxes, place a heavier burden on capital than on other factor inputs. One result is that state and local governments often feel compelled to grant selective tax incentives in an attempt to encourage business to locate or expand in their jurisdiction. The inherent soundness of business tax policies that are framed along general rather than special benefit lines was discussed in this Commission's report, *State-Local Taxation and Industrial Location*. The Commission concluded in the report that "special tax concessions to new industry can have baneful effects on our federal system by setting in motion a self-defeating cycle of competitive tax undercutting and irrational discriminations among business firms."[12]

The Commission also concluded in its earlier report that the locally administered tax on personal property is an inequitable tax because it discriminates erratically among firms, it is difficult to administer because much of the tax base is mobile, and it bears no direct relationship to either a firm's ability to pay or the benefits provided the firm by the government. The Commission recommended that the states eliminate the tax on business inventories and either move the administration of the tax on other classes of business personalty to the state level or provide strong state supervision over its administration to insure uniformity.

The adoption of a more neutral form of taxation, such as VAT, would provide more uniform tax treatment of capital and possibly reduce the need for states to grant selective tax incentives.

STABILITY OF BUSINESS TAX BASE

Many state and local governments are prevented by constitution or statute from operating a deficit budget. A highly volatile business tax structure can create periodic fiscal crises, disrupt budget planning, and result in an inefficient delivery of public services. A VAT would provide a more even revenue flow that would contribute to better fiscal planning and reduce the need for tax reductions during periods of slow economic growth.

CONCLUSION

This discussion of the attributes of the Michigan VAT should not be construed as an endorsement of value added taxation or the principles embodied in this type of tax system. However, these principles appear to have merit and a critical examination by policymakers of their validity in light of state and local tax objectives might be instructive.

Adherence to these principles does not depend exclusively on enactment of a value added tax. By modifications of the corporate income and other business taxes in current use, states could broaden their business tax base to include all forms of business organization. (New York State and City and the District of Columbia currently use unincorporated business taxes.) Allowances for capital investment in lieu of depreciation could also be built into the corporate income tax. The personal property tax on inventories could be phased out on a gradual basis or repealed and replaced by a higher corporate income tax or some other business tax. And, the corporate income tax could be revised to include a minimum tax (based on a certain percentage of gross receipts, for example) in order to insure that all businesses made a contribution for the services provided them by state governments.

A more detailed and critical analysis of the various objectives and economic effects of state and local business taxation would be required before any definitive statements can be made on the question of how business should be taxed. The State of Michigan, however, has taken a bold step to break away from many of the traditional tenets of taxation. How successful this new approach will be remains to be seen.

Hopefully, this discussion of business tax policy in general and the attributes of Michigan tax system in particular will generate a debate on state and local business tax policy that will advance the knowledge in this field and encourage the development of more definitive statements on this most complex subject.

FOOTNOTES

[1]Between 1960 and 1975 state and local taxes increased from 7.25% to 9.84% of GNP.

[2]John F. Due, "Identification of Business and Nonbusiness State and Local Taxes and the Policy Implications," TIA Symposium, November 5-6, 1970, *Business Taxes in State and Local Governments*, Lexington Books, D.C. Heath and Co., Lexington, MA, 1972.

[3]*Ibid*, p. 13.

[4]*Significant Features of Fiscal Federalism*, ACIR, 1976, p. 31.

[5]*Ibid*, p. 49.

[6]ACIR, *State-Local Taxation and Industrial Location*, Report A-30, Washington, DC, April 1967, pp. 57-58.

[7]*Ibid*, p. 70.

[8]For an excellent discussion of this issue see, Clara K. Sullivan, *The Tax On Value Added*, New York: Columbia University Press, 1965, pp. 156-177.

[9]Robert D. Ebel, "An Evaluation of a Value Added Tax for the State of Hawaii," Economic Research Center, University of Hawaii, Honolulu, January 1973, p. 47.

[10]See Indiana Department of Revenue, "Results of a Survey on the Uniformity of State Tax Laws by the State of Indiana," 1977.

[11]An example is a professional corporation that pays out all of its profits in the form of wages to its shareholders-employees and is therefore subject to little or no corporate income tax. Examples of this were cited in the Michigan VAT debate and made some impression on legislators.

[12]ACIR, Report A-30, *op. cit.*, p. 83.

Appendix A1

Michigan VAT: Sample Calculation and Examples for Selected Businesses

SAMPLE CALCULATION[1]

Add: Total Compensation =	Salaries & Wages (W-2)	$	
	F.I.C.A.	$	
	Unemployment Insurance	$	
	Workers' Compensation	$	
	Health Insurance	$	
	Pension, Profit Sharing	$	
	Subtotal		ST
Add: Taxable Income from Federal Return			$
Add: Net Interest (Paid less Received)			$
Add: All Depreciation on Federal Return for Assets purchased before (1-1-76)[2]			$
All Depreciation taken on Federal Return for assets purchased after (1-1-76)			$
SUBTOTAL: GROSS TAX BASE			ST
Calculate Labor Intensity Reduction Factor, if eligible[3]		%	
Subtract: 28% of Depreciation on Federal Return for assets purchased before 1-1-76[4]			$
SUBTOTAL: ADJUSTED GROSS TAX BASE			ST
Apportion by Three Factor Formula to Determine Michigan Tax Base[5]			
SUBTOTAL: MICHIGAN TAX BASE			ST
Subtract: Full Value of Real and Personal Property Capital Acquisitions[6]			$
SUBTOTAL: TAX BASE			ST
Subtract: Small Business/Low Profit Exclusion, if eligible[7]			$
SUBTOTAL: ADJUSTED TAX BASE			ST
Subtract: Gross Receipts Limitation, if eligible[8, 10]			$
Subtract: Labor Intensity Deduction, if eligible[9, 10]			$
NET TAX BASE			$
MULTIPLY BY TAX RATE			x .0235
TAX LIABILITY[11]			$

Notes:

[1] This example shows only the major steps used to calculate the tax base and tax liability. Please refer to Chapters 1, 2, and 3 of the act for full details on tax base calculation.

[2] All depreciation on capital goods purchased prior to January 1, 1976, is in the base at this point for the purposes of calculating the labor intensity deduction.

[3] The general formula for calculating the labor intensity reduction factor is:
LIRF = (Total Compensation ÷ Gross Tax Base) − .65

[4] The 28% of depreciation removed from the tax base on capital purchased prior to January 1, 1976, is raised to 50% for the 1977 tax year and 60% for the 1978 and following tax years.

[5] The three factors are sales, property and payroll. The formula is:

$$\text{Michigan Tax Base} = \text{Adjusted Gross Tax Base} \times \frac{\text{Sales Factor} + \text{Property Factor} + \text{Payroll Factor}}{3}$$

The factors are defined as the proportion of sales, property, or payroll in Michigan to total sales, property, or payroll in all places.

[6] The Capital Acquisition Deduction is done in two steps. The firm first deducts all real property acquired in Michigan. The second step is to apportion machinery and equipment. A two factor apportionment formula is used with property and payroll as the factors. The deduction is calculated by multiplying the apportionment factor by total investment in machinery and equipment in all places.

[7] The small business/low profit exemption is calculated as follows:

a. For firms with business income less than $34,000 ($36,000 in 1977 and thereafter), the exclusion is a flat $34,000 ($36,000 in 1977 and thereafter).

b. For firms with business income between $34,000 and $51,000 ($36,000 and $54,000, respectively, in 1977 and thereafter), the exclusion is (substitute $36,000 in 1977 and thereafter):
SBE = $34,000 (Business Income − $34,000) x 2)

c. For firms with business income over $51,000 ($54,000 in 1977 and thereafter) there is no exemption.

[8] The general formula for calculating the gross receipts limitation is:

GRL = Adjusted Tax Base − 50% of Gross Receipts

[9] The general formula for calculating the Labor Intensity Deduction is:

LID = Adjusted Tax Base x LIRF

[10] A firm eligible for both the GRL and the LID may only use one in any given tax year.

[11] Individuals are eligible for a credit against their individual income tax for a portion of their SBT liability.

If Net Business Income Is	*The Credit Is*
$20,000 or less	20% of the SBT
More than $20,000 but less than $40,000	15% of the SBT
More than $40,000	10% of the SBT

EXAMPLES

The examples below are intended to show typical firms and how the tax liability for each would be computed under a set of standard assumptions. The examples cover a wide range of firm types and sizes, including several receiving special treatment under the provisions of the law. The examples use 1976 as the tax year.

Example 1: Large Manufacturing Firm

Item	Amount
Total Compensation	$ 831,508
Taxable Income	323,110
Net Interest Paid	28,123
Depreciation on Assets purchased prior to 1/1/76	207,393
Depreciation on Assets purchased after 1/1/76	9,146
SUBTOTAL: GROSS TAX BASE	$1,399,280
Labor Intensity Reduction Factor	INELIGIBLE
Capital Acquisition Deduction	(91,457)
28% of Depreciation on Assets purchased prior to 1/1/76	(58,070)
SUBTOTAL: TAX BASE	$1,249,753
Small Business/Low Profit Exclusion	INELIGIBLE
SUBTOTAL: ADJUSTED TAX BASE	$1,249,753
Gross Receipts Limitation:	INELIGIBLE
Labor Intensity Deduction	INELIGIBLE
NET TAX BASE	$1,249,753
X Tax Rate	.0235
TAX LIABILITY	$ 29,369
Liability under previous taxes	
Corporate Income	$ 22,331
Franchise Fee	7,411
Intangibles Tax	592
Inventory Tax	18,092
Less: Inventory Credit	(7,056)
	$ 41,370

Example 2: Small Manufacturing Firm

Item	Amount
Total Compensation	$ 358,500
Taxable Income	21,803
Net Interest Paid	(798)
Depreciation on Assets purchased prior to 1/1/76	N/A
Depreciation on Assets purchased after 1/1/76	3,196
SUBTOTAL: GROSS TAX BASE	$ 382,701
Labor Intensity Reduction Factor 28.7%	
Capital Acquisition Deduction	(38,500)
28% of Depreciation on Assets purchased prior to 1/1/76	N/A
SUBTOTAL: TAX BASE	$ 344,201
Small Business/Low Profit Exclusion	(34,000)
SUBTOTAL: ADJUSTED TAX BASE	$ 310,201
Gross Receipts Limitation:	INELIGIBLE
Labor Intensity Deduction	(89,027)
NET TAX BASE	$ 222,994
X Tax Rate	.0235
TAX LIABILITY	$ 5,193
Liability Under Previous Taxes	
Corporate Income	$ 1,701
Corporate Franchise	20
Inventory	2,464
Inventory Credit	(961)
	$ 3,204

Example 3: Incorporated Retailer

Item	Amount
Total Compensation	$ 380,597
Taxable Income	121,597
Net Interest Paid	17,716
Depreciation on Assets purchased prior to 1/1/76	9,037
Depreciation on Assets purchased after 1/1/76	5,125
SUBTOTAL: GROSS TAX BASE	$ 534,072
Labor Intensity Reduction Factor ... 6.3%	
Capital Acquisition Deduction	(68,339)
28% of Depreciation on Assets purchased prior to 1/1/76	(2,530)
SUBTOTAL: TAX BASE	$ 463,203
Small Business/Low Profit Exclusion:	INELIGIBLE
SUBTOTAL: ADJUSTED TAX BASE	$ 463,203
Gross Receipts Limitation:	INELIGIBLE
Labor Intensity Deduction	(29,181)
NET TAX BASE	$ 434,022
X Tax Rate	.0235
TAX LIABILITY	$ 10,200

Liability Under Previous Taxes

Item	Amount
Corporate Income	$ 7,760
Corporate Franchise	3,591
Intangibles	8
Inventory Tax	7,315
Inventory Credit	(2,853)
	$ 15,821

