

Revised Michigan Business Tax, New Michigan Excise Tax on Services and Targeted "Loophole" Closings

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With the introduction of Governor Granholm's Tax Restructuring proposal, Michigan's historic restructuring of the state's tax levies is underway. The two principal elements of the proposal are the Michigan Business Tax, as well as a new sales tax on services, although dubbed an "excise" tax in an attempt to avoid a state Constitutional amendment. While final bills have not yet been introduced, clients should be immediately made aware of the substance of the proposals.

Revised Michigan Business Tax

The revised Michigan Business Tax ("MBT") is the three-part levy introduced by the Governor in the 2006 lame duck session, with a tax on net profit, a tax on gross receipts, and an asset tax based on a business's tangible and intangible property, regardless of location, and apportioned to the state based solely on sales. The main revision from the lame duck bill is a new headquarter credit for businesses located within the state that will provide approximately \$450M in net tax relief to Michigan businesses from the prior overall Single Business Tax ("SBT") collection of \$1.9M.

Taxes on financial organizations and insurance companies are expected to increase, as well as an anticipated \$100M increase in the shifting of Michigan's business tax burden to out-of-state companies who do business in the state.

Excise Tax on Services

Reminiscent of the Florida services tax, is Michigan's broad based proposed excise tax on services, which would levy a 2% tax on almost all services, with the limited exemptions indicated as follows:

- Health care services,
- Education services,
- Purchases by governmental agencies and school districts,
- Non-profit organizations' purchases if the service is related to the organization's primary purpose,
- Purchases for scientific research and development and computer system design, and
- Purchases by manufacturers that are directly used in manufacturing.

Services specifically taxed include legal services, accounting and bookkeeping and business-to-business services (the full list is available at http://www.michigan.gov/documents/budget/TwoPennyPlan_Impacted_2007_186931_7.pdf). The Governor hopes to raise approximately \$1.5 billion dollars, with just over \$1 billion being paid on business-to-business services. While some relief is provided to manufacturers, that relief is limited to those services used directly in the manufacturing process, which would be a change in policy from Michigan's current sales and use tax manufacturing exemption for the purchase of tangible personal property which currently follows an integrated plant theory approach, and is not limited to "direct use."

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The classification of the tax as an "excise" tax rather than a sales tax on services is to avoid the need for a state constitutional amendment, as the legislature is prohibited from levying any new sales taxes (or an increase in the current sales tax rate), without the approval of the majority of voters. It is also suspected that an excise tax label would avoid conflicting with the Streamlined Sales Tax Project ("SSTP"), of which Michigan is a full participating state member. Whether or not such labeling will avoid these problems will be the subject of a future alert.

The excise tax is a critical part of the Governor's overall restructuring, and collection processes must be in place by June 1, 2007 if the Governor is to be able to use revenue from the levy to meet current budget year deficits.

Other Tax Increases

The Governor has proposed a variety of other increases, such as:

- 5 cent increase on tobacco products,
- 10% additional markup on liquor, and
- Decoupling the state estate tax from the declining federal estate tax.

Target "Corporate Tax Loopholes"

The Governor is again targeting certain "corporate tax loopholes" which she has been unsuccessful in changing in prior years by proposing the following:

- **Single Business Enterprise (Affiliate Nexus).** Imposing the Multistate Tax Commission affiliate nexus standard, which would subject an affiliate of a Michigan-based business to sales and use collection, (and also potentially the excise tax on services collection!), **even though the affiliate has no physical presence in the state.** This proposal is of most concern to out-of-state businesses. Under the proposal, nexus would be deemed to exist for an affiliate if it shares a trademark or trade name with a related Michigan business, if the Michigan and out-of-state businesses share a common or substantially coordinated business plan, or if the Michigan and out-of-state business pay for each other's services in whole or in part.
- **Food Sold Through Vending Machines.** Eliminating sales tax exemption for food products that are not heated or chilled.
- **International and Certain Interstate Communications.** Requiring use tax to be paid on calls made to other countries, as well as taxing toll-free numbers, WATS services, interstate private networks and international calls.
- **Interstate Trucks and Trailers.** Requiring use tax even on all revenue miles, even if in-state miles are less than 10% of overall revenue miles.
- **Purchases Made by Inmates.** No comment.
- **Tax Treatment for Commercial Rental Property.** Eliminating the benefit of Proposal A and Headlee which essentially capped increases in value until the sale or transfer of property. Removing this protection for commercial rental property.

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- **Insurance Company Use Tax.** Eliminating the exemption from use tax for insurance companies, which was provided due to the "in lieu of" provisions of insurance levies. Insurance companies would also be subject to the 2% excise tax on service purchases.
- **Increase Penalties.** Increasing the penalties for failure to file a return or pay on time.

Timing

As indicated, timing for introduction of the required bills is immediate, and the Democrat-controlled House is preparing to move quickly on the legislation. It is critical that the State gets its 2008 revenue stream in place, as well as address the budget deficit for the remainder of the 2007 year. The mood in Lansing is similar to that in 1983 when the Legislature passed an income tax increase, which resulted in the recall of two Democrat senators and the Senate going into 24 years of Republican control.

The Governor is targeting an early passage of all the tax bills, with the excise tax legislation first on the fast track, with a goal of a finalized bill as early as April 1, 2007. The Legislature is scheduled for a two-week spring break on March 31, 2007.

If you have any questions regarding this alert, please contact any of the SALT tax experts:

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