

# The Revenue Situation

## Taxes and Other Revenue Sources



**MSU Leadership Program**

**Jeffrey P. Guilfoyle, Director  
Economic and Revenue Forecasting Division  
Michigan Department of Treasury  
December 4, 2006**

# Overview

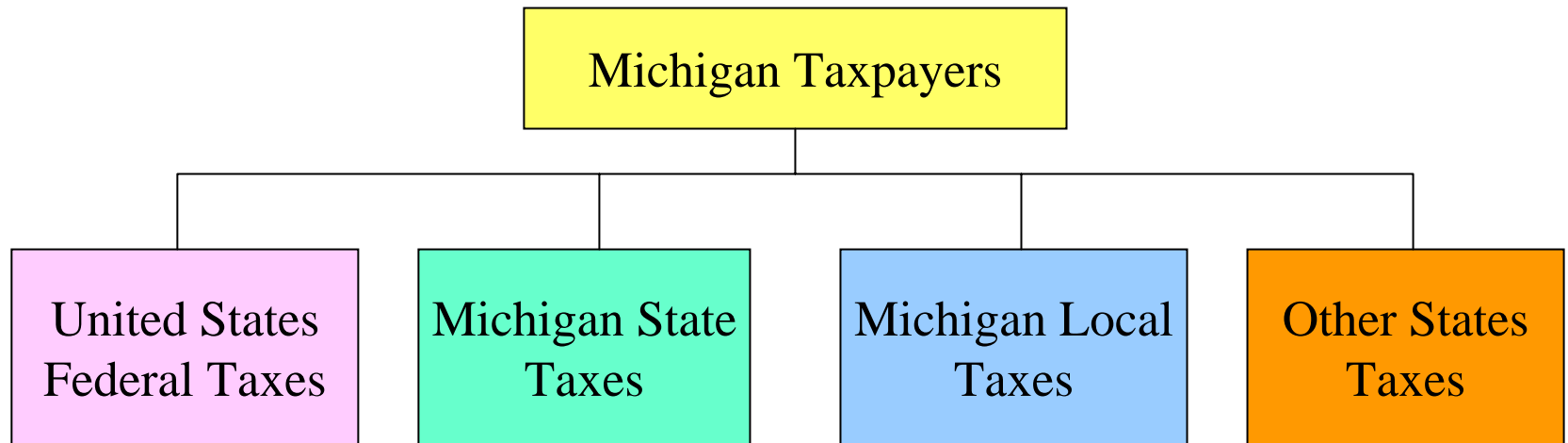
- Tax Structure Overview
- Legal and Economic Criteria
- Recent Revenue Trends
- Issues with Business Taxation