Example 4: Unincorporated Retailer

Item	Amount
Total Compensation	$ 65,529
Taxable Income	18,722
Net Interest Paid	1,962
Depreciation on Assets purchased prior to 1/1/76	3,899
Depreciation on Assets purchased after 1/1/76	158
SUBTOTAL: GROSS TAX BASE	$ 90,270
Labor Intensity Reduction Factor ... 7.3%	
Capital Acquisition Deduction	(1,567)
28% of Depreciation on Assets purchased prior to 1/1/76	(1,092)
SUBTOTAL: TAX BASE	$ 87,611
small Business/Low Profit Exclusion	(34,000)
SUBTOTAL: ADJUSTED TAX BASE	$ 53,611
Gross Receipts Limitation:	INELIGIBLE
Labor Intensity Deduction	(3,914)
NET TAX BASE	$ 49,697
X Tax Rate	.0235
TAX LIABILITY	$ 1,168
Individual Income Tax, 4 exemptions	585
	$ 1,753
Less SBT Credit	(234)
	$ 1,519

Liability Under Previous Taxes

Item	Amount
Individual Income	$ 585
Inventory Tax	368
Inventory Credit	(142)
	$ 808

Example 5: Self Employed Professional

Total Compensation	$ 22,510
Taxable Income	96,507
Net Interest Paid	456
Depreciation on Assets purchased prior to 1/1/76	N/A
Depreciation on Assets purchased after 1/1/76	1,397
SUBTOTAL: GROSS TAX BASE	$ 120,870
Labor Intensity Reduction Factor	INELIGIBLE
Capital Acquisition Deduction	(15,888)
28% of Depreciation on Assets purchased prior to 1/1/76	N/A
SUBTOTAL: TAX BASE	$ 104,982
Small Business/Low Profit Exclusion	INELIGIBLE
SUBTOTAL: ADJUSTED TAX BASE	$ 104,982
Gross Receipts Limitation:	(8,573)
Labor Intensity Deduction	INELIGIBLE
NET TAX BASE	$ 96,410
X Tax Rate	.0235
TAX LIABILITY	$ 2,266
Individual Income Tax, 4 exemptions	4,163
	$ 6,429
Less SBT Credit	(227)
	$ 6,202
Liability Under Previous Taxes	
Individual Income	$ 4,163

Example 6: Professional Corporation

Total Compensation	$ 97,454
Taxable Income	2,957
Net Interest Paid	4,315
Depreciation on Assets purchased prior to 1/1/76	2,729
Depreciation on Assets purchased after 1/1/76	1,805
SUBTOTAL: GROSS TAX BASE	$ 109,260
Labor Intensity Reduction Factor ... 24.2%	
Capital Acquisition Deducion	(24,068)
28% of Depreciation on Assets purchased prior to 1/1/76	(764)
SUBTOTAL: TAX BASE	$ 84,428
Small Business/Low Profit Exclusion	*(34,000)
SUBTOTAL: ADJUSTED TAX BASE	$ 50,428
Gross Receipts Limitation:	INELIGIBLE
Labor Intensity Deduction	(12,204)
TAX BASE	$ 38,224
X Tax Rate	.0235
TAX LIABILITY	$ 898
Liability Under Previous Taxes	
Corporate Income	$ 67
Corporate Franchise	313
	$ 380

* Compensation paid to corporate shareholders ($17,232 in this case) must be added to corporate profits for the purpose of determining the exemption. In this case, the business was still eligible for the full exemption.

Example 7: Service Corporation

Total Compensation		$ 103,419
Taxable Income		15,426
Net Interest Paid		412
Depreciation on assets purchased prior to 1/1/76		387
Depreciation on assets purchased after 1/1/76		417
SUBTOTAL: GROSS TAX BASE		$ 120,061
Labor Intensity Reduction Factor	21.1%	
Capital Acquisition Deduction		(4,327)
28% of Depreciation on Assets purchased prior to 1/1/76		(108)
SUBTOTAL: TAX BASE		$ 115,626
Small Business/Low Profit Exclusion		(34,000)
SUBTOTAL: ADJUSTED TAX BASE		$ 81,626
Gross Receipts Limitation:		*(2,877)
Labor Intensity Deduction		*(17,223)
NET TAX BASE		$ 64,403
X Tax Rate		.0235
TAX LIABILITY		$ 1,513
Liability Under Previous Taxes		
Corporate Income		$ 1,219
Corporate Franchise		92
		$ 1,311

* This firm qualifies for both the gross receipts limitation and the labor intensity deduction. However, the firm may only use one. In this case the labor intensity circuit breaker is chosen because it reduces the adjusted tax base by a greater amount.

Example 8: Food Seller, Unincorporated

Total Compensation		$ 247,312
Taxable Income		22,507
Net Interest Paid		1,710
Depreciation on Assets Purchased prior to 1/1/76		4,702
Depreciation on Assets Purchased after 1/1/76		912
SUBTOTAL: GROSS TAX BASE		$ 277,147
Labor Intensity Reduction Factor	54.2%*	
Capital Acquisition Deduction		(10,247)
28% of Depreciation on Assets purchased prior to 1/1/76		(1,317)
SUBTOTAL: TAX BASE		$ 265,583
Small Business/Low Profit Exclusion		(34,000)
SUBTOTAL: ADJUSTED TAX BASE		231,583
Gross Receipts Limitation:		INELIGIBLE
Labor Intensity Deduction		(125,518)
NET TAX BASE		$ 106,065
X Tax Rate		.0235
TAX LIABILITY		$ 2,493
Individual Income Tax, 4 exemptions		759
Less: SBT Credit		(347)
		$ 2,878
Liability Under Previous Taxes		
Personal Income Tax		$ 2,493
Inventory Tax		1,320
Inventory Credit		(515)
		$ 3,298

* The maximum proportion of the tax base that compensation may be is 35% rather than the 65% limit for most other businesses.

Example 9:
Rental Housing Corporation

Total Compensation	$ 34,129
Taxable Income	47,612
Net Interest Paid	126,418
Depreciation on Assets Purchased prior to 1/1/76	724,011
Depreciation on Assets Purchased after 1/1/76	52,937
SUBTOTAL: GROSS TAX BASE	$ 985,107
Labor Intensity Reduction Factor	INELIGIBLE
Capital Acquisition Deduction ...	(561,029)
28% of Depreciation on Assets Purchased prior to 1/1/76	(20,272)
SUBTOTAL: TAX BASE	$ 403,806
Small Business/Low Profit Exclusion	INELIGIBLE
SUBTOTAL: ADJUSTED TAX BASE	$ 403,806
Gross Receipts Limitation:	*(46,156)
Labor Intensity Deduction	INELIGIBLE
NET TAX BASE	$ 357,650
X Tax Rate	.0235
TAX LIABILITY	$ 8,405

Liability Under Previous Taxes	
Corporate Income Tax	$ 3,714
Corporate Franchise Fee	1,417
	$ 5,131

* A firm engaged in rental housing investment having at least 70% of its tax base in paid interest and depreciation on assets purchased prior to 1/1/76 may limit the adjusted tax base to 35% of gross receipts rather than the 50% limit used for other businesses.

The above examples are not intended to present all the nuances of the SBT. They do, however, show how the major provisions operate and how some typical business taxpayers can expect their tax liability to be computed.

Source: A Guide to Michigan's "Single Business Tax Act of 1975," Office of Economic Expansion, Michigan Department of Commerce, November 1975.

Appendix A2

Change in Michigan Tax Liability, by Industry

Exhibit 1

Analysis of Burden Shift in Tax Liability Under Senate and House Versions of Michigan VAT*

Category	Percentage and Dollar Increase (Decrease) in Tax Liability Per Firm			
	Senate Version		House Version	
	Percent	Amount	Percent	Amount
Agriculture, Forestry and Fisheries	95%	$1,916	86%	$1,736
Mining	(24)	(40,665)	86%	(9,858)
Construction**	63	40,576	88	56,877
Food and Kindred Products	(51)	(136,644)	(30)	(80,416)
Textile Products	(41)	(21,298)	(25)	(12,894)
Wood and Paper Products	(8)	(8,611)	24	27,441
Furniture and Fixtures	(46)	(42,707)	(44)	(41,319)
Printing and Publishing	(15)	(19,650)	(12)	(15,205)
Chemcial, Petroleum, Rubber and Mineral Products	(37)	(176,598)	(25)	(116,947)
Primary Metal Products	9	22,628	29	74,886
Fabricated Metal Products and Machinery	(20)	(83,499)	8	34,053
Motor Vehicles and Equipment	(18)	(631,750)	(12)	(428,913)
Miscellaneous Manufacturing Industries	(20)	(15,030)	(14)	(10,330)
Railroads	(84)	(40,667)	(85)	(41,094)
Water, Air, Local and Suburban Services	(21)	(8,870)	(12)	(5,024)
Motor Freight	(58)	(18,896)	(29)	(9,513)
Communications	(29)	(200,784)	(29)	(205,205)
Electric, Gas and Sanitary Services	(35)	(415,069)	(44)	(521,870)
Wholesale Trade	(36)	(78,202)	(20)	(43,163)
Home Furnishings and Building Supplies	(11)	(36,017)	29	97,747
Food Stores	30	67,389	32	70,890
Automotive Dealers and Service Stations	(47)	(12,557)	(5)	(1,320)
Eating and Drinking Places	1	142	22	6,073
Banking	(29)	(99,138)	(25)	(83,853)
Credit Agencies and Savings and Loans	(71)	(258,266)	(69)	(248,987)
Insurance and Real Estate	(28)	(15,775)	8	4,307
Hotels, etc.	36	2,825	39	3,101
Personal Services	62	5,319	78	6,727
Business Services	100	10,746	102	10,938
Automotive and Miscellaneous Repair Services	2	199	17	2,080
Motion Pictures, Amusements and Museums	31	3,811	58	7,229

*Based on a sample of 1973 Michigan corporate tax returns.

**Senate version provides 50% exclusion for construction labor contracted prior to enactment of legislation. Exclusion is not reflected in analysis due to lack of necessary data.

Source: Touche, Ross and Company, "Report Presented to the Michigan Senate Tax Committee," July 17, 1975.

Exhibit 2

Effect of Senate and House Versions of Michigan VAT on Unincorporated Businesses

	Business Receipts		Percent Increase (Decrease) in Tax Liability*				Average Dollar Increase (Decrease)			
			Small Firms		Large Firms		Small Firms		Large Firms	
Category	Small Firms	Large Firms	Senate Version	House Version	Senate Version	House Version	Senate Version	House Version	Senate Version	House Version
Farming and Related Agriculture	$ 3,466	$ 83,000	—%	—%	—%	—%	$—	$—	$—	$—
Contract Construction**	13,176	87,036	(32)	(32)	(16)	(17)	(82)	(82)	(123)	(135)
Manufacturing	13,632	86,036	(24)	(24)	(14)	(19)	(41)	(41)	(106)	(147
Wholesale Trade	27,016	371,172	(19)	(19)	(9)	(18)	(65)	(65)	(143)	(270)
General Merchandise Stores	4,026	84,967	(32)	(32)	(53)	(53)	(12)	(12)	(376)	(376)
Food Stores	62,034	362,806	(28)	(28)	(10)	(28)	(67)	(67)	(99)	(269)
Gasoline Service Stations	52,704	334,855	(32)	(32)	(44)	(49)	(61)	(61)	(888)	(996)
Eating and Drinking Places	24,524	166,528	—	—	78	50	—	—	517	333
Insurance and Real Estate										
Agents and Brokers	7,347	42,104	—	—	—	—	—	—	—	—
Physicians and Surgeons	48,180	157,791	4	4	39	41	50	54	1732	1815
Lawyers and Accountants	10,248	82,827	—	—	45	48	—	—	908	952
Personal Services	4,468	82,830	—	—	41	26	—	—	276	172
Business Services	5,944	84,446	—	—	27	21	—	—	253	193
Repair Services	7,957	43,674	(19)	(19)	(26)	(26)	(23)	(23)	(139)	(139)
Amusement and Recreation	3,060	42,981	—	—	—	—	—	—	—	—

*Current Michigan income tax calculated at 4.6%.

