

A photograph of the Michigan State Capitol dome, illuminated by the warm light of a sunset. The sky is a deep, clear blue, and a thin crescent moon is visible in the upper right. The dome's intricate architectural details, including its ornate spire and classical columns, are highlighted by the golden light. An American flag is visible on the right side of the building.

# A Spotlight On State and Local Business Taxes In Michigan

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# A Spotlight on State and Local Business Taxes in Michigan

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## I. Purpose and Approach

### PURPOSE

Michigan levies a variety of taxes on the individuals that live in, work in, or visit the state. It also levies taxes on the Michigan businesses that employ Michigan's citizens and serve its residents and visitors.

However, citizens in Michigan can find it very difficult to learn how businesses pay taxes and which taxes they pay, and often hear confusing information on these important questions.

To address the need for clarity on this topic, we assembled this *Spotlight on State and Local Business Taxes in Michigan*, which:

- Summarizes the state and local taxes paid by businesses in Michigan, including property taxes, income taxes, sales taxes, and other taxes;
- Illustrates how both small and large businesses pay multiple state and local taxes under current Michigan law; and
- Discusses how these taxes have changed over recent years.

### OUR APPROACH

Over a decade ago, Anderson Economic Group began surveying taxes paid by businesses and individuals across the fifty states. Beginning in 2006, we assembled this into a series of reports summarizing the taxes paid by businesses in each state and the relative tax burden.

Our analyses over the past decade consistently focus on the *amount of taxes actually paid by businesses*. Contrary to other indexes, rankings, and analyses, we do not weight some taxes more than others; rely on subjective assessments of which taxes or forms of taxation are better than others; or create a model of “fairness” or “efficiency” against which we compare each state.

Furthermore, we consider taxes paid by all businesses—large and small, corporation, partnership, and limited liability company, manufacturer and service provider—and aggregate them across the entire state. For some taxes (such as personal property and corporate income taxes), it is straightforward to identify the portion of taxes paid by businesses; for others (such as sales taxes and individual income taxes) we allocate the taxes paid using a variety of data sources and estimation methods.

This approach provides a comprehensive, objective measure of the state and local tax burden.

### THE DATA

The 2016 edition of the *State Business Tax Burden Rankings*, released in May 2016, provides the base data for this *Spotlight*. It covers fiscal year 2014 (FY 2014), the most recent year for which comprehensive data is available for all states. See “Additional Reports and Information” on page 10.

## II. Findings

### 1. Businesses paid over \$14 billion in state and local taxes in Michigan in FY 2014.

Businesses pay many different taxes at the state and local level. We have identified 11 types of state and local taxes that businesses in Michigan paid over the last several years.

In 2014, businesses paid a total of \$14.1 billion in taxes to Michigan state and local governments combined, as shown in Table 1 below.

**TABLE 1. Total State and Local Taxes Paid by Businesses in Michigan, 2014**

Type of Tax	Total Taxes Paid (millions of \$)	% of Total
Property tax	\$6,849	49%
General sales tax	\$2,355	17%
Unemployment insurance tax	\$1,810	13%
Corporate income tax	\$881	6%
Individual income tax on pass-thru business income	\$702	5%
Selective sales tax	\$684	5%
License fees	\$508	4%
Motor fuel excise tax	\$132	1%
Public utilities sales tax	\$80	1%
Severance tax	\$73	1%
Gross receipts tax	\$0	0%
<b>Total State and Local Taxes Paid by Businesses</b>	<b>\$14,074</b>	<b>100%</b>

*Source: Anderson Economic Group 2016 State Business Tax Burden Rankings.*

*Note: Numbers may not sum to total due to rounding. See discussion of tax categories on page 10.*

Property taxes, at \$6.8 billion, accounted for approximately half of all state and local taxes paid by businesses in Michigan in 2014. General sales taxes and unemployment insurance taxes combined for an additional 30% of taxes. In sum, these three taxes accounted for about 80% of total taxes paid by businesses in the state.