# **Tax Structure Overview**

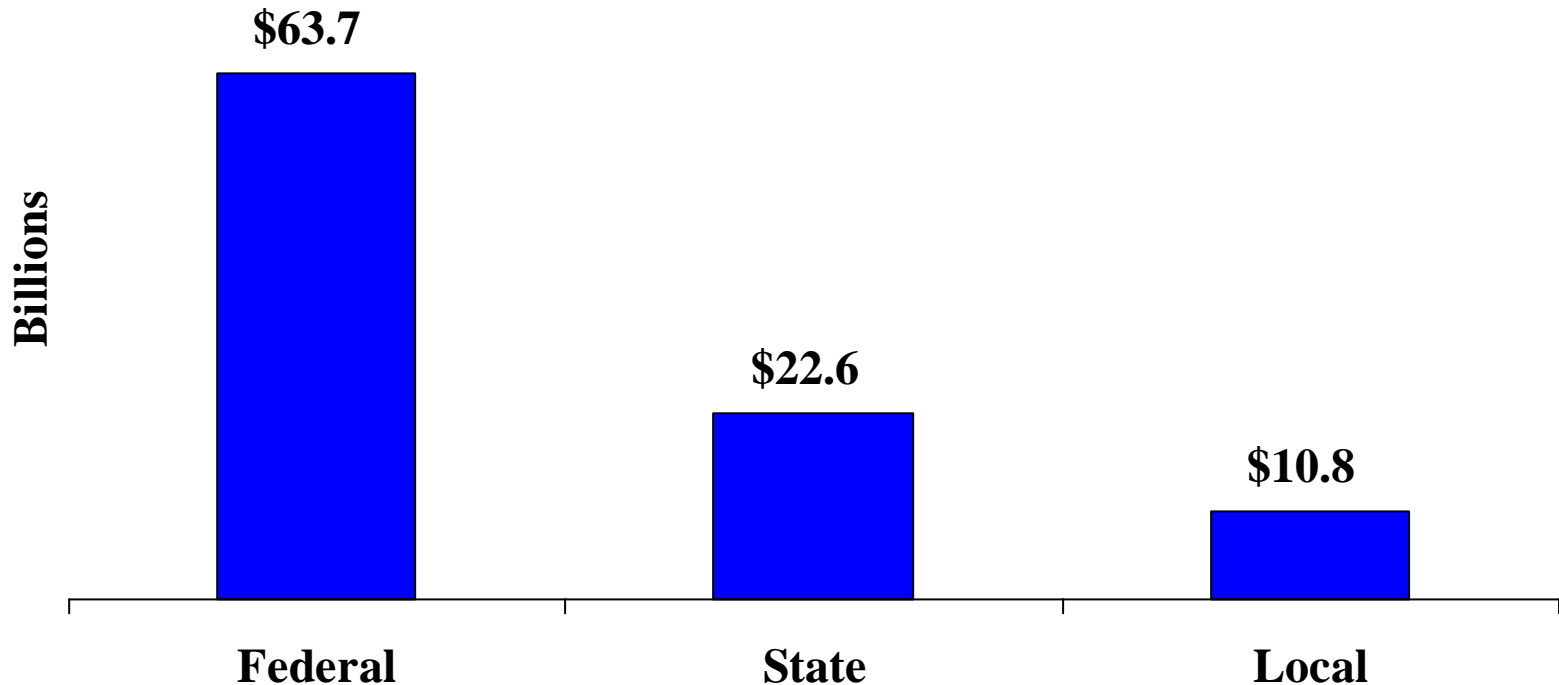
# Michigan Government Structure

- State Government
- 83 Counties
- 273 Cities
- 1,242 Townships
- 533 School Districts
- 57 Intermediate School Districts
- Special Purpose including library, community college, etc.

