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BILL ANALYSIS

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Senate Bill 1009 (Substitute S-1 as passed by the Senate)

Sponsor: Senator Nancy Cassis

Committee: Finance

Date Completed: 2-14-08

### **RATIONALE**

Some people believe that the Michigan Business Tax (MBT) Act, which went into effect on January 1, 2008, does not honor the relationship that Michigan has had with Canada regarding reciprocal taxation. Because Michigan and Canada are connected geographically and economically, taxes that cross international borders have consequences for businesses located on both sides. It has been suggested that, in order to conform to traditional practices for taxing foreign-based companies and to eliminate the new tax burden on Canadian companies, the Act should exempt foreign persons from the MBT.

### **CONTENT**

The bill would amend the Michigan Business Tax Act to exempt from the tax a foreign person that was domiciled in a subnational jurisdiction that did not impose an income tax on a similarly situated person domiciled in this State whose presence in the foreign jurisdiction was the same as the foreign person's presence in this State.

"Foreign person" would mean either an individual who is not a U.S. resident, whether or not the individual is subject to taxation under the Internal Revenue Code, or a person formed under the laws of a foreign country or a political subdivision of a foreign country, whether or not the person is subject to taxation under the Internal Revenue Code.

Notwithstanding any other provision of the Act to the contrary, a foreign person subject to the MBT would have to calculate its business income tax base and modified gross receipts tax base as provided in the

bill. Except as otherwise provided, the business income tax base and modified gross receipts tax base of a foreign person would be subject to all adjustments and other provisions of the Act.

The modified gross receipts tax base of a foreign person would include the sum of gross receipts and the adjustments under the modified gross receipts tax in the Act that were related to United States business activity. The business income tax base would include the sum of business income and adjustments under the business income tax in the Act that were related to United States business activity. The sales factor would be a fraction, whose numerator was the total sales of the taxpayer in the State during the tax year and whose denominator was the total sales of the taxpayer in the U.S. during the tax year. In calculating the sales factor of a foreign person, neither the numerator nor the denominator would include sales if title transferred outside the U.S.

"Business income" would mean, for a foreign person, gross income attributable to the taxpayer's U.S. business activity and gross income derived from sources within the U.S. minus the deductions allowed under the Internal Revenue Code that were related to that gross income. Gross income would include the proceeds from sales shipped or delivered to any purchaser within the U.S. and for which title transfers within the U.S., proceeds from services performed within the U.S., and a pro rata proportion of the proceeds from services performed both within and outside the U.S. to the extent the recipient receives benefit of the services within the U.S.

"Gross receipts" would mean, for a foreign person, gross receipts as defined in the Act from U.S. business activity or from sources within the U.S. Gross receipts would include all sales for which title transfers within the U.S., proceeds from all services performed within the U.S., and a pro rata portion of proceeds from services performed both within and outside of the U.S. to the extent the recipient receives benefit of the services within the U.S.

The bill states that it would be retroactive and effective January 1, 2008, and would apply to all business activity occurring after December 31, 2007.

MCL 208.1207

### **ARGUMENTS**

*(Please note: The arguments contained in this analysis originate from sources outside the Senate Fiscal Agency. The Senate Fiscal Agency neither supports nor opposes legislation.)*

#### **Supporting Argument**

Because Michigan and Canada are not economic competitors but are part of an economic unit, when Michigan raises taxes on Canadian businesses, citizens and businesses on both sides are affected. For example, products and manufactured parts often cross between Canada and Michigan multiple times during the manufacturing process and are frequently sold across international borders. If Michigan does not exempt Canadian businesses from taxation under the MBT Act, there is a possibility that Canada will tax Michigan businesses for the purpose of parity or retaliation, stifling trade and economic cooperation between the two and damaging Michigan's economy.

Canadian businesses still would be subject to other applicable Michigan taxes, including the fuel tax and sales tax, and businesses with permanent establishments in Michigan would be subject to the MBT.

#### **Opposing Argument**

While special considerations should be made under the MBT Act for Canadian businesses, the bill would apply to all foreign persons without regard to a specified type of business or country of origin. In order to prevent unforeseen consequences, the bill should specify the countries and types of businesses that would be exempt.

### **FISCAL IMPACT**

The bill would likely reduce General Fund revenue in FY 2007-08 and FY 2008-09 by an unknown amount, depending upon the specific business characteristics of the affected taxpayers. The bill would modify the tax computations for certain foreign entities and potentially exempt certain others. The number of taxpayers affected and their liability are unknown. Unlike somewhat similar provisions contained in the former Single Business Tax Act, the bill's provisions would affect all foreign entities, not just those associated with a specific country.

The bill would have no fiscal impact on local government.

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