**Senate version provides 50% exclusion for construction labor contracted prior to enactment of legislation. Exclusion is not reflected in analysis due to lack of necessary data.

Source: Touche, Ross and Company, "Report Presented to the Michigan Senate Tax Committee," July 17, 1975.

Administrative Aspects of the Michigan Single Business Tax (VAT)

by Sydney D. Goodman
Commissioner of Revenue

There is a provision in the law stating that any term used in the act and not defined differently shall have the same meaning as when used in comparable context in the laws relating to federal income taxes. Other sections in the law clearly refer to definitions and provisions of the *Internal Revenue Code*. We therefore have many references to the code and the starting point for the determination of the tax is federal taxable income. The base of the tax is therefore computed primarily from the federal income tax return. Having a beginning figure from said return, there are various additions to, and deductions from, federal taxable income in arriving at the single business tax base. This has caused a few problems with accountants and attorneys over the proper interpretation of various sections of the *Internal Revenue Code*. We have from time to time requested assistance in interpretation from internal revenue personnel. These were in the areas of the definition of compensation as pertaining to withholding and the provisions of the code concerning exempt organizations.

The definition of compensation has raised some concern. The largest element in the tax base is "compensation paid." This could amount to possibly 70% of the total tax base before adjustments and deductions. The law very broadly defines compensation to mean all wages, salaries, fees, bonuses, commissions, or other payments made in the taxable year on behalf of, or for the benefit of, employees.

Outside of a few objections to our interpretations in the area of compensation, it is this provision that has caused a "hue and cry" from high-labor-intensive businesses low-profit firms and firms losing money. From studies made we have found that compensation has in many instances exceeded 70% of the bax base. The only relief granted in the law is a circuit breaker provision limiting compensation to 65% of the tax base so that high-labor-intensive firms would have some relief. The issue at the present time is whether this limit should be lowered in order to prevent the single business tax from being a tax on labor.

Another important provision is that concerning "affiliated groups." There is no problem with the definition, but the statutory requirements for the filing of a combined return leaves the door open for a great deal of pressure to be brought notwithstanding these requirements. Let us review these tests.

1. All members of the affiliated group must be Michigan taxpayers.
2. Each member of the affiliated group must maintain a relationship with one or more members of the group which includes intercorporate transactions of a substantial nature other than control, ownership or financing arrangements, or any combination thereof.
3. Each member of the affiliated group must be subject to the same apportionment formula. All members must be subject either to the three-factor formula, or one of the special formulas, i.e., transportation, financial organizations, or so forth. If one member of the group is subject to the transportation formula and the other members subject to the three-factor (formula), permission to file consolidated or combined returns cannot be granted.

A number of requests have been received for permission to file combined returns, listing only the Michigan taxpayers of an affiliated group and excluding non-Michigan taxpayers

from the list. In such cases the statutory requirements are not met, all members of the affiliated group must be Michigan taxpayers.

Another complication is the provision of the law that the controlling member of the affiliated group and the Commissioner of Revenue can mutually agree to the filing of a combined or consolidated return notwithstanding the previous requirements outlined in the law. This is in direct conflict with the previous requirements of the law and for that reason I have not authorized combined filing unless all prior requirements have been met.

In the many conferences and seminars around the state, the estimated tax requirements of the law were soundly criticized. The act provides that a taxpayer who expects his liability for the tax year to exceed $500 or his adjustments to exceed $100,000 shall file an estimated return and pay an estimated tax for each quarter of his tax year. Calendar year taxpayers must file and make their payments by April 30, June 30, October 31, and January 31. Fiscal year taxpayers are to file and pay on the appropriate due date which in the taxpayer's fiscal year corresponds to the calendar year. These requirements cause calendar year taxpayers to complain about the second quarter, June 30, filing date. A problem also occurs because of the provision that estimated taxes filed during the year must equal 90% of the year end tax liability. Failure to do so can result in an interest assessment by the department. Under the income tax statute the department followed the "safe haven" provisions of the *Internal Revenue Code*. The single business tax has no safe haven provisions and it is predicted that one of the first amendments will be a safe haven clause.

In speaking of administrative aspects of the act, I must mention financial organizations. The *Single Business Tax Act* provides for a special computation by any person "90% of whose assets are intangible personal property or 90% of whose gross income is dividends, interest or other charges resulting from the use of money and credit." The act does not define a "financial institution." The income tax statute did have a financial institution which was exactly as above stated. It was the department's thinking that the legislature attempted to make a definite distinction between financial organizations and other taxpayers for the following reasons:

1. The tax base of a financial organization is different than the tax base of other taxpayers.

2. There is a special apportionment provision for financial organizations. *Section 23 (f)* of the act states that after allocation or apportionment, the tax base shall be adjusted by deducting any unused carryforward of a net operating loss from the Michigan corporate income tax, etc. . . . The income tax act dealt with three separate classes of taxpayers, the individual with one rate, the corporation with another rate and the financial institution with a third rate, which in our opinion was an entirely separate tax completely different from the corporate income tax. Because of this we concluded that a financial institution could not take advantage of *Section 23 (f)* and, not having been subject to the corporate income tax rate, could not take advantage of the deduction for any loss carryforward on its single business tax return. This was our initial reaction. After thoroughly studying the situation we concluded that inasmuch as a financial institution was organized as a corporation, even filing a federal corporation income tax return, it was entitled to take advantage of the same loss carryforward provisions as other corporations.

The act attempts to define "business activity" but it does not adequately clarify certain types of activity. Michigan's old *Business Activities Tax* had a similar definition. There is some confusion concerning the outside activity of a taxpayer which is incidental to his other business activity. We hope to clarify this problem with an amendment to the act. We are of the opinion that any transaction made or engaged in by a person which is incidental to that person's business activity is actually a business activity within the meaning of the act.

AMENDED STATUTES

In addition to the single business tax, eight other existing statutes were amended or re-

pealed as part of the overall business tax package.

The taxes repealed were the corporate income tax, financial institutions income tax, corporation franchise tax, personal property tax on inventories, domestic insurance company privilege tax, and the tax on building and loan and savings and loan associations. The individual income tax and the intangibles tax were modified.

The intangibles tax was amended to exempt intangible personal property owned by any person or business subject to the single business tax. The question that arose was whether a person or business enterprise must actually incur a single business tax liability in order to qualify for the exemption or was the exemption available to any person or business enterprise which was subject to the provisions of the *Single Business Tax Act*. The exact wording of *The Intangibles Tax Act* exemption is as follows:

> Intangible personal property owned by or comprising the assets of any person or business enterprise subject to tax levied by the *Single Business Tax Act*.

It was the opinion of many persons in business that as long as the business enterprise was subject to the *Single Business Tax Act* their intangibles were exempt from the intangibles tax. Such a ruling would have exempted them from intangibles tax although no single business tax was paid. Afer consultation with our legal staff and giving clear meaning to the language of *The Intangibles Tax Act* as above mentioned, it was concluded that the exemption can be granted only to those who are "subject to tax levied by the single business tax." In other words the person or business enterprise must actually be burdened by a tax which is levied upon them in order to be exempt from the intangibles tax. The exemption is therefore triggered by *paying* a single business tax. A person who engages in a business activity in Michigan and incurs no single business tax liability cannot be exempt from intangibles tax. The legislature has under consideration a bill to remove the ambiguity that exists.

The Intangibles Tax Act was also amended by reducing the tax on bank deposits, savings and loan or building and loan association shares from 40¢ to 20¢ per $1,000 on the face value of deposits or shares. Originally banks paid the tax for their depositors with the right of reimbursement from the depositor. Few banks followed this option and elected to pay the tax themselves. The amendatory language in the act presently does not give a bank, savings and loan, or building and loan association the right to charge this back to their depositors.

Of particular interest is the administrative effect of the repealed taxes. There has been a bit of confusion in the business community over these. In our attempt to explain the shift in the tax system to the single business tax we found that many business firms had the impression that the corporation franchise fee was immediately repealed. Actually the act called for one more filing, May 15, 1976, but remains in effect until May 14, 1977. Of particular interest in the repealer law is the "phase out" provision providing that the statute remains in full force and effect for the collection and enforcement of any fee payable for any period in which it was in effect prior to its repeal. In other words, the department has the right to pursue and collect any franchise fee liability due for the period up to, and including the final levy, which has not been paid.

The repeal of the business portion of the income tax and the allowance of a portion of the single business tax as a credit against that individual's income tax has brought a complaint by the individual in business that he is being subjected to double taxation. The present income tax statute allows a credit for a portion of the tax imposed by the single business tax against this individual's income tax. For example, if a person's net business income is $20,000 or less he is allowed a credit of 20% of the single business tax off his income tax. If a person's net income is more than $20,000 and less than $40,000 he is allowed a credit of 15% of the single business tax off his income tax. If his net business income is more than the $40,000 he is allowed a credit of 10% of the single business tax off his income tax. This credit, however, cannot exceed the personal tax liability of the taxpayer and cannot be claimed by any taxpayer who elects the 50% gross receipts limitation under the *Single Business Tax Act*.

In order to alleviate the double taxation theory one proposal submitted was to allow a

credit on the personal income tax for the full single business tax paid but not to exceed the personal income tax liability of the taxpayer. Another recommendation was to eliminate from single business tax liability all unincorporated businesses including servicers and professionals and have them subject to an income tax instead. The single business tax applies to unincorporated business as well as corporations and the fact that the individual income tax is still in effect subjects the individual person in business to both an income tax and a single business tax. It is felt by many that the credits allowed in the income tax statute for the single business tax paid are insufficient.

One of the questions frequently asked by real estate brokers, insurance agents, lawyers and others concerns gross receipts, particularly amounts received in an agency or representative capacity. The single business tax provision was taken directly from the old *Business Activities Tax Act* and states that gross receipts does not include amounts received in an agency or other representative capacity solely on behalf of another or others *but not including amounts received by persons having the* power or authority to expend or otherwise appropriate such amounts in payment for, or in consideration of, sales or services made or rendered by themselves or by others acting under *their direction and control....** The problem here created concerns a request for reimbursement of expenses incurred by an attorney on behalf of his client. These could include filing fees, stamp fees, recording fees, etc. We have ruled that a charge for services rendered by an attorney would be considered gross receipts. While reimbursement to the attorney for filing fees, stamp fees, and recording fees would be excluded from his gross receipts. Similar problems occur with real estate commissions and other broker's receipts. The test seems to be "control" by the agent. Does the agent have "authority" to expend the funds? Is he doing it for his own benefit or for the benefit of his principal? The rule of thumb is that if the agent disburses funds received for his own benefit those funds are includable in his gross receipts. If the funds given him are disbursed solely for the principal's benefit they would be exluded from his gross receipts.

A common question from real estate brokers is how to handle commissions paid by the broker to an independent salesperson. We have ruled that the independent salesperson is subject to the single business tax and is required to file a return if his commissions exceed $34,000. The gross receipts of the real estate broker would include the total commission received without exclusion for the amount paid the independent salesperson.

In the case of a real estate broker who has entered into an agency relationship with a seller of a house and a salesperson, where it can clearly be shown that there is a principal-agency relationship with the broker acting as agent of both, he may exclude the amount paid to the seller of the home and also exclude the amount he pays to the independent salesperson.

An important consideration is knowing legislative intent. However, the statutory language in many areas does not meet legislative intent. There are numerous sections which have three or four different methods of statutory construction. The language dealing with the tax base is also inconsistent. Numerous technical amendments have been prepared for introduction in the legislature which should clarify the ambiguities mentioned.

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*Italics are the writer's.