# Taxes Paid by Michigan Taxpayers



# Overall Taxes Paid By Michigan Taxpayers

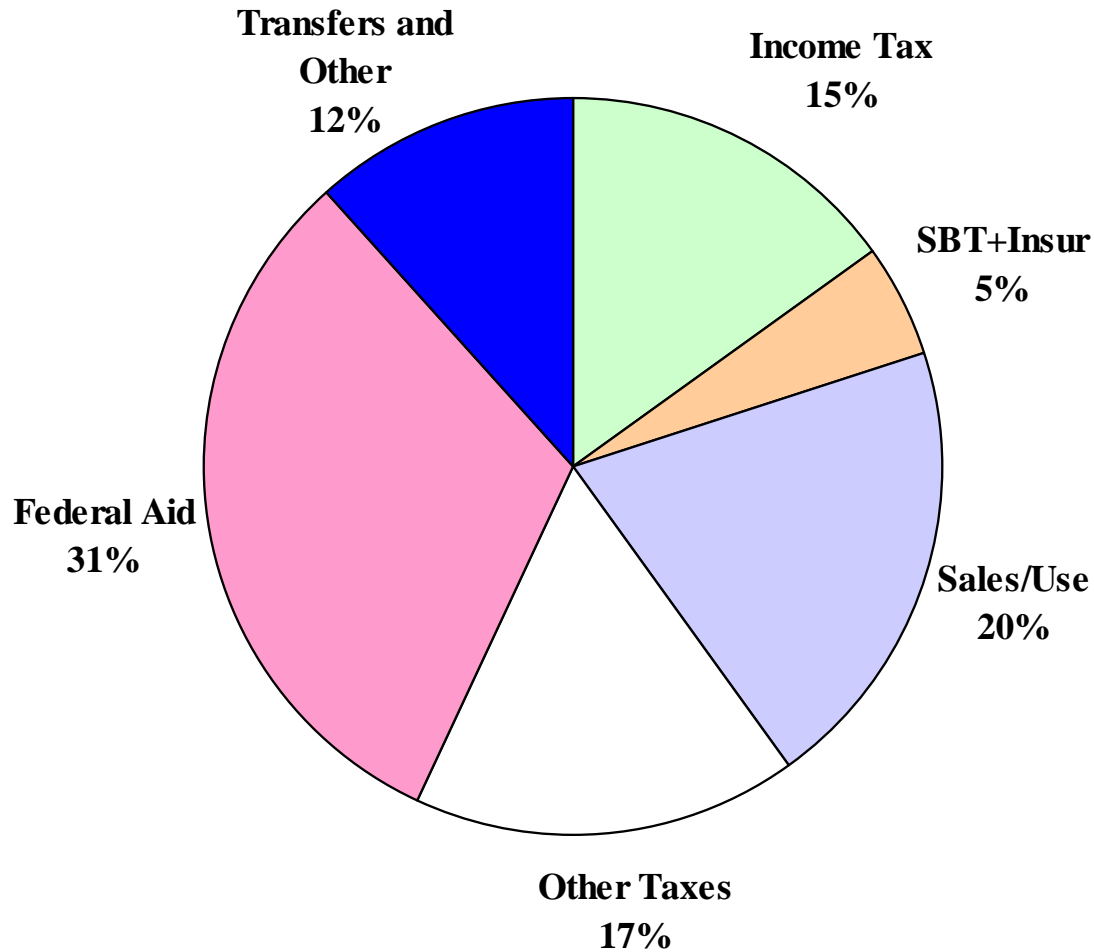


Source: U.S. Census and ERF calculations  
Data are for FY 2004

[Economic and Revenue Forecasting Division, Michigan Department of Treasury](#)

