



Memorandum

Date: April 29, 2015

To: Charles Owens, State Director
National Federation of Independent Business Michigan

From: Jason Horwitz, Senior Consultant
David Westlake, Analyst

Re: The Tax Burden on Businesses in Michigan, Fiscal Year 2013

Cc:

I. Findings

In this memo we present the findings of our annual Business Tax Burden study, as they apply to the State of Michigan. The full Business Tax Burden study will be released shortly. We also present a brief discussion of how these taxes affect small businesses throughout the state. Our analysis resulted in the following findings:

1. Michigan state and local governments collected \$14.3 billion in taxes from businesses in 2013 (out of \$36.8 billion total taxes collected).
2. These taxes represented 8.9% of firms' pre-tax operating surplus, placing Michigan 23rd among all states in business tax burden.
3. This was an estimated decline in tax collections from businesses of nearly \$1 billion from the previous year.
4. This decline in taxes paid by business is primarily the result of the elimination of the gross receipts tax due to repeal of the Michigan Business Tax, and a decrease in property taxes and general sales taxes paid.
5. A majority of businesses are organized as sole proprietorships, partnerships, or S corporations, and the owners of these companies pay taxes on net profits through the individual income tax. Individual income taxes on so-called "pass-through" income from these businesses increased to \$800 million in 2013.
6. Certain forms of taxes disproportionately affect small businesses relative to other firms, including personal income tax on pass-through income, general sales taxes, and license fees.

II. Overview of Methodology

Our approach to measuring the state and local tax burden is to estimate the total amount of state and local tax paid by businesses in each state and the District of Columbia, and divide it by a measure of business operating margin. This approach has the advantage of providing an objective measure which does not impose any external set of tax policy preferences. Our tax burden measure does not attempt to consider “fairness,” business decisions at the margin, the effects of different taxes on different types of business operations, or the incidence of any individual tax.

We used over a dozen state and national sources to collect this information on 10 different categories of taxes, including property, income, sales, excise, license, severance, and other taxes. All data that we use is publicly available. See our annual Tax Burden Study for a full description of our methodology.¹

III. Business Taxes in Michigan

Businesses in Michigan pay many different taxes at the state and local level. We have identified 10 types of state and local taxes paid by business totaling over \$14.3 billion combined in 2013, as shown in Table 1. This represented nearly two-fifths of the \$36.8 billion of total taxes collected by state and local governments in Michigan that year. The taxes paid by all Michiganders increased from the previous year’s total of \$35.9 billion, while the amount paid by businesses declined from \$15.3 billion.

TABLE 1. Total State and Local Taxes Paid by Michigan Businesses, 2012 and 2013

Type of Tax	2013 Taxes Paid (millions of \$)	% of Total	2012 Taxes Paid (millions of \$)
Property tax	\$6,787	47.4%	\$7,259
General sales tax	\$2,494	17.4%	\$2,735
Unemployment compensation tax	\$1,864	13.0%	\$1,924
Corporate income and gross receipts tax	\$901	6.3%	\$1,322
Individual income tax on pass-thru business income	\$801	5.6%	\$677
Selective sales tax	\$661	4.6%	\$621
License Fees	\$499	3.5%	\$460
Motor fuel sales tax	\$136	1.0%	\$122
Public utilities sales tax	\$100	0.7%	\$96
Severance tax	<u>\$70</u>	<u>0.5%</u>	<u>\$64</u>
Total State and Local Taxes Paid by Businesses	\$14,312	100%	\$15,280

Source: Anderson Economic Group analysis and estimates, using base data from U.S. Census of Governments State and Local Finance Survey and other federal and state sources.

The largest category of taxes assessed on businesses were property taxes, encompassing nearly half of the total at \$6.8 billion. General sales taxes and unemployment compensation accounted for another \$2.8 billion and \$1.9 billion, respectively. Six other taxation categories we tracked

1. Alex Rosaen and Jason Horwitz, “2014 State Business Tax Burden Rankings: 5th Installment, Anderson Economic Group Annual Report,” Anderson Economic Group, LLC, July 29, 2014.

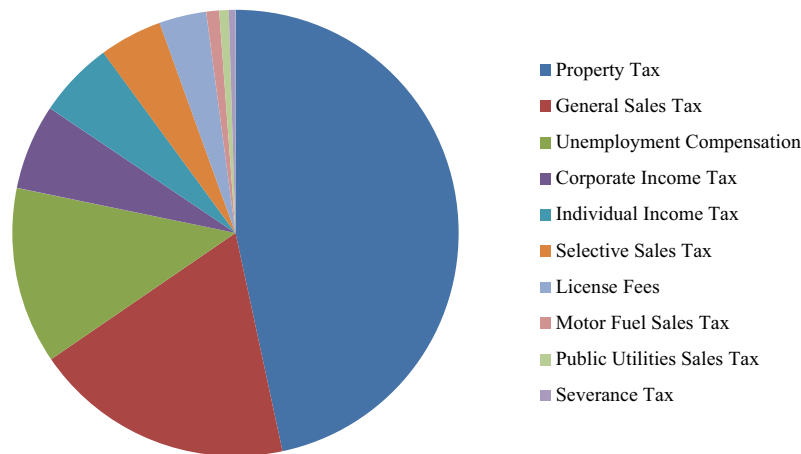
accounted for a combined \$3.2 billion, the most prominent of which were corporate income tax at \$901 million and individual income tax assessed on pass-through business income at \$801 million.