Corporate income taxes account for only 6% of all taxes on businesses in Michigan. As we describe more on page 5, business owners for almost all small businesses, as well as larger businesses that are not organized as C corporations, pay taxes on their business income through the individual income tax as opposed to the corporate income tax. Individual income taxes on pass-through business income totaled \$700 million in 2014, or 5% of the total.

*2. The State's General Fund and School Aid Fund each received over \$2 billion from taxes paid by businesses in FY 2014. School districts and other local governments combined received over \$6 billion from taxes paid by businesses.*

State and local taxes paid by businesses contribute to government at all levels in Michigan. Local governments include counties, cities, townships, libraries, community colleges, and more. This is summarized in Table 2 below.

**TABLE 2. Disbursement of Business Taxes, FY 2014 (billions)**

<b>State Government</b>	
General Fund	\$2.5
School Aid Fund	\$2.7
Other Funds	\$2.4
<b>Local Governments</b>	
School Districts	\$3.2
Local governments (e.g., Counties, cities, and townships, ISDs, and community colleges)	\$3.3

*Sources: AEG Analysis, using base data from annual Business Tax Burden Rankings, Citizens Research Council Tax Guide, and Michigan Treasury Property Tax Reports*

We describe the destinations for business taxes in Michigan in more detail below.

**State General Fund.** The state's General Fund is in part funded by business payments of:

- General sales tax
- Corporate income tax
- Individual income tax on pass-thru business income
- Selective sales taxes such as special taxes on medical providers and insurance claims
- Motor fuel excise taxes
- Severance tax

**School Aid Fund.** The state's School Aid Fund is in part funded by business payments of:

- Property tax
- General sales tax
- Public utilities sales tax

**Other State Funds.** All motor fuel excise taxes in Michigan in FY 2014 went to the Michigan Transportation Fund. Similarly, unemployment insurance taxes go to a separate fund exclu-

sively used to pay claims for unemployment benefits. In addition, a portion of general sales taxes go to other state funds.

**School Districts.** Nearly half of local property taxes paid by businesses go directly to school districts. In combination with the funds going to the School Aid Fund, business taxes contributed \$5.9 billion to K-12 education in Michigan in FY 2014.

**Local Governments and Other Property Taxes.** Local property taxes paid by businesses fund local governments such as counties, cities, townships, and villages, as well as community colleges, libraries, and intermediate school districts. These local governments also receive 15% of the general sales taxes and 20% of the license fees paid by businesses.

In addition to those taxes, a portion of individual income taxes and public utilities taxes went to the City of Detroit.

*3. Small and large businesses pay many of the same taxes in nearly the same manner, including sales, property, and excise taxes. However, they often pay tax on business income in a different manner.*

For most of the categories of taxes paid by Michigan businesses, the same tax is paid by both “small” and “large” businesses, as well as by manufacturers and service providers, in both cities and rural settings. The taxes that are paid in nearly the same manner include unemployment insurance taxes; general sales taxes on goods and services used for operations; real property taxes on buildings and land; personal property taxes on equipment and office furnishings; and excise taxes on fuel used for transporting goods or traveling employees.

However, businesses that are “C corporations” pay tax on business income in a different manner from businesses that are organized as limited liability companies or “LLCs”, partnerships, “S corps,” and sole proprietorships.

Partnerships, LLCs, S corps, and sole proprietorships are considered “pass through entities” because any income from the business “passes through” the business entity to the owner or owners of the business. These owners then pay individual income tax on the profits of the business. The large majority of business entities in Michigan, as well as across the country, are in this category. Most, but not all, “small” businesses are organized as pass-through entities.

C corporations, on the other hand, pay a corporate income tax at the business entity level. Some of these earnings may then be taxed a second time if they are distributed to shareholders in the form of dividends, and the shareholders directly own the shares (rather than holding them in a 401(k) account or pension fund).