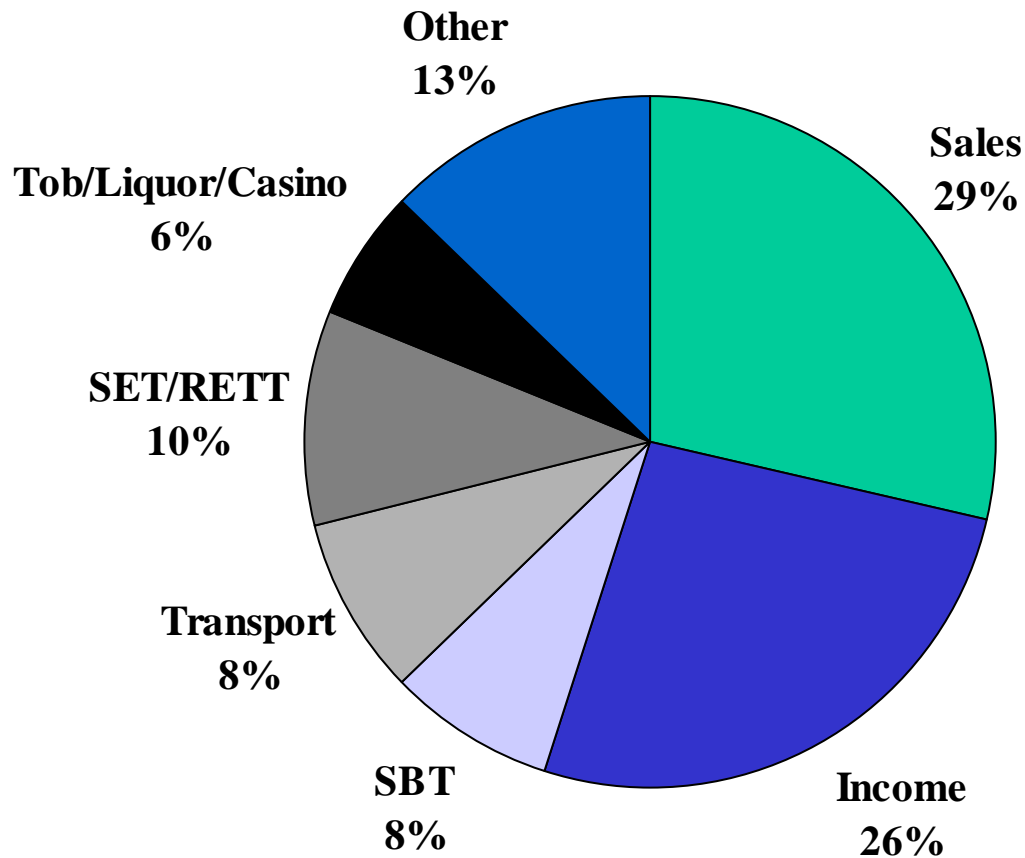
# Michigan's State Revenue Sources

FY 2007 Revenue Totals \$43 Billion



# Sources of Michigan Tax Revenue

FY 2007 Taxes Total \$24.3 Billion



# Michigan's Major Taxes

- **Individual Income Tax**

- Will raise \$6.4 billion in FY 2007
- Approx. 3/4 to GF-GP and 1/4 to schools
- Tax base starts with federal AGI
- 4.0% rate for 2003 down from 4.4% in 1999; fell to 3.9% July 1 of 2004
- Homestead property tax credit if property taxes exceed 3.5 percent of income

# Michigan's Major Taxes

- **Sales Tax**

- Will raise \$7.0 billion in FY 2007
- 73% to schools; 24% to local governments; 1% to transportation and 2% GF-GP
- Tax on retail sales
- 6.0% rate

- **Use Tax**

- Will raise \$1.9 billion in FY 2007
- Tax on use and storage of personal property
- 6.0 percent rate - 1/3 to schools; 2/3 to GF-GP
- Complement to sales tax

# Michigan's Major Taxes

- **Single Business Tax**

- Will raise \$1.9 billion in FY 2007
- Rate 1.9%
- Modified value added tax
- Repealed after December 2007

- **State Education Tax**

- Will Raise \$2.1 billion in FY 2007
- Statewide property tax of 6 mills on all property
- Money goes to K-12 schools

# Michigan's Major Taxes

- **Tobacco**

- Cigarette rate raised to \$1.25 in August 2002
- Increased to \$2.00 in July 2004 (ranks 4<sup>th</sup> highest among state taxes)
- Other tobacco products 32% of wholesale price
- Will raise \$1.2 billion in FY 2007

- **State Lottery and Detroit Casinos**

- All lottery to SAF, Casinos to SAF and GF-GP
- Lottery raises approx. \$600 million, casino tax \$150 million
- Casino tax rate increased from 18% to 24% in September of 2003 (State gets roughly 1/2)