We attribute this decline in business taxes in large part to the repeal of the Michigan Business Tax. As more and more businesses file under the new corporate income tax, the gross receipts tax on all businesses has been reduced to nearly zero. It accounted for well over \$1 billion in revenue in FY 2011.

There also appears to have been a reduction in property taxes and general sales taxes on goods and services purchased by businesses. We see no explanation for these trends in intentional policy changes (this analysis was for the year prior to implementation of the personal property tax repeal). Property tax revenues across the state, for both owner-occupied households and for businesses, have been trending downward in Michigan, presumably due to the aftermath of the housing crisis and its impact on valuations.

Since our sales tax estimates are based on gathering data from many different sources with varying levels of certainty, from year to year there is a certain amount of unexplained variation. According to our analysis, while sales tax collections remained flat from 2012 to 2013, the share of those sales taxes paid by business ticked downward from 32% to 30%.

FIGURE 1. Proportion of Michigan Business Taxes by Type

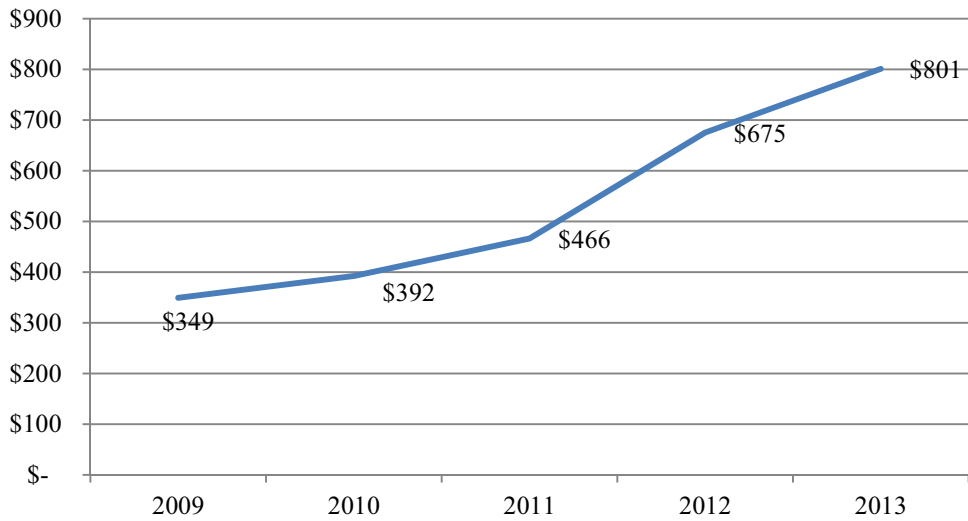


Source: Anderson Economic Group analysis and estimates, using data from U.S. Census of Governments State and Local Finance Survey and other sources.

IV. Impact on Small Businesses

Clearly, not all taxes are distributed equally among Michigan businesses. The individual income tax that is assessed on pass-through business income is predominantly paid by small business owners, particularly sole proprietors, partnerships, LLCs and S Corporations which are not subject to the corporate income tax. Profit returned to owners is treated as if it were regular individual income by the state. As Michigan has recovered from the recent recession, individual income tax revenues from net business income have risen considerably, more than doubling from under \$400 million to approximately \$800 million in 2013. See Figure 2 on page 4.

FIGURE 2. Individual Income Tax on Pass-through Business Income, FY 2009 to FY 2013



Source: Anderson Economic Group analysis and estimates, using base data from U.S. Census of Governments State and Local Finance Survey and other federal and state sources.

Other taxes which are likely to have a disproportionate impact on small businesses include the property tax, general sales tax, and various licensing fees. While assessed on all businesses regardless of size, the nature of many small businesses makes it likely that these will represent a larger proportion of their overall tax burden than is the case for larger enterprises. In particular, general sales taxes on major purchases for construction or equipment are often exempted for larger enterprises, while small businesses tend to purchase more goods that are subject to taxation.

TABLE 2. Michigan State and Local Taxes That Particularly Impact Small Businesses

Type of Tax	Total Taxes Paid (millions of \$)
Property tax	\$6,787.0
General sales tax	\$2,737.0
Individual income tax on pass-thru business income	\$801.1
Selective sales tax	\$661.1
License fees	\$499.0
Total	\$11,485.2
<i>Other State and Local Taxes Paid by Businesses</i>	<i>\$2,949.5</i>

Source: Anderson Economic Group analysis and estimates, using base data from U.S. Census of Governments State and Local Finance Survey and other federal and state sources.

Note: These totals include payments by both small and large businesses in Michigan. We show here the total amounts paid by business for the types of taxes that tend to particularly impact small businesses.

Taxes that are less frequently assessed on small businesses include corporate income tax and severance taxes. Corporate income tax is assessed on C Corporations, relatively few of which are small businesses. Severance taxes are those assessed for the extraction of mineral resources, primarily oil, natural gas, and coal but also quarried stone and other minerals. Michigan has little

production of these substances compared to other states and because most such processes are very capital intensive, the firms that engage in them are seldom small businesses.

V. Ranking Relative to Other States

Michigan improved its standing significantly in 2013 relative to the other 49 states and the District of Columbia in terms of the share of pre-tax operating surplus that was collected from businesses as taxes. The Great Lakes State came in 23rd overall, marking a substantial rise from Michigan's 28th place in our last study.