**TABLE 3. Selected State and Local Taxes Paid by Businesses in Michigan**

Tax	Small Business (e.g., LLC filing as S corp.)	C Corporation
Property Tax	✓	✓
Sales Tax	✓	✓
Unemployment Insurance Tax	✓	✓
Business License Fee	✓	✓
Individual Income Tax	✓	-
Corporate Income Tax	-	✓

On the following page, we describe some example businesses across a range of industries and how they pay state and local taxes in Michigan.

### *Small Retailer*

A small retailer, owned and operated by a married couple out of a building that they own, would pay property tax on the building (and on the equipment in it); sales tax on the office supplies used in the business; and excise taxes on fuel used to transport the goods to and from the store. Retailers of this type often employ a number of full-time and part-time people, and the business would be liable for unemployment insurance taxes on these employees. The small retailer could be organized as an S corp, and if so, the business owners would pay individual income tax on any earnings from the store.

Of course, the employees themselves would pay individual income taxes on the wages from the store, including the owners if they paid themselves a wage. We do not consider this a business tax. In addition, customers of the store would pay sales taxes on most non-grocery purchases. Though the business would collect that and remit it to the state, we do not consider this a business tax unless it is paid by the business on business purchases.

### *Large Manufacturer*

A large manufacturer with over 100 employees operating a plant would usually pay large amounts of real and personal property taxes. The manufacturer would also pay sales taxes on many of the supplies used in business operations (but would receive an industrial processing exemption for goods that were inputs to the manufacturing process itself). In addition, the business would pay large amounts of unemployment insurance; and would also pay substantial excise taxes on fuel used to transport raw materials to the facility and to ship out the finished product.

Just as with the small retailer, employees would have income taxes withheld from their paychecks, which we would not consider a business tax.

### *Medium-Sized Professional Services Firm*

A typical professional services firm, such as a doctor or dentist office, a Realtor® office, an accounting or law firm, or a consulting firm, would also pay an array of Michigan business taxes. This would include sales tax on most office purchases; real property taxes on any land or buildings owned (and, at least indirectly, on property that was leased); personal property taxes on equipment and furnishings; and excise taxes on fuel. In addition, the firm would be liable for unemployment insurance taxes. The partners in the firm would owe individual income taxes on any profits from the firm, most of which are organized as a pass-through entity such as a partnership.

*Note: These examples are provided to illustrate the current Michigan tax system, and do not reflect an exhaustive review of the tax laws nor advice on tax filings for any actual business.*

*4. Business tax payments declined by 7% from FY 2011 to FY 2014. Due to policy changes, the economy, and the after-effects of the recession, payments under some taxes went up while others went down.*

In our annual tax burden studies, we estimated taxes paid by businesses in Michigan for each year from 2011 to 2014. As shown in Table 4 below, total business taxes paid in Michigan declined from \$15.2 billion to \$14.1 billion during this time period.

**TABLE 4. Total State and Local Taxes Paid by Businesses in Michigan, FY 2011 to FY 2014 (millions)**

Type of Tax	FY 2011	FY 2012	FY 2013	FY 2014	Change, FY 2011 to FY 2014
Property tax	\$7,069	\$6,970	\$6,884	\$6,849	-\$220
General sales tax	\$2,555	\$2,735	\$2,403	\$2,355	-\$200
Unemployment insurance tax	\$1,776	\$1,924	\$1,864	\$1,810	+\$34
Corporate income tax	\$720	\$804	\$901	\$881	+\$161
Gross receipts tax	\$1,379	\$518	\$0	\$0	-\$1,379
Individual income tax on pass-thru business income	\$464	\$675	\$746	\$702	+\$238
Selective sales tax	\$483	\$621	\$663	\$684	+\$201
License fees	\$466	\$466	\$504	\$508	+\$42
Motor fuel excise tax	\$123	\$122	\$136	\$132	+\$9
Public utilities sales tax	\$95	\$91	\$100	\$80	-\$15
Severance tax	\$70	\$64	\$70	\$73	+\$3
<b>Total State and Local Taxes Paid by Businesses</b>	<b>\$15,201</b>	<b>\$14,990</b>	<b>\$14,271</b>	<b>\$14,074</b>	<b>-\$1,127</b>

*Source: Anderson Economic Group State Business Tax Burden Rankings, reports from years 2014 to 2016.*

*Note: Numbers may not sum to total due to rounding.*

The driving force behind these changes vary by tax and can be divided into three general causes: deliberate policy changes, the economy, and after-effects of the recession.