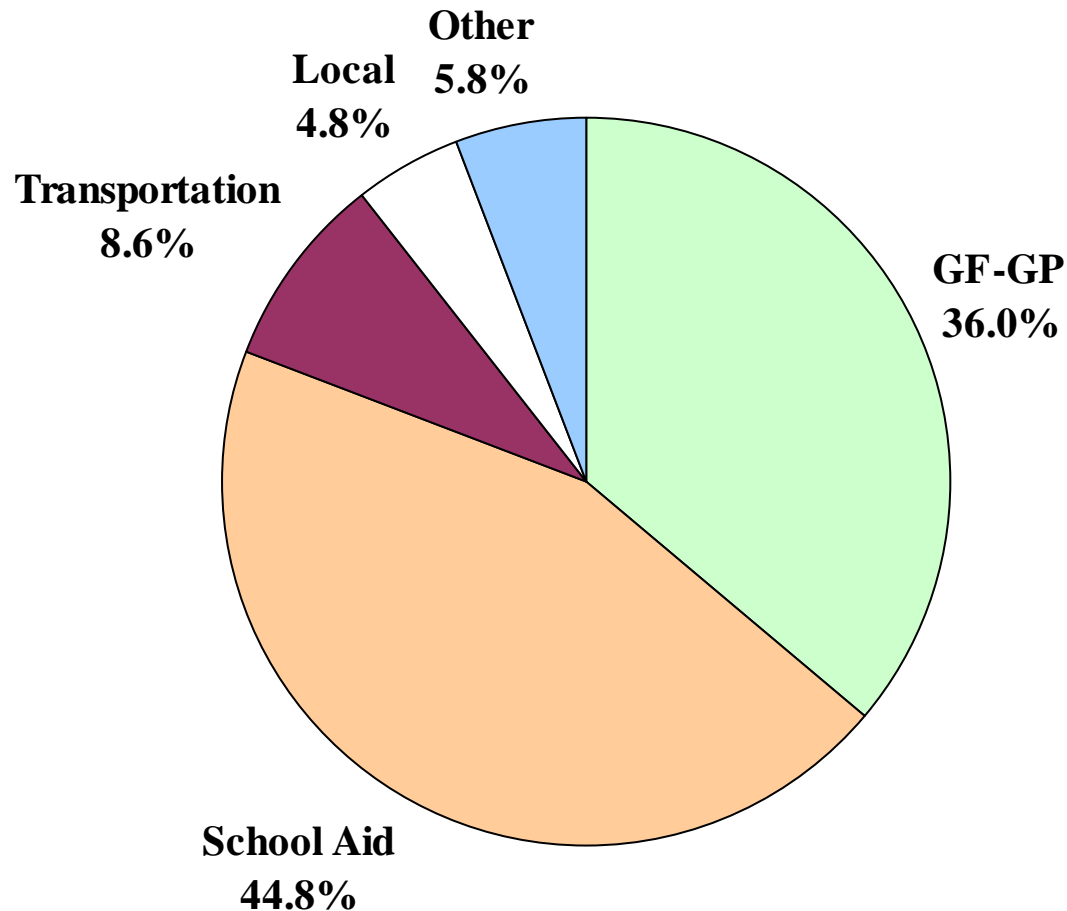
# FY 2007 Earmarked Taxes (Sources)

(millions)

<u>Tax</u>	<u>Amount</u>	<u>Amount</u> <u>Earmarked</u>	<u>% Earmarked</u>
Income	\$6,395.9	\$2,117.3	33%
Sales	\$6,959.9	\$6,261.3	90%
Use	\$1,501.4	\$489.2	33%
SBT/Insur	\$2,178.8	\$0.0	0%
Tobacco	\$1,158.9	\$927.5	80%
Other	<u>\$6,149.4</u>	<u>\$5,790.6</u>	<u>94%</u>
	\$24,344.3	\$15,585.9	64%

# Total Taxes (Uses)

FY 2007 Taxes Total \$24.3 Billion



# **Legal and Economic Criteria**

# Michigan Taxing Authority

- **State**
  - **Constitutional:** property tax, sales tax, fuel tax, some restrictions on income tax
  - **Statutory:** income tax, single business tax, oil & gas, alcohol, tobacco, lottery, motor vehicle registration
- **Local**
  - **Constitutional:** property
  - **Statutory:** income

# Constitutional Taxing Provisions

- **Income Tax**

- Prohibits graduated rate or base

- **Sales Tax**

- Sets maximum rate at 6 percent

- Earmarks 73% to education

- Earmarks 10% to cities, townships, and villages

- **Motor Fuels**

- Restricts for transportation purposes

# Constitutional Taxing Provisions

- **Property Tax**

- Sets maximum rate
- Limits assessment to 50% of true cash value
- Limits assessment increases to inflation
- Requires 3/4 vote of legislature to raise school operating taxes

