

Michigan State Tax Alert

February 1, 2007

With less than a week to go before Governor Granholm's State of the State address on February 6, the state's economic crisis is deepening. Two Wall Street rating agencies have taken negative action, with Fitch Ratings downgrading the state's bond rating for its general obligation and school loan bond funds, and Moody's Investors Services gave Michigan a "negative" outlook. Action from Standard & Poor's is expected soon. These actions mean that it costs the state more to borrow funds.

The agencies highlighted that Michigan's economic downturn is remarkable not only as the longest-running in the state's history, but because it has occurred during an expansion in the national economy. Fitch indicated that "The state has demonstrated a willingness to manage the downturn and remedy budgetary imbalances through prompt corrective actions."

For taxpayers, those "prompt corrective actions" mean higher taxes, as well as new taxes. The Governor's financial emergency panel will turn their report over to her no later than Friday, February 2, and circulating drafts include a recommendation for a broad base sales tax on services, in addition to a business tax(es) to replace the repealed Single Business Tax (SBT).

In addition to the SBT replacement proposals already introduced, the Republican Party released its proposed replacement to the SBT, labeled the Business Economic Stimulus Tax (BEST), to replace approximately 83% of the revenue generated by the SBT with a "choice of two" plan. The proposal, with three different taxes, would allow taxpayers to pay a business net income tax, and then a choice of paying either a modified gross income tax or a franchise tax based on net worth, giving businesses their choice to choose the "best" option for their business (with varying combinations). The proposal provides a 10% personal property tax credit for property acquired within the past five years, and a 100% personal property tax exemption for new industrial property. In addition, the proposal provides for a new Michigan Entrepreneur Exemption, which would abate taxes for businesses meeting certain growth and investment criteria and have revenues of less than \$25 million.

Designed as an amalgam of all the proposals introduced to date, the Republicans' proposal is not administratively simple or comparable to any other state's tax regime. In fact, the Tax Foundation has recently criticized all the SBT replacement plans, indicating that implementation of any one of them would still result in Michigan having a unique tax structure, as well as relying heavily on exporting taxes to out-of-state businesses.

The Governor is also looking at the spending side, and has issued nine directives to restrict across the board spending by departments and agencies within the Executive Branch of Government. Of concern to the financial emergency panel was the lack of true understanding by the state's residents of how dire the state's financial situation really is.

We look forward to keeping you abreast of these latest Michigan events, and will continue to do so in the future. If you have any questions regarding this alert, please contact any of the SALT tax experts:

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