#### *Policy Changes*

The largest change in any individual tax occurred due to the elimination of gross receipts taxes following the transition to the corporate income tax (CIT) in Michigan starting in 2012. The change from the MBT to the CIT eliminated a double tax on income from businesses that were not C corporations, and phased out many tax incentives. The MBT included both a gross receipts tax and a tax on business income, and it was applied to all businesses in Michigan. The CIT resulted in a net increase in taxes on corporate income for those businesses still subject to the tax, but eliminated the gross receipts component. While no new MBT credits are

available, many tax credit agreements made during the 2008 recession under the MBT will remain in effect until 2030 or later.

### *Economy*

The economy in Michigan has been performing well over the past six years, resulting in greater revenues for businesses and a corresponding increase in tax collections on business income. For example, despite the fact that individual income tax rates ticked down from 4.35% to 4.25% during this time period, individual income tax collections from pass-thru business income increased by over 50%. Similarly, despite the fact that many fewer businesses are now subject to the corporate income tax under the CIT than under the MBT, total collections under the corporate income tax (excluding the gross receipts tax) increased over this time period, as well.

### *After-Effects of Recession*

There are two taxes paid by businesses that are still impacted by consequences of the recession of 2008 and 2009. The recession coincided with a significant drop in the value of real estate, nationally, and Michigan was no exception. Because of the nature of assessment and taxation of property in Michigan, this drop in market real estate values had a lagging impact on assessments. Due to this lag, property taxes continue to drop across the state.

Unemployment in the state increased to nearly 15% at its peak in 2009, putting immense pressure on the state's unemployment insurance fund after years of already-high unemployment. Taxes on businesses to replenish the fund automatically went up in response to this pressure. As a result, unemployment insurance taxes increased rapidly through the year 2012, and are only recently beginning to decrease.

*5. Michigan’s business tax burden ranking has improved from 32nd to 20th over the past four years, the second-fastest improvement in the U.S.*

In each of our annual business tax burden studies, we rank all fifty states and the District of Columbia on their business tax burden. We define business tax burden as the share of pre-tax gross operating surplus (a measure similar to profits) paid in state and local government taxes.

In FY 2011, Michigan was ranked 32nd in the country, with a tax burden of 10.2%. By the year FY 2014, that ranking had improved to 20th, and the tax burden on businesses dropped to 8.4%. This 12-slot improvement over four years is the second-greatest improvement among any of the 50 states and the District of Columbia. The only other state to improve more over that time period was Iowa, which improved from 17th to 4th.

See Table 5 below for a summary of Michigan’s position and improvement relative to some other states of interest.

**TABLE 5. Business Tax Burden for Michigan and Other States, FY 2011 to FY 2014 (dollar amounts in millions)**

State	Rank	2 0 1 4		Rank	2 0 1 1	
		Tax Burden	Business Taxes		Tax Burden	Business Taxes
Oregon	1	6.6%	\$6,558	1	5.8%	\$5,745
Indiana	6	7.3%	\$10,267	7	7.3%	\$9,491
Texas	12	7.8%	\$61,207	13	8.1%	\$51,668
Ohio	16	8.3%	\$18,868	19	8.8%	\$17,820
California	18	8.4%	\$80,992	21	9.0%	\$76,857
<b>Michigan</b>	<b>20</b>	<b>8.4%</b>	<b>\$14,074</b>	<b>32</b>	<b>10.2%</b>	<b>\$15,201</b>
Pennsylvania	28	9.7%	\$24,272	24	9.4%	\$21,867
Illinois	32	10.3%	\$29,939	25	9.4%	\$24,812
New Jersey	36	10.7%	\$23,181	38	10.4%	\$20,497
Wisconsin	37	10.9%	\$11,709	36	10.4%	\$10,113
New York	39	11.3%	\$65,936	41	11.6%	\$57,161
North Dakota	51	19.2%	\$5,522	50	17.5%	\$3,393

Source: Anderson Economic Group State Business Tax Burden Rankings, reports from the years 2016 and 2014.