- **Revenue Limit**

- Restricts total state revenues to a fixed share of the State's personal income

# Recent Issues

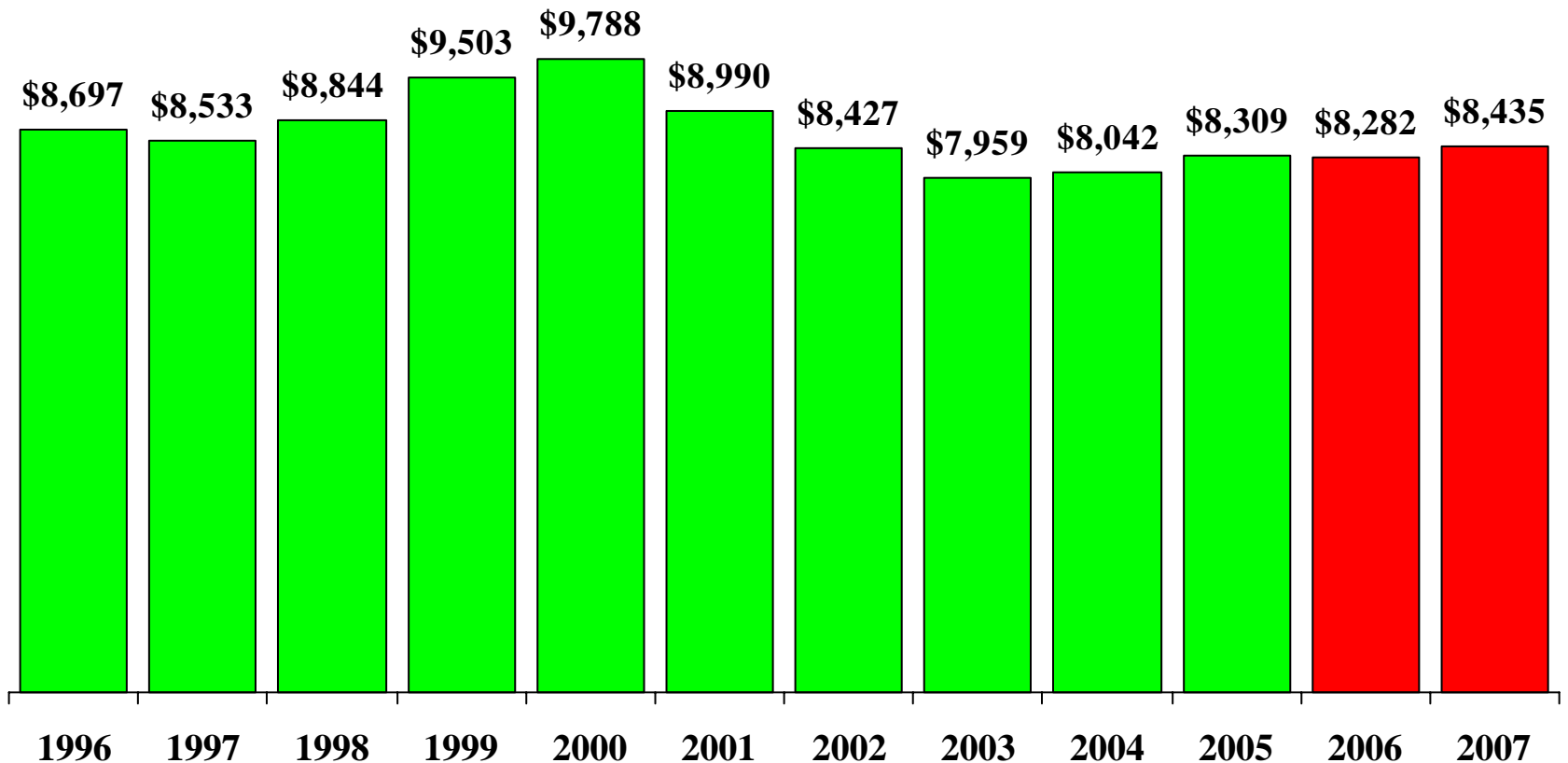
# Major Taxes Perform Poorly

(millions)

	<u>Amount</u> <u>FY 2000</u>	<u>Amount</u> <u>FY 2007</u>	<u>Over</u> <u>7 Years</u>
Income	\$7,136	\$6,386	-10.5%
Sales	\$6,278	\$6,959	10.9%
SBT	\$2,324	\$1,886	-18.9%
GF-GP	\$9,788	\$8,435	-13.8%