Source: Sydney D. Goodman, "Administrative Aspects of Michigan's Single Business Tax, a paper delivered at the NTA-TIA Annual Conference, November 16, 1976.

Appendix A4

Revenue Effect of 1977 Amendments to the Michigan VAT

Amendment	Revenue Effect
All depreciation is included in the tax base. Previously 50% of depreciation on capital for which a capital acquisition deduction had not been taken was exempt from taxation.	+ $60 million
A new tax credit of up to 50% of tax liability for qualifying small businesses.	— $37 million
Reduction in the labor intensity factor from 65% to 63% and hence an increase in the labor intensity deduction from a maximum of 35% to 37% for taxpayers electing this tax base reporting option.	— $20 million
An increase in the exclusion for small, low-profit businesses from $36,000 to $40,000 and from $10,000 to $12,000 for partners and stockholders of *Internal Revenue Code, Subchapter S* corporations.	—$11 million
A shift of the unincorporated business credit from the income tax to the SBT and extension of the credit to all unincorporated business filers.	— $ 4 million
Exemption of the tax base attributable to agricultural production.	— $ 4 million

Act No. 228
Michigan Public Act of 1975

(As amended by Act No. 389 of 1976)

AN ACT to provide for the imposition, levy, computation, collection, assessment and enforcement, by lien or otherwise, of taxes on certain commercial, business, and financial activities; to prescribe the manner and times of making certain reports and paying taxes; to prescribe the powers and duties of public officers and state departments; to permit the inspection of records of taxpayers; to provide for interest and penalties on unpaid taxes; to provide exemptions, credits, and refunds; to provide penalties; to provide for the disposition of funds; to provide for the interrelation of this act with other acts; and to provide an appropriation.

The People of the State of Michigan enact:

CHAPTER 1

Sec. 1. This act shall be known and may be cited as the "single business tax act".

Sec. 2. (1) For the purposes of this act, the words and phrases defined in sections 3 to 10 shall have the meanings respectively ascribed to them in those sections.

(2) A term used in this act and not defined differently shall have the same meaning as when used in comparable context in the laws of the United States relating to federal income taxes in effect for the tax year unless a different meaning is clearly required. A reference in this act to the internal revenue code includes other provisions of the laws of the United States relating to federal income taxes.

Sec. 3. (1) "Affiliated group" means 2 or more corporations, 1 of which owns or controls, directly or indirectly, 80% or more of the capital stock with voting rights of the other corporation or corporations.

(2) "Business activity" means a transfer of legal or equitable title to or rental of property, whether real, personal, or mixed, tangible or intangible, or the performance of services, or a combination thereof, made or engaged in, or caused to be made or engaged in, within this state, whether in intrastate, interstate, or foreign commerce, with the object of gain, benefit, or advantage, whether direct or indirect, to the taxpayer or to others, but shall not include the services rendered by an employee to his employer or a casual transaction. Although an activity of a taxpayer may be incidental to another or other of his business activities, each activity shall be considered to be business engaged in within the meaning of this act.

(3) "Business income" means federal taxable income, except that for a person other than a corporation it means that part of federal taxable income derived from business activity. For a partnership, business income includes payments and items of income and expense which are attributable to business activity of the partnership and separately reported to the partners.

Sec. 4. (1) "Casual transaction" means a transaction made or engaged in other than in the ordinary course of repeated and successive transactions of a like character, except that a transaction made or engaged in by a person which is incidental to that person's regular business activity, shall be considered to be a business activity within the meaning of this act.

(2) "Commissioner" means the state commissioner of revenue.

(3) "Compensation" means all wages, salaries, fees, bonuses, commissions, or other payments made in the taxable year on behalf of or for the benefit of employees, officers, or directors of the taxpayers and subject to or specifically exempt from withholding under section 3401 of the internal revenue code. Compensation includes, on a cash or accrual basis consistent with the taxpayer's method of accounting for federal income tax purposes, payments to state and federal unemployment compensation funds, payments under the federal insurance contribution act and similar social insurance programs, payments, including self-insurance, for workmen's compensation insurance, payments to individuals not currently working, payments to dependents and heirs of individuals because of current or former labor services rendered by those individuals, payments to a pension, retirement, or profit sharing plan, and payments for insurance for which employees are the beneficiaries. Compensation does not include discounts on the price of the taxpayer's merchandise or services sold to the taxpayer's employees, officers, or directors which are not available to

other customers or payments to an independent contractor.

(4) "Department" means the revenue division of the department of treasury.

Sec. 5. (1) "Employee" means an employee as defined in section 3401(c) of the internal revenue code. A person from whom an employer is required to withhold for federal income tax purposes shall prima facie be deemed an employee.

(2) "Employer" means an employer as defined in section 3401(d) of the internal revenue code. A person required to withhold for federal income tax purposes shall prima facie be deemed an employer.

(3) "Federal taxable income" means taxable income as defined in section 63 of the internal revenue code.

(4) "Internal revenue code" means the United States internal revenue code of 1954, as amended, and in effect on November 15, 1976.

Sec. 6. (1) "Person" means an individual, firm, bank, financial institution, limited partnership, copartnership, partnership, joint venture, association, corporation, receiver, estate, trust, or any other group or combination acting as a unit.

(2) "Rent" includes a lease payment or other payment for the use of any property to which the taxpayer does not have legal or equitable title.

Sec. 7. (1) "Sale" or "sales" means the gross receipts arising from a transaction or transactions in which gross receipts constitute consideration: (a) for the transfer of title to, or possession of, property that is stock in trade or other property of a kind which would properly be included in the inventory of the taxpayer if on hand at the close of the tax period or property held by the taxpayer primarily for sale to customers in the ordinary course of its trade or business, or (b) for the performance of services, which constitute business activities other than those included in (a), or from any combination of (a) or (b).

(2) "State" means any state of the United States, the District of Columbia, the Commonwealth of Puerto Rico, any territory or possession of the United States, and any foreign country, or political subdivision of any of the foregoing.

(3) "Gross receipts" means the sum of sales, as defined in subsection (1) and rental or lease receipts. Gross receipts does not include the losses incurred by an insurance carrier as reported to the Michigan insurance bureau or amounts received in an agency or other representative capacity, solely on behalf of another or others but not including amounts received by persons having the power or authority to expend or otherwise appropriate such amounts in payment for or in consideration of sales or services made or rendered by themselves or by others acting under their direction and control or by such fiduciaries as guardians, executors, administrators, receivers, conservators, or trustees other than trustees of taxes received or collected from others under direction of the laws of the federal government or of any state or local governments.

Sec. 8. "Tax" includes interest and penalties unless the intention to give it a more limited meaning is disclosed by the context.

Sec. 9. (1) "Tax base" means business income, before apportionment, or allocation as provided in chapter 3, even if zero or negative, subject to the adjustments in subsections (2) to (8).

(2) Add gross interest income and dividends derived from obligations or securities of states other than Michigan, in the same amount that was excluded from federal taxable income, less related expenses not deducted in computing federal taxable income because of section 265 of the internal revenue code.

(3) Add all taxes on or measured by net income and the tax imposed by this act to the extent the taxes were deducted in arriving at federal taxable income.

(4) Add, to the extent deducted in arriving at federal taxable income:

(a) Any carryback or carryforward of a net operating loss.

(b) Any capital loss incurred after the effective date of this act.

(c) Any deduction for depreciation, amortization, or immediate or accelerated write-off related to the cost of tangible assets for which a capital acquisition deduction was claimed in any tax year pursuant to section 23, and for the 1976 tax year, 72%, for the 1977 tax year, 50%, and for 1978 and subsequent tax years 40% of any deduction for other depreciation, amortization, or immediate or accelerated write-off related to

the cost of tangible assets.

(d) Any dividends paid or accrued except dividends that represent reduction of premiums to policy holders of insurance companies.

(e) Any deduction or exclusion by a taxpayer due to its classification as a domestic international sales corporation, western hemisphere trade corporation, China trade act corporation or any like special classification the purpose of which is to reduce or postpone the federal income tax liability. This subsection shall not apply to the special provisions of sections 805, 815(c) (2) (A), 809, 823 (c), and 824 (A) of the internal revenue code.

(f) All interest except amounts paid, credited, or reserved by insurance companies as amounts necessary to fulfill the policy and other contract liability requirements of sections 805 and 809 of the internal revenue code.

(g) All royalties.

(5) Add compensation as defined in section 4(3).

(6) Add any capital gains related to business activity of individuals to the extent excluded in arriving at federal taxable income.

(7) Deduct, to the extent included in arriving at federal taxable income:

(a) Dividends received or deemed received, including the foreign dividend gross-up provided for in the internal revenue code.

(b) All interest.

(c) All royalties.

(8) Deduct any capital loss not deducted in arriving at federal taxable income in the year the loss occurred.

(9) To the extent included in federal taxable income, add the loss or subtract the gain from the tax base that is attributable to another entity whose business activities are taxable under this act or would be taxable under this act if the business activities were in this state.

Sec. 10. (1) "Tax year" or "taxable year" means the calendar year, or the fiscal year ending during the calendar year, upon the basis of which the tax base is computed under this act. When a return is made for a fractional part of a year, tax year means the period for which the return is made. Except for the first return required by this act, a taxpayer's tax year shall be for the same period as is covered by his federal income tax return.

(2) "Taxpayer" means a person liable for a tax, interest or penalty under this act.

(3) "Unrelated business activity" means any business activity that gives rise to unrelated taxable income as defined in the internal revenue code.

(4) "Financial organization" means a bank, industrial bank, trust company, building and loan or savings and loan association, bank holding company as defined in 12 U.S.C. 1841, credit union, safety and collateral deposit company, regulated investment company as defined in the internal revenue code, and any other association, joint stock company, or corporation at least 90% of whose assets consist of intangible personal property and at least 90% of whose gross receipts income consists of dividends or interest or other charges resulting from the use of money or credit.

Sec. 20. The tax base of nonprofit persons not required to pay federal income taxes shall be the sum of the net additions specified in sections 9 and 23 less the deductions specified in those sections.

Sec. 21. The tax base of a financial organization shall be the sum of business income and the adjustments provided in section 9, with the exception of section 9(4)(f) and (7)(b).

Sec. 22. The tax base of an insurance company not subject to the provisions of the premiums tax under sections 440 to 446 of Act No. 218 of the Public Acts of 1956, as amended, being sections 500.440 to 500.446 of the Michigan Compiled Laws, shall be the sum of the business income and the adjustments provided in section 9. The tax calculated thereon shall be in lieu of all other privilege or franchise fees or taxes imposed by another law of the state, except taxes on real and personal property.

Sec. 23. After allocation as provided in section 40 or apportionment as provided in section 41, the tax base shall be adjusted by the following:

(a) Deduct the cost, including fabrication and installation, paid or accrued in the taxable year of tangible assets of a type which are, or under the internal revenue code will become, eligible for depreciation or amortization for federal income tax purposes excluding costs of assets which are defined in section 1250 of the internal revenue code. This deduction shall be multiplied by a fraction, the numerator of which is the payroll factor plus the property factor and the denominator of which is 2.

(b) Add the gross proceeds from the sale of the tangible assets defined in subdivision (a) minus the gain and plus the loss from the sale reflected in federal taxable income and minus the gain from the sale added to the tax base in section 9(6). This addition shall be multiplied by a fraction, the numerator of which is the payroll factor plus the property factor and the denominator of which is 2.

(c) Deduct the cost, including fabrication and installation, excluding the cost deducted under subdivision (a) paid or accrued in the taxable year of tangible assets of a type which are, or under the internal revenue code will become eligible for depreciation or amortization for federal income tax purposes, provided that the assets are physically located in Michigan.

(d) Add the gross proceeds from the sale of the tangible assets defined in subsection (c), minus the gain, multiplied by the apportionment factor for the taxable year as defined in chapter 3, and plus the loss, multiplied by the apportionment factor as defined in chapter 3, from the sale reflected in federal taxable income and minus the gain from the sale added to the tax base in section 9(6).

