

## CHAPTER 8

# Taxes

Based on the available national data, business costs in Michigan appear high in a number of key areas, including overall tax burden. When local and state tax burdens are combined, Michigan is more competitive. Business location decisions are driven by several key factors in addition to business costs, including proximity to markets and access to transportation, specialized workforce skills and technology. While high tax rates might discourage firms from locating in a particular state, higher rates may also indicate that a state has the resources to improve its infrastructure and public education system.

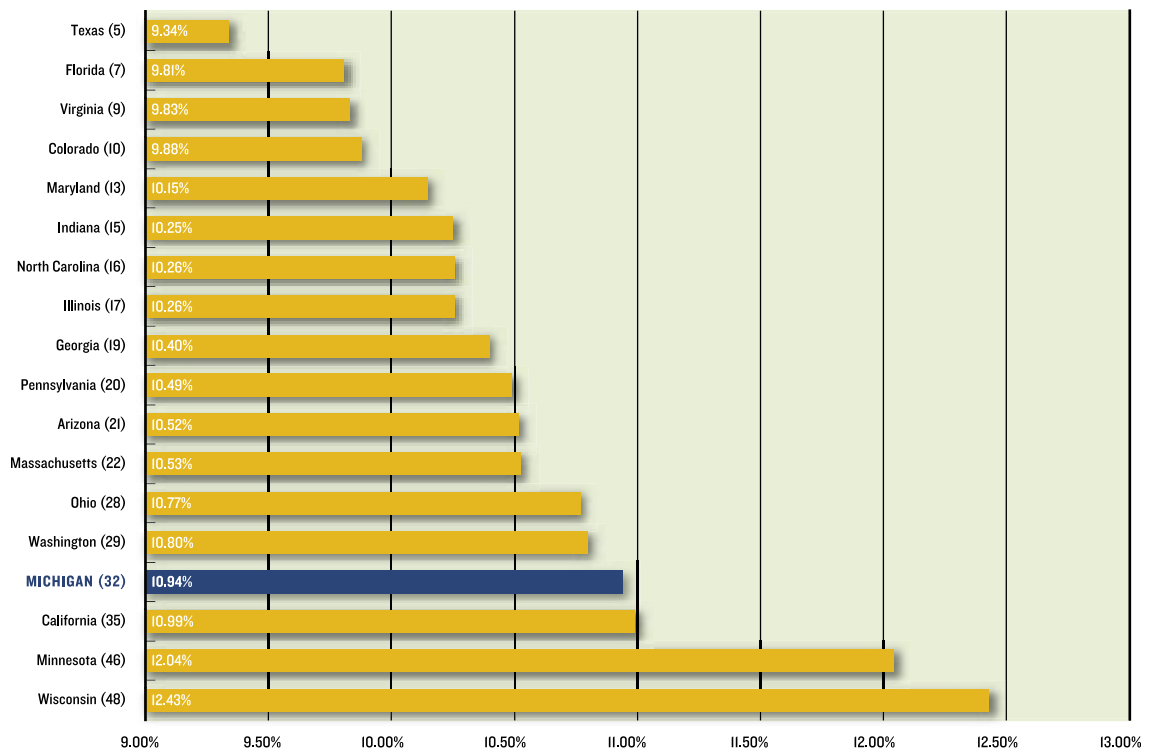
In several cases, the indicators and national data available to benchmark business costs fail to offer comparable in-depth information and analysis needed to determine a state's level of competitiveness. For example, the national data on

workers' compensation insurance are limited to a few narrow measures that do not take into consideration the wide variation in workers' compensation insurance programs nationally. The data can actually present a distorted picture of the worker's compensation insurance climate in a state. Additional analysis will assist public policy leaders in determining Michigan's true level of competitiveness.

Considering the myriad of taxes imposed by state and local governments that affect the competitiveness and profitability of businesses, it is important to ascertain what is the overall level of state and local taxes levied within each state. The overall tax burden indicator measures total state and local tax revenues collected as a percentage of total personal income within a state. This measurement is a proxy indicator for comparing the total effective tax burden across states.

TOTAL STATE AND LOCAL TAX REVENUES AS A PERCENTAGE OF PERSONAL INCOME

1999



SOURCE: CENSUS BUREAU & BUREAU OF ECONOMIC ANALYSIS

In 1999, Michigan had the 4<sup>TH</sup> highest tax burden among the benchmark states, exceeded only by Wisconsin, Minnesota and California. Its state and local tax burden of 10.9% of personal income is higher than the national average and places Michigan 32<sup>ND</sup> nationally on this indicator. However, it should be noted that the state tax burden (excluding taxes levied by local governments) in Michigan has declined somewhat since 1998, falling from 8.5% of personal income in 1998 to 8.2% in 2000. This decline is a very positive step for improving the business cost and tax climate in the state.

Accurate comparison of states' tax burden is an elusive target. Data published by the census bureau allow analysis of a fairly comprehensive array of taxes, but may understate the tax burden for some states. Michigan likely fares worse than some of its competitors as a result.

Some of the unique features of Michigan's Single Business Tax (SBT) also create a competitive disadvantage for the state. Michigan has the highest corporate state tax burden when the SBT is compared to its benchmarking peers and nationally it has the 2<sup>ND</sup> highest corporate tax burden, after Alaska. The SBT is confusing and complicated. As a result, aside from the comparative tax burden the SBT remains highly unpopular.

#### RECOMMENDED ACTIONS:

- Develop recommendations for transitioning Michigan's SBT to a fairer and more competitive tax structure:
  - Analyze competitor states' tax structure to accurately determine overall tax burden, and to assess the reliability of published national data for accurately depicting total tax burden.
  - Analysis should take into account the proportionate tax burden borne by businesses and individuals and consider the need for administrative simplicity. Businesses are also concerned with the cost of compliance related to taxes.
  - Any proposed change to the business tax structure should reflect the state's economic development priorities and be attentive both to the relative overall burden placed on new versus existing businesses, and ensure fair treatment of capital expenditures.
  - Using reliable data, develop a state policy that overall tax burden be no higher than the national average or the average of the benchmark states. Consider global competitiveness when developing this policy.
- Explore strategies to address the perceptions about Michigan's business costs and tax burden. In a number of instances, for example workers compensation insurance, the indicators and national data available to benchmark business costs fail to offer comparable in-depth information and analysis needed to determine Michigan's competitiveness.