# Nominal General Fund Net Revenue in 2007 Less Than in 1996

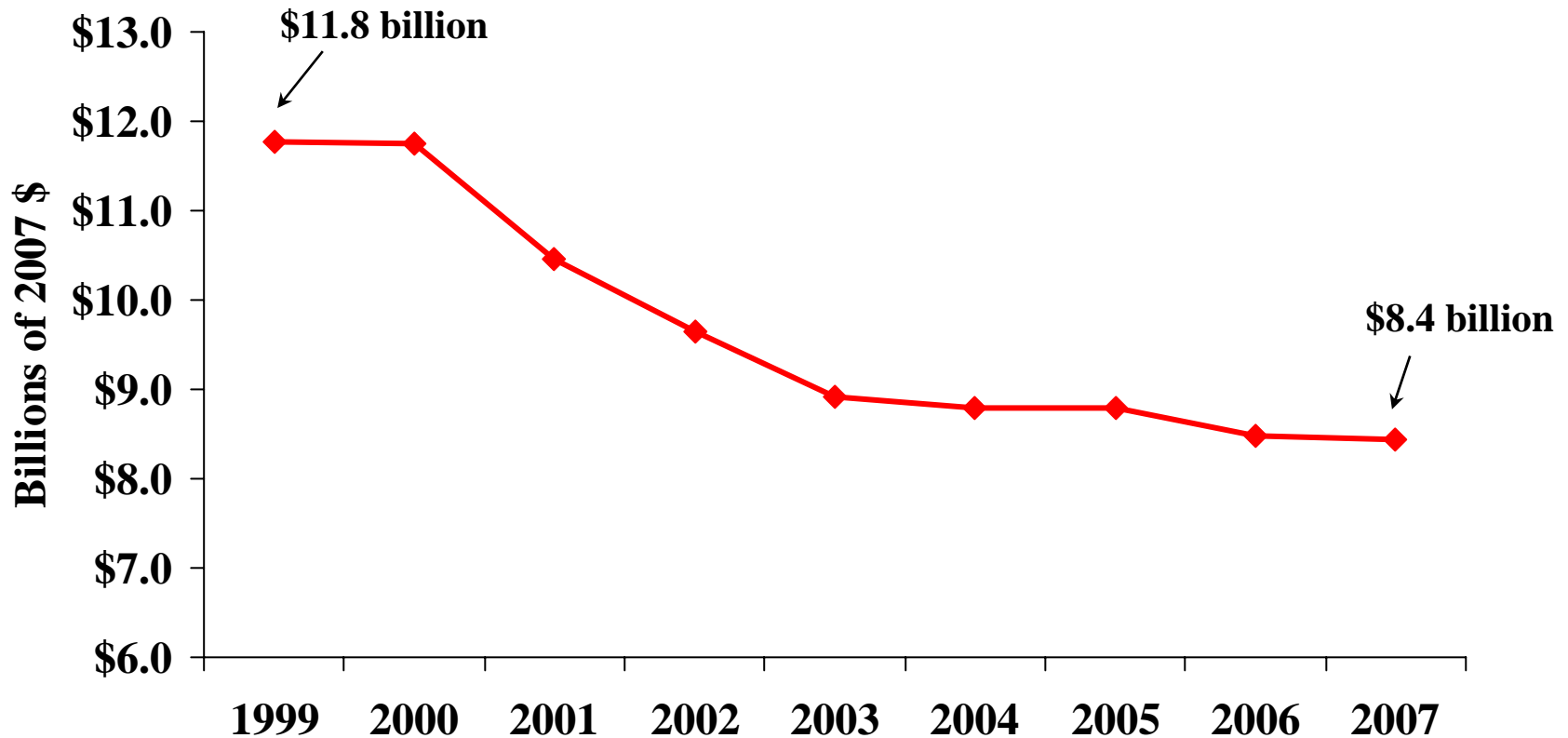
(millions)



May 2006 Estimates

*Note: Totals exclude transfers and savings from adjusting statutory revenue sharing payments to local governments.*