(e) Deduct any available business loss. "Business loss" means any negative amount after allocation or apportionment as provided in chapter 3 and adjustments as provided in subdivisions (a) to (d) without regard to the deduction under this subdivision. The business loss shall be carried forward to the year next following the loss year as an offest to the tax base, then successively to the next 9 taxable years following the loss year or until the loss is used up, whichever occurs first, but for not more than 10 taxable years after the loss year.

(f) Deduct any unused carry forward of net operating loss from the Michigan corporate income tax. This deduction shall not be made for a tax year ending after December 31, 1980.

CHAPTER 2

Sec. 31. (1) There is hereby levied and imposed a specific tax of 2.35% upon the adjusted tax base of every person with business activity in this state which is allocated or apportioned to this state.

(2) As used in this section "adjusted tax base" means the tax base allocated or apportioned to this state pursuant to chapter 3 and the adjustments permitted by section 23 and the exemptions permitted by sections 35 and 37. If the adjusted tax base exceeds 50% of the gross receipts apportioned or allocated to Michigan with the apportionment fraction calculated pursuant to section 45, the adjusted tax base may, at the option of the taxpayer, be reduced by such excess. The taxpayer shall not be entitled to the adjustment provided in section 31(5), (6), or (7) for the same taxable year.

(3) A person whose interest paid and whose depreciation on assets acquired before January 1, 1976 together comprise 70% or more of the adjusted tax base as defined in subsection (2) derived from rental housing investments, may elect to reduce the adjusted tax base by that amount which is in excess of 35% of the gross receipts apportioned or allocated to this state. This subsection shall not apply to a person whose tax base is calculated pursuant to section 21 and shall expire December 31, 1977.

(4) The tax so levied and imposed is upon the privilege of doing business and not upon income.

(5) In lieu of the adjustment provided in subsection (2) or (3) a person may elect to reduce the adjusted tax base by the percentage that compensation exceeds 65% of the total tax base. The deduction shall not exceed 35% of the adjusted tax base.

(6) A person whose business includes the sale at retail of food for human consumption as defined in section 4g of Act No. 167 of the Public Acts of 1933, being section 205.54g of the Michigan Compiled Laws, and whose gross receipts from the sale at retail of food for human consumption as defined in section 4g of Act No. 167 of the Public Acts of 1933, equals 75% or more of the gross receipts may elect to reduce the

adjusted tax base by the percentage that compensation exceeds 35% of the total tax base. The deduction shall not exceed 65% of the adjusted tax base. This subsection shall expire December 31, 1977.

(7) A person whose principal business is licensed and regulated under Act No. 330 of the Public Acts of 1968, as amended, being sections 338.1051 to 338.1085 of the Michigan Compiled Laws, or a person whose principal business is a building maintenance company may elect to reduce the adjusted tax base by the percentage that compensation divided by the total tax base exceeds 35%. The deduction shall not exceed 65% of the adjusted tax base. As used in this subsection, "building maintenance company" means a person whose gross receipts from the cleaning of the interior of a building equals 85% or more of total gross receipts and who performs those services on not less than a monthly basis. This subsection shall expire December 31, 1977.

(8) For the purposes of subsections (5), (6), and (7) when calculating the total tax base the effects of the adjustments provided in section 23 shall be excluded and any depreciation, amortization, or immediate or accelerated write-off related to the cost of tangible assets not added in section 9(4)(c) shall be included.

Sec. 35. There shall be exempt from the tax imposed by this act:

(a) For the 1976 tax year the first $34,000.00 of the tax base of every person, $36,000.00 for the 1977 tax year, and each year thereafter. This exemption shall be increased by $10,000.00 for each partner of a partnership or shareholder of a subchapter S corporation or professional corporation in excess of one who is a full-time employee of the taxpayer, whose business income from that business is at least $10,000.00, and who owns at least 10% of that business. The total increased exemption shall be not more than $40,000.00. For a taxpayer whose business activity is for a fractional part of a year, the $34,000.00 exemption provided in this subsection including the increased exemption of not more than $40,000.00 shall be prorated for the period of the taxpayer's business activity. This exemption shall be reduced by $2.00 for each $1.00 that business income exceeds the amount of the exemption. For the purposes of computing the exemption, business income shall be as defined in section 3(3) plus salaries or fees paid or accrued for the benefit of shareholders of a corporation and any carryback or carryforward of a net operating loss or capital loss to the extent deducted in arriving at federal taxable income. In calculating eligibility for the exemption provided in this subdivision, a person who is not a corporation may elect to average his business income for the current year and the previous 4 taxable years. Business income, as defined in this subdivision shall not be less than zero. For the purposes of this subdivision, tax base shall be after allocation and apportionment provided in chapter 3 and the adjustments provided in section 23.

(b) The United States, this state, other states, and the agencies, political subdivisions, and enterprises of each.

(c) A person who is exempt from federal income tax pursuant to the provisions of the internal revenue code is exempt from the tax imposed by this act except:

(i) An organization included under section 501(c)(12) and 501(c)(16) of the internal revenue code.

(ii) An organization exempt under section 501(c)(4) of the internal revenue code which would be exempt under section 501(c)(12) of the internal revenue code but for its failure to meet the requirements in section 501(c)(12) that 85% or more of its income must consist of amounts collected from members.

(iii) The adjusted tax base attributable to the activities giving rise to the unrelated taxable business income of an exempt person.

(d) A foreign or alien insurance company subject to the provisions of the premium tax under sections 440 to 446 of Act No. 218 of the Public Acts of 1956, as amended, being sections 500.440 to 500.446 of the Michigan Compiled Laws. This exemption shall not apply to the tax base derived from a business activity other than insurance carrier services.

(e) That portion of the payroll of domestic insurers or of a marketing corporation that constitutes insurance sales commissions paid to employees and salaries of employees primarily concerned with the adjustment of claims. This exemption shall not apply to a marketing corporation which is not controlled, directly or indirectly, by stock ownership or common management, by the domestic insurer or insurers from which it derives all or substantially all of its gross income, exclusive of income from investments.

(f) Fifty percent of compensation directly related to the completion of construction contracts for the planning, design, construction, alteration, repair, or improvement of real property, for which a bid was submitted or a contract signed on or before September 1, 1975. A taxpayer claiming this exemption shall file a copy of the bid or contract, or that portion of either that clearly shows the date and dollar amount of the

bid or contract, with the annual return. This subsection shall not apply to any compensation paid or accrued after December 31, 1977.

(g) A nonprofit cooperative housing corporation. As used in this subdivision, "nonprofit cooperative housing corporation" means a nonprofit cooperative housing corporation which is engaged in providing housing services to its stockholders and members and which does not pay dividends or interest upon stock or membership investment but which does distribute all earnings to its stockholders or members. This exemption shall not apply to any business activity of a nonprofit cooperative housing corporation other than providing housing services to its stockholders and members.

Sec. 37. An affiliated group as defined in this act and a controlled group of corporations as defined by the internal revenue code shall be entitled to only 1 exemption allowed by section 35(a) whether or not a combined or consolidated return is filed.

Sec. 38. (1) At the election of taxpayers not subject to Act No. 281 of the Public Acts of 1967, as amended, being sections 206.1 to 206.532 of the Michigan Compiled Laws, there shall be allowed as a credit against the tax imposed by this act for the taxable year, an amount, subject to the applicable limitations provided by this section, equal to 50% of the aggregate amount of charitable contributions made by the taxpayer during the year to public libraries, institutions of higher learning located within this state, the Michigan colleges foundation, and only for the tax years of 1974 to 1980 to a nonprofit corporation, fund, foundation, trust, or association organized and operated exclusively for the benefit of institutions of higher learning. The tax credit shall be permitted only where the donee corporation, fund, foundation, trust, or association is controlled or approved and reviewed by the governing boards of the institutions benefiting from the charitable contributions. The nonprofit corporation, fund, foundation, trust, or association shall provide copies of their annual independently audited financial statements to the auditor general of the state and chairmen of the senate and house appropriations committees.

(2) The amount allowable as a credit under this section for any taxable year shall not exceed 5% of the tax liability for that year as determined without regard to this section or $5,000.00, whichever is less.

(3) As used in this section, "institution of higher learning" means an educational institution located within this state meeting all of the following requirements:

(a) It maintains a regular faculty and curriculum and has a regularly enrolled body of students in attendance at the place where its educational activities are carried on.

(b) It regularly offers education above the twelfth grade.

(c) It awards associate, bachelors, masters, or doctoral degrees or any combination thereof or higher education credits acceptable for those degrees granted by other institutions of higher learning.

(d) It is recognized by the state board of education as an institution of higher learning and appears as such in the annual publication of the department of education entitled "the directory of institutions of higher education".

(4) As used in this section, "public library or libraries" means a library as defined in section 2 of Act No. 286 of the Public Acts of 1965, being section 397.502 of the Michigan Compiled Laws.

(5) The credit allowed by this section shall not be in excess of the tax liability of the taxpayer.

Sec. 39. (1) A taxpayer subject to Act No. 282 of the Public Acts of 1905, as amended, being sections 207.1 to 207.21 of the Michigan Compiled Laws, shall be allowed a credit against the tax imposed by this act for the taxable year, an amount equal to 5% of the tax imposed under Act No. 282 of the Public Acts of 1905, as amended. The credit allowed by this section shall not be in excess of the tax liability of the taxpayer under this act. Except as provided in subsection (2) this subsection shall not apply to a taxpayer who files pursuant to the provisions of section 57.

(2) A person eligible to file under section 57 who has a net operating loss for 2 or more years immediately preceding the 1976 tax year, shall be allowed a credit against the tax imposed by this act for the 1976 and 1977 tax years only in an amount equal to 5% of the tax imposed under Act No. 282 of the Public Acts of 1905, as amended. The credit allowed by this subsection shall not be in excess of the tax liability of the taxpayer under this act.

CHAPTER 3

Sec. 40. In the case of a taxpayer whose business activities are confined solely to this state, the entire tax base of the taxpayer shall be allocated to this state except as provided in section 56.

Sec. 41. A taxpayer whose business activities are taxable both within and without this state, shall apportion his tax base as provided in this chapter.

Sec. 42. For purposes of apportionment of the tax base from business activities under this act, a taxpayer is taxable in another state if, (a) in that state he is subject to a business privilege tax, a net income tax, a franchise tax measured by net income, a franchise tax for the privilege of doing business or a corporate stock tax, a tax of the type imposed under this act, or (b) that state has jurisdiction to subject the taxpayer to 1 or more of the taxes regardless of whether, in fact, the state does or does not.

Sec. 45. All of the tax base, other than the tax base derived principally from transportation, financial, or insurance carrier services or specifically allocated, shall be apportioned to this state by multiplying the tax base by a fraction, the numerator of which is the property factor plus the payroll factor plus the sales factor, and the denominator of which is 3.

Sec. 46. The property factor is a fraction, the numerator of which is the average value of the taxpayer's real and tangible personal property owned or rented in this state during the tax year and the denominator of which is the average value of all the taxpayer's real and tangible personal property owned or rented during the tax year.

Sec. 47. Property owned by the taxpayer is valued at its original cost. Property rented by the taxpayer is valued at 8 times the net annual rental rate. Net annual rental rate is the annual rental rate paid by the taxpayer less any annual rental rate received by the taxpayer from subrentals.

Sec. 48. The average value of property shall be determined by averaging the values at the beginning and ending of the tax year, but the commissioner may require the periodic averaging of values during the tax year if reasonably required to reflect properly the average value of the taxpayer's property.

Sec. 49. The payroll factor is a fraction, the numerator of which is the total wages paid in this state during the tax year by the taxpayer and the denominator of which is the total wages paid everywhere during the tax year by the taxpayer. For the purposes of this chapter only, "wages" means wages as defined in section 3401 of the internal revenue code.