Note: Tax burden shown as a share of pre-tax gross operating surplus in the state.

### *III. Additional Reports and Information*

#### **ANDERSON ECONOMIC GROUP BUSINESS TAX BURDEN RANKINGS**

Almost all data presented in this report is from Anderson Economic Group's annual *State Business Tax Burden Rankings*. We have analyzed state and local business taxes in this series for ten years, starting with the publication of our first report in 2006. Links to our previous reports can be found at our State Business Tax Burden Rankings page at [www.andersoneconomicgroup.com/Publications/StateBusinessTaxRankings.aspx](http://www.andersoneconomicgroup.com/Publications/StateBusinessTaxRankings.aspx).

In our annual *State Business Tax Burden Rankings* report, we use 11 standardized categories to describe state and local taxes across all 50 states and the District of Columbia. Note that these categories often include more than one statutory tax. For example, the "Corporate income tax" category includes all state and local taxes on net business income, which in Michigan includes the MBT, CIT, Single Business Tax (SBT), and a tax on insurance company income. For this reason, numbers presented in a category in this report will not exactly match numbers in state reports for a specific tax.

#### **SOURCES FOR THIS SPOTLIGHT**

Anderson Economic Group, *2016 State Business Tax Burden Rankings*, edited by Patrick L. Anderson, East Lansing, Michigan, 2016.

Anderson Economic Group, *2015 State Business Tax Burden Rankings*, edited by Patrick L. Anderson, East Lansing, Michigan, 2015.

Anderson Economic Group, *2014 State Business Tax Burden Rankings*, edited by Patrick L. Anderson, East Lansing, Michigan, 2014.

Citizens Research Council of Michigan, "Outline of the Michigan Tax System: 2016 Edition," Lansing, Michigan, 2016.

State of Michigan Department of Treasury, "2014 Commercial, Industrial and Utility Property Tax Report," March 2015.

State of Michigan Department of Treasury, "2014 Ad Valorem Property Tax Report," March 2015.

#### **SOURCES FOR STATE BUSINESS TAX BURDEN RANKINGS**

Please find further information about our sources and methods in the methodology sections of our annual *State Business Tax Burden Rankings* reports. Major sources used in our annual business tax burden study include:

U.S. Census Bureau, "2013 State and Local Government Finances," State & Local Summary Tables by Level of Government, <http://www.census.gov/govs/local/>.

U.S. Census Bureau, "Annual Survey of State Government Tax Collections," 2014, <http://factfinder.census.gov/faces/tableservices/jsf/pages/productview.xhtml?src=bkmk>.

Internal Revenue Service, Statistics of Income, Table 2. Individual Income and Tax Data, by State and Size of Adjusted Gross Income, Tax Year 2013, [http://www.irs.gov/file\\_source/pub/irs-soi/12in54cm.xls](http://www.irs.gov/file_source/pub/irs-soi/12in54cm.xls).

CCH Tax Law Editors, *2016 State Tax Handbook*, CCH Press, 2015.

Bureau of Economic Analysis, U.S. Dept. of Commerce, 1998-2011 KLEMS Intermediate Use Estimates.

Bureau of Labor Statistics, U.S. Dept. of Labor, Consumer Expenditure Survey, Public Use Microdata, 2014.

Official reports on the taxable value of property and on commodity-specific general sales tax exemptions from all fifty states and the District of Columbia, where available.

#### *IV. Sponsors of this Michigan Business Tax Spotlight*

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