



Memorandum

Date: January 18, 2019

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

From: Jason Horwitz, Senior Consultant

Re: The Tax Burden on Businesses in Michigan, Fiscal Year 2016

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 \$14.0 billion in taxes from businesses in 2016 (out of \$41.8 billion total taxes collected).
2. These taxes represented 7.5% of firms' pre-tax operating surplus, placing Michigan 9th among all states in business tax burden.
3. This was an estimated 3% decline in tax collections from businesses from the previous year.
4. Michigan's business tax collections have remained flat for several years, hovering around \$14 billion from 2013 to 2016.
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.
6. Individual income taxes on so-called "pass-through" income from sole proprietorships, partnerships, and S corporations increased from \$829 million in 2015 to \$843 million in 2016, and is up 81% in five years.
7. 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 business

operating margin. This approach has the advantage of providing an objective measure which does not impose any external set of tax policy preferences. Specifically, 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 Business 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 categories of state and local taxes paid by business totaling over \$14.0 billion combined in 2016, as shown in Table 1. This represented roughly a third of the \$41.8 billion of total taxes collected by state and local governments in Michigan that year. The taxes paid by all Michiganders increased by 3% from the previous year’s total of \$40.7 billion, while the amount paid by businesses declined by 3% from \$14.5 billion.

TABLE 1. Total State and Local Taxes Paid by Michigan Businesses, 2015 and 2016

Type of Tax	2016 Taxes Paid (millions of \$)	% of Total	2015 Taxes Paid (millions of \$)
Property tax	\$6,368	45.6%	\$6,439
General sales tax	\$2,947	21.1%	\$3,051
Unemployment compensation tax	\$1,353	9.7%	\$1,478
Corporate income tax	\$898	6.4%	\$1,186
Individual income tax on pass-thru business income	\$843	6.0%	\$829
Selective sales tax	\$754	5.4%	\$683
License Fees	\$542	3.9%	\$522
Motor fuel sales tax	\$143	1.0%	\$140
Public utilities sales tax	\$100	0.7%	\$99
Severance tax	\$24	0.2%	\$37
Total State and Local Taxes Paid by Businesses	\$13,972	100%	\$14,463

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.

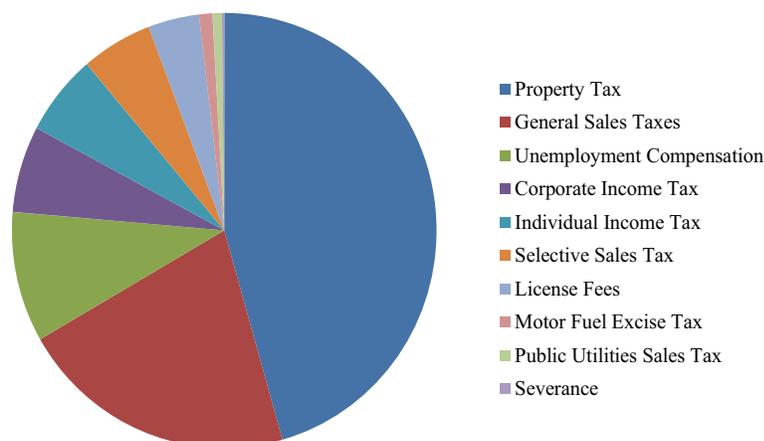
The largest category of taxes assessed on businesses were property taxes, encompassing nearly half of the total at \$6.4 billion. General sales taxes and unemployment compensation accounted for another \$2.9 billion and \$1.4 billion, respectively. Seven other taxation categories we tracked accounted for a combined \$3.3 billion, the most prominent of which were corporate income tax at \$898 million and individual income tax assessed on pass-through business income at \$843 million.

1. Jason Horwitz and Judy Zhang, “2018 State Business Tax Burden Rankings: 9th Edition of the Annual Anderson Economic Group Comprehensive Report on State and Local Business Tax Burden Across the United States,” Anderson Economic Group, LLC, June 13, 2018.

The decline in business taxes from FY 2015 to FY 2016 was largely due to lower corporate income tax collections and unemployment compensation costs.

Corporate income taxes are a noisy source of revenues, so a one-year decline of this magnitude is not unusual, but they have generally trended downward since corporate income tax reforms that went into effect in 2012. Unemployment compensation costs increased significantly during the Great Recession and are still in the process of coming down to a more stable level.

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.

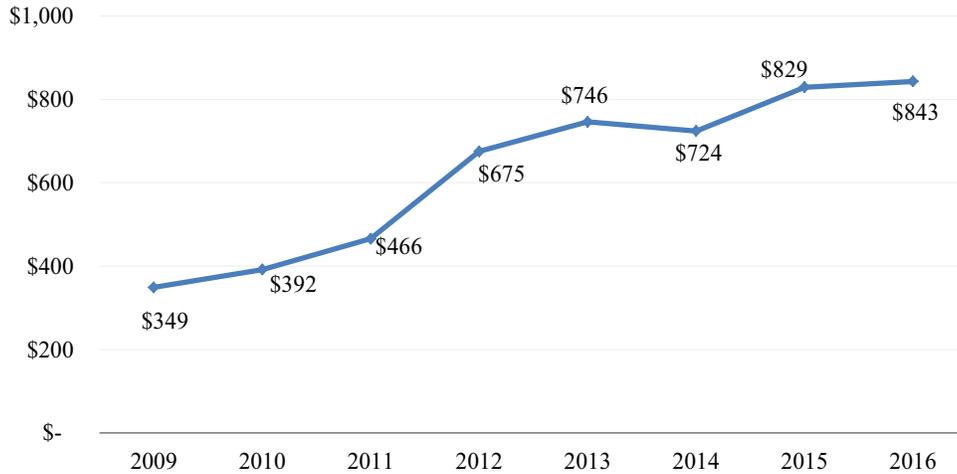
IV. Impact on Small Businesses

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, limited liability corporations (LLCs) and S Corporations—that 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 the current economic expansion continues, individual income tax revenues from net business income have risen considerably, more than doubling from under \$400 million in 2010 to over \$800 million in 2015. See Figure 2 on page 4.

Other taxes which tend 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 small business operations leaves them with a larger overall tax burden for these taxes. For example, 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. Also, property taxes tend to be passed through directly to office and commercial tenants.

Taxes that are less frequently assessed on small businesses include corporate income tax and severance taxes. Corporate income tax is assessed on C Corporations, which are only very rarely small businesses. Severance taxes are 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.

FIGURE 2. Individual Income Tax on Pass-through Business Income, FY 2009 to FY 2016



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

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

Type of Tax	Total Taxes Paid (millions of \$)
Property tax	\$6,367.9
General sales tax	\$2,947.2
Individual income tax on pass-thru business income	\$843.0
Selective sales tax	\$754.1
License fees	\$542.1
Total	\$11,454.3
<i>Other State and Local Taxes Paid by Businesses</i>	<i>\$2,517.5</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.

V. Ranking Relative to Other States

Michigan broke into the top ten for the first time in our business tax burden rankings in 2016, with the 9th-lowest burden. Business tax burden is the share of pre-tax operating surplus that is collected from businesses for state and local taxes. Michigan moved up from 11th place the previous year, and has steadily improved its position in our rankings since 2012.