Sec. 50. Wages are paid in this state if:

(a) The individual's service is performed entirely within the state.

(b) The individual's service is performed both within and without the state, but the service performed without the state is incidental to the individual's service within the state.

(c) Some of the service is performed in the state and the base of operations, or if there is no base of operations, the place from which the service is directed or controlled is in the state; or the base of operations or the place from which the service is directed or controlled is not in any state in which some part of the service is performed, but the individual's residence is in this state.

Sec. 51. The sales factor is a fraction, the numerator of which is the total sales of the taxpayer in this state during the tax year, and the denominator of which is the total sales of the taxpayer everywhere during the tax year.

Sec. 52. Sales of tangible personal property are in this state if:

(a) The property is shipped or delivered to a purchaser, other than the United States government, within this state regardless of the free on board point or other conditions of the sales.

(b) The property is shipped from an office, store, warehouse, factory, or other place of storage in this state and the purchaser is the United States government, or the taxpayer is not taxable in the state of the purchaser. For the purposes of this subdivision only, "state" means any state of the United States, the District of Columbia, the commonwealth of Puerto Rico, any territory or possession of the United States, or

political subdivision thereof.

Sec. 53. Sales, other than sales of tangible personal property, are in this state if:

(a) The business activity is performed in this state.

(b) The business activity is performed both in and outside this state and, based on costs of performance, a greater proportion of the business activity is performed in this state than is performed outside this state.

(c) Receipts derived from services performed for planning, design, or construction activities within this state shall be deemed Michigan receipts.

Sec. 56. The tax base of a taxpayer whose business activities consist of transportation services rendered either entirely within or partly within and partly without this state shall be determined under the provisions of sections 57 and 58.

Sec. 57. (1) In the case of a taxpayer under section 56 other than one whose activity consists of the transportation of oil or gas by pipeline, the tax base attributable to Michigan sources shall be that portion of the tax base of the taxpayer derived from transportation services wherever performed that the revenue miles of the taxpayer in Michigan bear to the revenue miles of the taxpayer everywhere. A revenue mile means the transportation for a consideration of 1 net ton in weight or 1 passenger the distance of 1 mile. The tax base attributable to Michigan sources in the case of a taxpayer engaged in the transportation both of property and of individuals, shall be that portion of the entire tax base of the taxpayer which is equal to the sum of his passenger miles and ton mile fractions, separately computed and individually weighted by the ration of gross receipts from passenger transportation to total gross receipts from all transportation, and by the ratio of gross receipts from freight transportation to total gross receipts from all transportation, respectively.

(2) If it is shown to the satisfaction of the commissioner that the foregoing information is not available or cannot be obtained without unreasonable expense to the taxpayer, the commissioner may use such other data which may be available and which in the opinion of the commissioner will result in an equitable allocation of the receipts to this state.

(3) For any tax year ending on or before December 31, 1977, the tax base attributable to this state shall be 30% of the tax base otherwise computed under the provisions of subsection (1). In no event shall the tax so computed be less than an amount equal to the 5-year average tax liability measured as a percentage of gross receipts, determined by computing the percentage that the taxpayer's liability for the taxes levied under Act No. 85 of the Public Acts of 1921, as amended, being sections 450.304 to 450.310 of the Michigan Compiled Laws, Act No. 281 of the Public Acts of 1967, as amended, being sections 206.1 to 206.532 of the Michigan Compiled Laws, Act No. 301 of the Public Acts of 1939, as amended, being sections 205.131 to 205.147 of the Michigan Compiled Laws, and the tax levied on the inventory portion of personal property under Act No. 206 of the Public Acts of 1893, as amended, being sections 211.1 to 211.157 of the Michigan Compiled Laws, or Act No. 282 of the Public Acts of 1905, as amended, being sections 207.1 to 207.21 of the Michigan Compiled Laws, bears to the gross receipts of the taxpayer. The 5-year average tax liability under this subsection shall be computed and determined from the 1971 to 1975 tax years. This subsection shall expire December 31, 1977.

Sec. 58. (1) When the tax base is derived from the transportation of oil by pipeline, the tax base attributable to Michigan shall be the tax base of the taxpayer in the ratio that the barrel miles transported in Michigan bear to the barrel miles transported by the taxpayer everywhere.

(2) When the tax base is derived from the transportation of gas by pipeline, the tax base attributable to Michigan shall be the tax base of the taxpayer in the ratio that the 1,000 cubic feet miles transported in Michigan bear to the 1,000 cubic feet miles transported by the taxpayer everywhere.

Sec. 62. The tax base of a domestic insurer doing business both within and without the state or partly within and without the state shall be that portion of the tax base of the taxpayer that the gross direct premiums received for insurance upon property or risk in this state, deducting premiums upon policies not taken and returned premiums on canceled policies from Michigan bears to the gross direct premiums received for insurance upon property or risk deducting premiums upon policies not taken and returned premiums on canceled policies everywhere.

Sec. 65. The tax base of a financial organization attributable to Michigan sources shall be taken to be:

(a) The entire tax base of a taxpayer whose business activities are confined solely to this state.

(b) In the case of a taxpayer whose business activities are conducted partially within and partially without this state that portion of its tax base as its gross business in this state is to its gross business everywhere during the period covered by its return. Gross business includes the sum of:

(i) Fees, commissions, or other compensation for financial services.

(ii) Gross profits from trading in stocks, bonds, or other securities.

(iii) Interest charged to customers for carrying debit balances of margin accounts, without deduction of any costs incurred in carrying the accounts.

(iv) Interest and dividends received.

(v) Any other gross income resulting from the operation as a financial organization.

Sec. 68. (1) If the taxpayer's business activities within this state do not include owning or renting real estate or tangible personal property, and whose dollar volume of gross sales made during the tax year within this state is not in excess of $100,000.00, the taxpayer may elect for that year to report and pay a tax on the tax base arrived at by multiplying total sales in this state for the taxable year by the ratio of the tax base, for the tax imposed by this act, to total sales as reported on the taxpayer's federal income tax return for the same taxable year.

(2) The election is not available for any taxable year for which a consolidated or combined return is filed.

Sec. 69. (1) If the apportionment provisions of this act do not fairly represent the extent of the taxpayer's business activity in this state, the taxpayer may petition for or the commissioner may require, in respect to all or any part of the taxpayer's business activity, if reasonable:

(a) Separate accounting.

(b) The exclusion of any 1 or more of the factors.

(c) The inclusion of 1 or more additional factors which will fairly represent the taxpayer's business activity in this state.

(d) The employment of any other method to effectuate an equitable allocation and apportionment of the taxpayer's tax base.

(2) An alternate method will be effective only if it is approved by the commissioner.

CHAPTER 4

Sec. 71. (1) A taxpayer who reasonably expects his liability for the tax year to exceed $500.00 or his adjustments under section 23 to exceed $100,000.00 shall file an estimated return and pay an estimated tax for each quarter of his tax year.

(2) For taxpayers on a calendar year basis the quarterly returns and estimated payments shall be made by April 30, June 30, October 31, and January 31. Taxpayers not on a calendar year basis shall file quarterly returns and make estimated payments on the appropriate due date which in the taxpayers fiscal year corresponds to the calendar year.

(3) The estimated payment made with each quarterly return of each tax year shall be for the estimated tax base for the quarter or 1/4 of the estimated annual liability. The second, third, and fourth estimated payments in each tax year shall include adjustments, if necessary, to correct underpayments or overpayments from previous quarterly payments in the tax year to a revised estimate of the annual tax liability.

(4) The interest provided by this act shall not be assessed if any of the following occur:

(a) If the sum of the estimated payments equals at least 90% of the liability for the tax year and the amount of each estimated payment reasonably approximates the tax liability incurred during the quarter for which the estimated payment was made.

(b) If the preceding year's tax liability was $10,000.00 or less and if the taxpayer submitted 4 equal installments the sum of which equals the previous year's tax liability.

(c) For 1976 only, the sum of the estimated payments made in accordance with subsection (3) equals 80% or more of the liability for the tax year.

(5) Each estimated return shall be made on a form prescribed by the department and shall include an estimate of the annual tax liability and other information required by the commissioner.

(6) With respect to a taxpayer filing an estimated tax return for his first tax year of less than 12 months, the amounts paid with each return shall be proportional to the number of payments made in the first tax year.

(7) Payments made under this section shall be a credit against the payment required with the annual tax return required in section 73.

(8) The commissioner, when he deems it necessary to insure payment of the tax, may require filing of the returns and payment of the tax for other than quarterly or annual periods.

(9) A taxpayer who elects under the internal revenue code to file an annual federal income tax return by March 1 in the year following his tax year and does not make a quarterly estimate or payment, or does not make a quarterly estimate or payment and files a tentative annual return with a tentative payment by January 15, in the year following his tax year and a final return by April 15 in the year following his tax year, shall have the same option in filing the estimated and annual returns required by this act.

Sec. 72. A taxpayer subject to this act, may elect to compute the tax for the first taxable year if less than 12 months in accordance with 1 of the following methods:

(a) The tax may be computed as if this act were effective on the first day of the taxpayer's annual accounting period and the amount so computed shall be multiplied by a fraction, the numerator of which is the number of months in the taxpayer's first taxable year, and the denominator of which is 12.

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(b) The tax may be computed by determining the tax base in the first taxable year in accordance with an accounting method, satisfactory to the commissioner, which reflects the actual tax base attributable to the period.

Sec. 73. (1) An annual or final return shall be filed with the department, in the form and content prescribed by the department by the last day of the fourth month after the end of the taxpayer's tax year. Any final liability shall be remitted with this return. A person whose apportioned or allocated gross receipts are less than $34,000.00 need not file a return or pay the tax provided under this act. For a person whose apportioned or allocated gross receipts are for a tax year less than 12 months, the $34,000.00 shall be multiplied by a fraction, the numerator of which is the number of months in the tax year and the denominator of which is 12.

(2) The commissioner upon application of the taxpayer and for good cause shown may extend the date for filing the annual return. Interest at the rate of 9% per annum shall be added to the amount of the tax unpaid for the period of the extension. The commissioner shall require a tentative return and payment of an estimated tax.

(3) When a taxpayer is granted an extension of time within which to file his federal income tax return for any taxable year, the filing of a copy of the request for extension with the commissioner by the due date provided in subsection (1) shall automatically extend the due date for the filing of a final return under this act for an equivalent period plus 60 days.

Sec. 75. (1) A taxpayer required to file a return under this act may be required to furnish a true and correct copy of any return or portion of any return which he has filed under the provisions of the internal revenue code.

(2) A taxpayer shall file an amended return with the department showing any alteration in or modification of his federal income tax return which affects his tax base under this act. The amended return shall be filed within 120 days after the final determination by the internal revenue service.

Sec. 76. (1) At the request of the department, a person required by the internal revenue code to file or submit an information return of income paid to others shall, to the extent the information is applicable to residents of this state, at the same time file or submit the information in form and content as may be prescribed to the department.

(2) A voluntary association, joint venture, partnership, estate, or trust at the request of the department shall file a copy of any tax return or portion of any tax return which was filed under the provisions of the internal revenue code. The department may prescribe alternate forms of returns.

Sec. 77. (1) The commissioner may require or permit the filing of a consolidated or combined return by an affiliated group of corporations which are Michigan taxpayers if all of the following conditions exist:

(a) All members of the affiliated group are Michigan taxpayers.

(b) Each member of the affiliated group maintains a relationship with 1 or more members of the group which includes intercorporate transactions of a substantial nature other than control, ownership, or financing arrangements, or any combination thereof.

(c) The business activities of each member of the affiliated group are subject to apportionment by a specific apportionment formula contained in this act which specific formula also is applicable to all other members of the affiliated group, and would be so applicable to each member even if it were not a member of the affiliated group.