# Inflation Adjusted GF-GP Revenue Down 28 Percent Since FY 1999



*Totals Exclude Transfers and are adjusted to 2007 dollars using U.S. CPI-U.*

# **Issues with Business Taxation**

# Taxation Basics

- There are two costs to taxes: amount paid, and cost of economic distortions
  - A \$100 tax on ice cream would raise little money compared to economic distortion
- Tax changes affect who pays and shape of econ distortions
- Generally trying to increase equity of tax also increases economic distortions

# Why Tax Businesses

- Businesses generally believed to pay more in taxes than they receive in services
- Businesses taxed to increase equity
  - Generally business taxes are often taxes on return to capital or on capital owners and wealthier individuals own more capital
  - Business taxes may be paid by out-of-state firms or out of state consumers
  - Econ incidence of bus taxes less transparent (i.e. does a corp inc tax affect wages?)

# Replacement Considerations

- Simplicity
- Distortions created
  - Low rate and broad base have lower distortions
  - Does it discourage capital formation, business location, or employment?
- Stability
- Equity (ability to pay)
- Nexus Issues
- Business type coverage

# Michigan SBT

- Based on value added tax base
  - Profits plus compensation plus interest plus depreciation
- Pros
  - Stable revenue
  - Broad nexus
  - Covers all business types
  - Capital deduction or credit reduces capital distortion
  - Broad base allows for low rate given the revenue raised
- Cons
  - Unique among states (although Texas and New Hampshire have similar taxes)
  - Special credits and calculation methods made tax complex
  - Unprofitable firms still pay which some view as inequitable
  - Complaints about labor in base
  - Repealed after 2007

# Michigan Personal Property Tax

- Property tax levied on personal property including machinery and equipment
  - The state and local governments get substantial revenue from tax
  - 38 states tax some form of personal property, but movement away from machinery and equip; OH repealing;
- Pros
  - Stable revenue base
- Cons
  - Direct tax on potentially mobile capital which may discourage firms from investing in the state
  - Pay even lose money
  - Administrative Issues
    - Problems with compliance (value self reported)
    - Difficulties valuing property

# Corp or Business Income

- Levy Tax on Corp profits
  - 44 states have some form of business income tax
  - States without: Michigan (SBT), Washington (Gross receipts); Texas (combo gross receipts, gross profit, or receipts less comp), Wyoming (no tax); Nevada (no tax); Ohio is repealing and going to gross receipts
- Pros
  - Relatively easy to admin for corps since piggyback to federal
  - Seen as equitable since based on ability to pay
- Cons
  - Very volatile
  - Narrow base would require high rate
  - Narrower Nexus standard (PL 86-272)
  - Problems with sheltering income
  - Reduces return to capital so may discourage investment in state

# Gross Receipts Tax

- Levied on firms gross receipts (revenue received from all sources)
  - WA has tax and OH is transitioning to tax; KY and NJ use as alternative min tax to corp inc tax, Delaware has tax on receipts from goods and services rendered in state, TX has gross receipts as a base firms can choose
- Pros
  - Broad base & low rate; covers all business types; broader nexus than income tax
- Cons
  - Hurts low margin businesses (i.e. retailers)
  - Tax pyramiding – same good can be taxed multiple times as bought and resold
  - Unprofitable firms still pay; labor still in base
  - Issues with exemptions – hospitals? GR related to food?

# Subtractive VAT

- Value Added Tax Base
  - Total revenues less cost of materials and sometimes capital expenditures
- Pros
  - Stable revenues
  - Does not discourage capital investment
  - Broad base & low rate; covers all business types; broader nexus than income tax
- Cons
  - Unique among states although Texas and SBT similar
  - Firms pay even if they lose money
  - Too similar to SBT?

# Michigan Business Tax

- Rate 0.125% on Assets and Sales
- Rate 1.875% on Business Income
- Industrial and Commercial Property Exempt from 24 Education Mills
- Firms with Gross Receipts less than \$350,000 do not pay
- Apportioned with 100 percent sales factor

# For More Information

- See [www.michigan.gov/treasury](http://www.michigan.gov/treasury)
  - Click on Revenue, Economic, and Revenue data quick link
- Michigan Department of Treasury
  - Economic and Revenue Forecasting Division  
517-373-2697
  - Tax Analysis Division 517-373-2697