Sec. 78. Except as expressly provided in section 77, a provision of this act shall not be construed to permit or require the filing of a consolidated or combined return or a consolidation or combination of the tax base or apportionment factors of 2 or more corporations.

CHAPTER 5

Sec. 81. (1) If it appears, either from the examination of the return or from the examination authorized by section 83, that the taxpayer has not satisfied his liability under this act, the tax shall be determined by the department and the taxpayer notified thereof. If the amount paid exceeds the correct amount of tax, the excess so paid may be credited against a subsequent tax or shall be refunded if requested by the taxpayer.

(2) If the amount paid is less than the amount which should have been paid, the deficiency, together with interest thereon at the rate of 3/4 of 1% per month from the time the tax was due, shall become due and payable after notice and conference as provided in this act.

(3) When the amount paid with a quarterly estimated tax return is less than the amount required by section 71 interest on that deficiency at the rate of 3/4 of 1% per month from the time the quarterly estimated tax payment was due, shall become due and payable after notice and conference as provided in this act.

(4) If any part of the deficiency is due to negligence or intentional disregard of this act or of the authorized rules of the department, but without intent to defraud, there shall be added as a penalty 10% of the total amount of the deficiency in the tax, and interest shall be collected at the rate of 3/4 of 1% per month on the amount of the deficiency in the tax from the time it was due, which interest and penalty shall become due and payable after notice and conference as provided in this act.

(5) If any part of the deficiency is due to a fraudulent intent to evade the tax, then there shall be added as a penalty 100% of the deficiency, and the whole amount of tax unpaid, together with the penalty, shall become due and payable after notice and conference as provided in this act, and an additional 1% per month on the tax shall be added from the date the tax was due until paid.

Sec. 82. (1) If a person fails or refuses to file a return or pay the tax as required by this act within the time specified in this act, the department as soon as possible shall assess the tax against the person and shall notify him of the amount thereof as provided in this act.

(2) In case of failure or refusal to file a return or pay the tax required by this act, within the time prescribed by this act, there shall be added a penalty of $5.00 or 5% of the tax, whichever is greater, if the failure is for not more than 1 month or a fraction of 1 month, with an additional 5% for each additional month or fraction thereof during which the failure continues, or the tax and penalty is not paid, to a maximum of 25%. In addition to the penalty, there shall be added interest at the rate of 3/4 of 1% per month on the amount of the tax from the time the tax was due until the date of payment.

(3) For failure or refusal to file an information return, information report or statement of compensation required by this act, within the time specified by this act, there may be added a penalty of $5.00 per day for each day for each separate failure or refusal. The total penalty for each separate failure or refusal shall not exceed $200.00.

(4) When a return or report is filed or remittance is paid after the time specified by this act and it is shown to the satisfaction of the department that the failure to file was due to reasonable cause and not to wilful neglect, the penalty may be waived.

Sec. 83. (1) If a person fails or refuses to make a return, either in whole or in part, or if the department has reason to believe that any return made does not supply sufficient information for an accurate determination of the amount of tax due, the department may obtain information on which to base an assessment of the tax. The department by its duly authorized agents may examine the books, records, and papers and audit the accounts of any person or any other records pertaining to the tax. As soon as possible after procuring the information as may be found to be available, the department shall assess the tax determined to be due and shall notify the person assessed of the amount thereof and the specific reasons for the assessment.

(2) The assessment by the department shall be final as to any person except as may be otherwise determined under the provisions of section 87.

(3) A person liable for any tax imposed under this act shall keep and maintain accurate records in such form as to make it possible to determine the tax due under this act. When the department deems it necessary, it may require a person, by notice served upon him, to make a return, render under oath such statements, or keep such records as the department deems sufficient to show whether or not the person is liable to tax under this act. If the taxpayer fails to file a return or to keep and maintain proper, accurate, and complete records as prescribed in this section, the department may assess, upon the information as is available or may come into possession of the department, the amount of the tax due from the taxpayer. The assessment after notice and conference as provided in this act shall be deemed to be prima facie correct for the purpose of this act and the burden of proof of refuting the assessment shall be upon the taxpayer.

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Sec. 85. (1) A deficiency, interest, or penalty shall not be assessed for any year after the expiration of 4 years after the date set for the filing of the annual return for each year or the date the return was filed whichever is later. If a person subject to tax under this act fraudulently conceals any liability for the tax or any part thereof, the department within 2 years of the discovery of the fraud shall assess the tax with interest and penalties as provided in this act, computed from the date on which the tax liability originally accrued, and the tax, penalties, and interest shall become due and payable after notice and conference as provided in this act.

(2) The limitation of action provision shall be suspended for the period pending final determination of litigation of or conference or waiver on a taxpayer's federal income tax return or on the return required by this act, or if a notice is required under section 75, and for 1 year thereafter. The suspension shall apply to those items required to be reported under section 75(2) which may be the subject of assessment or refund.

(3) The limitation of action provision shall be suspended for the period for which the taxpayer and the commissioner consented in writing that the period be suspended. The period so extended may be further extended by subsequent consent in writing made before the expiration of the extended period.

(4) The limitation of action provision shall be suspended for any taxable year for which a return was not filed.

Sec. 87. (1) In carrying out the provisions of this act, the department after determining the amount of tax due from a taxpayer shall give notice to the taxpayer of its intent to levy the tax. The taxpayer, if he so desires and serves notice thereof upon the department within 20 days, may request an informal conference on the question of his liability for the assessment. Thereupon, the department shall set a time and place for the conference and shall give the taxpayer reasonable notice thereof. The conference provided for by this subsection shall not be subject to the provisions of Act No. 306 of the Public Acts of 1969, as amended.

(2) The taxpayer may appear or be represented before the department and present testimony and argument. After the conference the department shall render its decision in writing setting forth its reasons and authority and by order levy any tax, interest, and penalty found by it to be due and payable.

Sec. 88. A taxpayer aggrieved by any determination of tax liability made by the department may appeal to the state tax tribunal under Act No. 186 of the Public Acts of 1973, being sections 205.701 to 205.779 of the Michigan Compiled Laws, or after payment of the amount of tax, interest, and penalties found to be due by the department, he may bring an action in the state court of claims to recover the amount paid. The action shall be commenced within 6 months after payment of the tax or after the adverse determination by the department of the validity of the taxpayer's claim for refund, whichever occurs later, and shall be conducted in accordance with the statutes and rules of procedure concerning actions at law not inconsistent with the provisions of this act.

Sec. 89. (1) When notice is required under this act, it shall be given either by personal service or by certified mail addressed to the last known address of the taxpayer. Service upon the commissioner may be made in the same manner.

(2) An injunction shall not issue to stay proceedings for the assessment and collection of any tax levied under this act.

Sec. 91. (1) If the tax imposed by this act is not paid at the time required in this act, the department shall make a demand for payment thereof on the delinquent taxpayer. If the tax remains unpaid for 10 days after demand and proceedings are not taken to review same, the commissioner may issue a warrant under the official seal of his office. The commissioner, through any state officer authorized to serve process or through his authorized employees may levy upon all property and rights to property, both real and personal, tangible and intangible, belonging to the taxpayer or on which there is a lien provided by law for amount of the tax, and sell the real and personal property of the taxpayer, without exemption, found within the state for the payment of the tax, the cost of executing the warrant and the added penalties and interest. The officer or agent serving the warrant shall proceed upon the warrant in all respects and in the same manner as prescribed by law in respect to executions issued against property upon judgments by a court of record. The state, through the department or an agent designated by it, may bid for and purchase any property sold under the provisions of this section.

(2) A person who fails or refuses to surrender any property or rights to property, subject to levy, upon demand by the commissioner or his agent, is liable in his own person and estate to the state in a sum equal to the value of the property or rights not so surrendered, but not exceeding the amount of taxes for the collection of which the levy was made, together with costs and interest on the sum at the rate of 6% per annum from the date of the levy. An amount, other than costs, recovered under this subsection shall be credited against the tax liability for the collection of which the levy was made.

(3) In addition to the personal liability imposed by subsection (2), if a person required to surrender property or rights to property fails or refuses to surrender the property or rights to property without reasonable cause, the person shall be liable for a penalty equal to 50% of the amount recoverable under subsection (2). None of the penalty shall be credited against the tax liability for the collection of which the levy was made.

(4) A person in possession of, or obligated with respect to, property or rights to property subject to levy upon which a levy was made who, upon demand by the commissioner or his agent, surrenders the property or rights to property or discharges the obligation to the commissioner or his agent or who pays a liability under subsection (1) shall be discharged from an obligation or liability to the delinquent taxpayer with respect to the property or rights to property arising from the surrender or payment.

Sec. 92. The commissioner may utilize the services, information, or records of any other department or agency of the state government, including the withholding of state licenses or permits, in the performance of its duties hereunder, and other departments or agencies of the state government shall furnish the services, information, or records, and withhold issuance of licenses or permits, upon the request of the department.

Sec. 93. (1) If the department finds that a person liable for tax under any provisions of this act designs quickly to depart from the state or to remove his property therefrom, to conceal himself or his property herein, or to do any other act tending to prejudice or to render wholly or partly ineffectual proceedings to collect the tax unless the proceedings are brought without delay, the department shall give notice of the findings to the person, together with a demand for an immediate return and immediate payment of the tax. A warrant may issue immediately upon issuance of a jeopardy assessment. Thereupon, the tax shall become immediately due and payable. If the person is not in default in making a return or paying a tax prescribed by this act, and furnishes evidence satisfactory to the department under rules prescribed by it that he will duly return and pay the tax to which the department's finding relates, then the tax shall not be payable prior to the time otherwise fixed for payment.

(2) In addition to the mode of collection provided in this chapter, the department may institute an action at law in any county in which the taxpayer resides or transacts business.

Sec. 95. (1) The specific tax imposed by this act, together with interest and penalties thereon, shall be a lien in favor of the state against all property and rights of property, both real and personal, tangible and intangible, owned at the time the lien attaches, or afterwards acquired by any person liable for the tax, to secure the payment of tax. The lien shall attach to the property from and after the date that any report or

return upon which the specific tax levied by this act is required to be filed with the department and shall continue for 6 years thereafter and no longer unless proceedings are begun to enforce the same.

(2) The lien imposed by subsection (1) shall take precedence over all other liens and encumbrances whatsoever, except bona fide liens recorded prior to the date the lien of this act attaches, but the lien shall not be valid as against any mortgagee, pledgee, purchaser, including a contract purchaser, or judgment creditor until notice thereof is recorded in the office of the register of deeds of the county within which the property or rights to property subject to the lien is situated. When notice of the lien in favor of the state is presented for recording, the register of deeds, upon receiving the same fee as is provided by law for recording real estate mortgages, shall record the notice in full and enter it in an alphabetical state tax lien index, showing the name and last known post-office address of the taxpayer named in the notice, the date and hour of presenting for recording and the amount of tax with the interest and penalties.

(3) The department shall issue a certificate of discharge of the lien when it finds that the liability for the tax imposed by this act, together with interest and penalties thereon, is fully satisified or becomes legally unenforceable or if the department deems the action otherwise advisable. The certificate of discharge issued by the department may be recorded in the office of the register of deeds where the original notice of lien is recorded. Upon receiving the same fee as is provided by law for recording real estate mortgage discharges, the register of deeds shall record the certificate of discharge in full and index separately in the manner provided by law for recording real estate mortgage discharges.

Sec. 97. (1) The department shall credit or refund all overpayments of taxes, all taxes erroneously or illegally assessed or collected, all penalties collected without authority, and all taxes that are found unjustly assessed or excessive in amount, or wrongfully collected.

(2) A taxpayer who paid a tax which he claims was not due under this act may, on or before the expiration date of 4 years after the date set for the filing of the annual or final return for the year or the date the tax was paid, whichever is later, petition the department in writing to refund the amount so paid. If the annual return reflects an overpayment or credits in excess of the tax, the declaration thereof on the return constitutes a claim for refund. If the department agrees that the taxpayer's claim is valid, the amount of overpayment, at the request of the taxpayer, shall be refunded to the taxpayer, or credited against any current or subsequent tax liability.

(3) A refund shall be certified to the state disbursing authority who shall pay the amount out of the proceeds of the tax in accordance with the accounting laws of the state. Interest at the rate of 3/4 of 1% per month shall be added to the refund 45 days after the due date or date the return is filed, whichever is later.

(4) Other provisions of this act notwithstanding, refunds for amounts of less than $1.00 shall not be paid.

Sec. 98. (1) The department of commerce shall withhold the issuance of any certificate of dissolution or withdrawal in the case of any corporation organized under the laws of this state or organized under the laws of another state and admitted to do business in this state until the receipt of a notice from the department to the effect that all taxes levied under this act against the corporation are paid, or until it is notified by the department that the applicant is not indebted for any taxes levied hereunder by reason of payment or indemnification.

(2) An estate of a person subject to tax under this act shall not be closed without the payment of the tax levied by this act, both in respect to the liability of the estate and decedent prior to his death.

(3) If a person liable for a tax levied by this act, or any employer required to deduct or withhold a tax from salaries or wages, sells out his business or stock of goods or ceases his business activity, his successor or succeeding successors shall withhold sufficient of the purchase money to satisfy the amount of tax which may be due and unpaid until the former owner produces a certificate from the department stating that a tax is not due. A successor who fails to withhold purchase money is liable personally for any tax accruing by virtue of the business of the former owner.

Sec. 99. A person shall keep such records, books, and accounts as may be necessary to determine the amount of tax for which the person is liable under this act and as the department requires for 6 years. The records, books, and accounts shall be open for examination at any time during regular business hours of the taxpayer by the department and its agents. A person who violates this section is guilty of a misdemeanor and shall be fined not more than $1,000.00, or imprisoned for not more than 1 year, or both.

Sec. 101. (1) A person shall not:

(a) Fail or refuse to make the return required by this act, within the time specified by this act, or make,

aid, abet, or assist another in making a false or fraudulent return or false statement in a return required by this act with intent to defraud the state or to evade the payment of the tax, or any part thereof, imposed by this act.

(b) Aid, abet, or assist another in an attempt to evade the payment of the tax, or any part thereof, imposed by this act.

(c) Make or permit to be made for himself or for any company or association any false return or a false statement in a return, either in whole or in part, required by this act.

(2) A person violating any provision of this section with the intent to evade or assist in evading the payment of the tax is guilty of a felony and upon conviction thereof shall be fined not more than $5,000.00, or imprisoned for not more than 5 years, or both.

(3) In addition to the foregoing penalties, a person who knowingly swears to or verifies a false or fraudulent statement, with the intent to defraud or to aid, abet, or assist in defrauding the state, is guilty of perjury and shall be punished in the manner provided by law.

Sec. 102. (1) Unless in accordance with a judicial order, or as required in the proper administration of this act, or as permitted by Act No. 122 of the Public Acts of 1941, as amended, a member of the department or agent or employee thereof, or former member, agent or employee, shall not divulge any facts or information obtained in connection with the administration of this act except as provided by law.

(2) A person who violates this section is guilty of a misdemeanor and shall be fined not more than $1,000.00, or imprisoned not more than 1 year, or both.

Sec. 103. An officer, agent, or employee of this state or of any department or agency of this state may divulge any information set forth or disclosed in a return or report filed under this act or by an investigation or audit authorized under this act to an office or department of the state government when it is required for the more effective administration or enforcement of the laws of this state, to any proper officer of the United States department of treasury, and to any proper officer of any other state imposing a tax of a substantially similar nature and reciprocating in this privilege. The commissioner may enter into reciprocal agreements with the United States department of treasury, or taxing officials of other states for the enforcement, collection, and exchange of data in connection with the administration of this act.

Sec. 104. (1) The tax imposed by this act shall be administered by the department. The department shall prescribe forms for use by taxpayers and shall promulgate rules in conformity with this act for the maintenance by taxpayers of records, books, and accounts, and for the computation of the tax, the manner and time of changing or electing accounting methods and of exercising the various options contained in this act, the making of returns, and the ascertainment, assessment, and collection of the tax imposed hereunder. The rules insofar as possible without being inconsistent with the provisions of this act, shall follow the rulings of the United States internal revenue service with respect to the federal income tax, and the department may adopt as a part of the rules any portions of the internal revenue code or rulings, in whole or in part.

(2) Rules shall be promulgated under this act pursuant to Act No. 306 of the Public Acts of 1969, as amended, being sections 24.201 to 24.315 of the Michigan Compiled Laws.

Sec. 106. (1) The tax imposed by this act is in addition to all other taxes for which the taxpayer may be liable and the proceeds derived from the tax shall be credited to the general fund of the state to be allocated and distributed as hereinafter provided.

(2) All remittances of taxes imposed by this act shall be made to the department by bank draft, check, cashier's check, money order, or money. A remittance other than cash is not a final discharge of liability for the tax herein levied unless and until it is paid in cash.

Sec. 121. The department shall prepare and publish statistics from the records kept to administer the tax imposed by this act detailing the distribution of tax receipts by type of business, legal form of organization, sources of tax base, timing of tax receipts and types of deductions. The statistics shall not result in the disclosure of information regarding any specific taxpayer.

CHAPTER 6

Sec. 131. As used in this chapter:

(a) "Property taxes" means general ad valorem property taxes levied under Act No. 206 of the Public Acts of 1893, as amended, being sections 211.1 to 211.157 of the Michigan Compiled Laws.

(b) "Inventory" means, in the case of a person filing the sworn statement of personal property inventories for tax day December 31, 1974, under Act No. 206 of the Public Acts of 1893, as amended:

(i) The stock of goods held for resale in the regular course of trade of a retail or wholesale business.

(ii) Finished goods, goods in process, and raw materials of a manufacturing business.

(iii) Materials and supplies, including repair parts and fuel.

(iv) Inventory does not include personal property under lease or principally intended for lease rather than sale. Inventory does not include property allowed a deduction or allowance for depreciation or depletion under the internal revenue code.

Sec. 132. (1) The local assessor shall report the state equalized value of inventory as defined in this chapter. The state equalized valuation for inventory shall be reported as a total for each city, village, and township in the amount upon which taxes were actually levied during 1975. Where the local units are divided among more than 1 county the local assessor shall report the amounts of inventory property in each county separately. The reports shall be filed with the department by February 1, 1976.

(2) The department of treasury may audit the personal property statements of any taxpayer and may audit the total value reported by any city, village, or township. If errors are found, the department of treasury may correct the figure used in calculating payments under this act and so notify the local government of the change in inventory based state equalized value credited to that local government. The department of treasury shall certify and report to the department of management and budget the state equalized value of inventory property for each city, village, and county as of tax day 1975 as equalized by county and state according to law.

Sec. 134. The department of treasury shall calculate the amount of payment to be made to a city, village, and township by multiplying the amount of state equalized value of tax exempt inventory property as certified by the department of treasury under section 132 times the property tax rate for each taxing unit as certified each year to the department of treasury for purposes of this act. The amount due under this section shall be paid to the cities and villages between July 1 and October 2 of each year beginning in 1976. The townships shall receive their funds by February 1 of each year, beginning in 1977.

Sec. 135. The department of treasury shall pay to each county by February 1 of each year, following the year the amount was calculated, an amount of money equal to the product of the state equalized value based upon inventory as certified by the department of treasury under section 132 times the county property tax rate for the county as reported to the department of treasury under section 138. The payments shall begin in 1977 for the previous year.

Sec. 136. (1) The department of treasury shall total the amounts payable to cities, villages, and townships under section 134 between July 1, 1976 and February 1, 1977, but excluding any payments under section 137.

(2) Between July 1, 1977 and February 28, 1978, an additional amount of the single business tax equal to 5% of the amount calculated in subsection (1) shall be distributed to all cities, villages, and townships through the relative tax effort formula as defined in Act No. 140 of the Public Acts of 1971, as amended, being sections 141.901 to 141.919 of the Michigan Compiled Laws.

(3) For every year following June 30, 1978, the growth in the single business tax payable to cities, villages, and townships by the relative tax effort formula is calculated in the following manner:

(a) The percentage that the amount calculated in subsection (1) is of the gross collections before refunds of the single business tax from July 1, 1976, through June 30, 1977.

(b) The percentage calculated in subdivision (a) is multiplied by the gross collections before refunds of the single business tax from each July 1 through June 30, starting with the gross collections before refunds from July 1, 1977, through June 30, 1978. From this amount subtract the amount necessary to make the payments to cities, villages, and townships under section 134 for the same year. The difference shall be distributed to cities, villages, and townships by the relative tax effort formula between August 1 and February 28 following the calculation based upon the preceding June 30. At least 1/2 of this payment shall be distributed before October 1 in any year that money is distributed under this section.

(4) During each June, starting in 1976, the department of treasury shall distribute to cities, villages, and townships through the relative tax effort formula, as defined in Act No. 140 of the Public Acts of 1971, as amended, being sections 141.901 to 141.919 of the Michigan Compiled Laws, an amount, to replace payments to cities, villages, and townships from the intangibles tax previously made under section 13 of Act No. 140 of the Public Acts of 1971, as amended. The amount shall be determined as follows:

(a) For the June 1976 payment only, $35,000,000.00 of the collections of the tax levied by this act and for the June 1977 payment only, $35,000,000.00 of the collections of the tax levied by this act.

(b) For payments after January 1, 1978, a percentage of the gross collections before refunds of the tax levied by this act for the most recent fully completed July 1 through June 30 period and as certified by the department of treasury as of May 31. The percentage set aside for distribution is calculated by dividing $40,000,000.00 by the gross collections before refunds of the single business tax from July 1, 1976, through June 30, 1977.

Sec. 137. (1) The treasurer of any city, village, township, or county who collects money for an authority that levies property taxes, shall pay an eligible authority its proportionate share of the reimbursements under sections 134 and 135. The proportionate share shall be calculated by the percentage that the property taxes collected by the authority are to the property taxes of the assessing unit. The property taxes of such authorities may be added to the millages used in section 134.

(2) For an authority to be eligible for compensation under this act, that authority must have an authorization to have taxes levied for its use as provided by law.

(3) School districts, intermediate school districts, community college districts, vocational education, and special education districts shall not be included under the provisions of this chapter.

Sec. 138. (1) Each city, village, township, and county shall report its local property taxes to the department of treasury as required by Act No. 282 of the Public Acts of 1905, as amended, being sections 207.1 to 207.21 of the Michigan Compiled Laws. The local property taxes of eligible authorities levied within that assessing unit shall be reported separately on the form filed by the assessing unit by December 1 of each year. If a city, village, county, township, or eligible authority fails to so report, its local property tax rate shall be entered as zero for the preceding calendar year. The department of treasury shall report to the department of management and budget not later than May 15 each year the local property taxes and the total state equalized value for each city, village, township, and county for the preceding calendar year.

(2) The department of treasury shall report to the department of management and budget the tax collections available for distribution. The department of management and budget may make the distribution in a single warrant.

Sec. 139. There is allocated and appropriated each fiscal year an amount sufficient to make the payments under this chapter.

Sec. 141. The department of treasury and the department of management and budget shall furnish the senate and house taxation committees with an estimate of quarterly receipts under this act on the first day of January, April, July, and October and certify the amount of tax liability under this act within 30 days after the quarterly returns and final returns are due.

Sec. 144. There is hereby appropriated from the general fund the sum of $800,000.00 for the 1975-76 fiscal year to the department of treasury for administration of this act.

Sec. 145. This act shall take effect January 1, 1976.

This act is ordered to take immediate effect.

Approved by Governor August 27, 1975

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