Gerald Faverman, Ph.D. • *Chairman of the Board*
Robert J. Kleine and Frances Spring • *Editors*
Vol. 2, No. 6 • June 1992

Public Sector Reports

Michigan ECONOMIC BULLETIN

The Good News

- Nearly across-the-board gains, including a 1.2-percent rise in business equipment manufacturing, allowed U.S. **industrial production** to increase for the fourth consecutive month, by 0.6 percent in May.

- Nationally, **consumer prices** rose 0.1 percent in May, the smallest increase since January. The small gain, coupled with a meager 2.5-percent rise in **hourly wage costs** over the past 12 months, eased inflation fears brought on by the 0.4-percent rise in May's **producer prices** index, which generally is a precursor of rising consumer prices.

➤ The **Michigan unemployment rate** fell to a seasonally adjusted 8.6 percent in May from 9.4 percent in April. Among the eleven largest states, California (for the first time in memory) and New Jersey had higher unemployment rates than Michigan. **Total employment** rose 82,000 during the month, the largest gain since February 1988. The number of unemployed fell from 430,000 in April to 399,000 in May.

➤ May was a good month for domestic auto producers: **Sales of Big Three-produced passenger cars and light trucks** increased 4.1 percent from sales in May 1991, with a 12.9-percent increase in light truck sales more than offsetting the 1.7-percent decline in car sales. Due partly to recent price hikes, **Japanese vehicle sales** fell 12.7 percent. **Total vehicle sales** fell 0.4 percent.

- **Sales of domestic cars and light trucks** during the second ten days of June were up 1.5 percent from the year-ago period; vehicles sold at an annual rate of 6.4 million units, the same rate as a year ago.

- For the fifth consecutive month, the **index of leading economic indicators** rose in April, by 0.4 percent to 148.9 from the revised March figure of 148.3 (1982=100). The consecutive gains in the index—designed to foretell the state of the economy in the coming six to eight months—signify that the recovery is indeed under way.

➤ Revised estimates for first-quarter **gross domestic product** show that the economy grew at a 2.4-percent annual pace as opposed to the 2-percent rate originally reported. The major contributor to the change was an upward revision in business inventories.

The Bad News

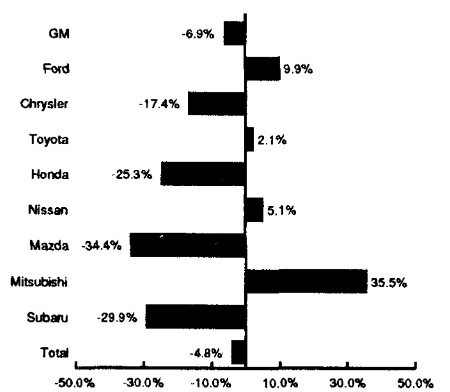
- The **national unemployment rate** jumped from 7.2 percent in April to 7.5 percent in May, the highest monthly rate posted since 1984. The increase was caused by a 331,000-person surge in the labor force, some of whom are newly graduated high school and college students looking for work. The figures indicate that the recovery may not be strong enough to spur employers to hire more workers.

IN THIS ISSUE

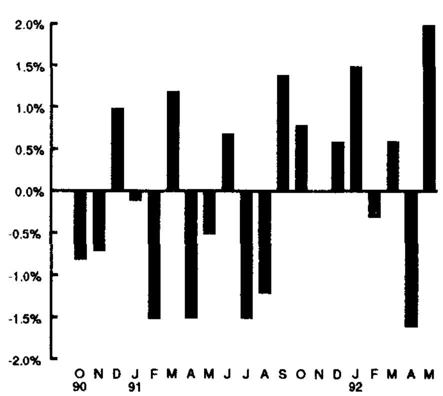
Effects of the Supreme Court Decision on Mail Order Taxes	p. 2
Inheritance Tax; Budget Targets; Enterprise Zones	p. 3
Publications of Interest	p. 3
Michigan Revenue Report	p. 4

MICHIGAN ECONOMIC INDICATORS

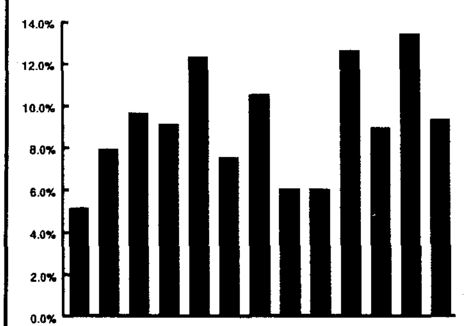
Mid-June Sales of Domestically Produced Cars, Percentage Change from Year Ago



Percentage Change in Michigan Monthly Employment (seasonally adjusted)



Unemployment Rates in Michigan Labor Markets, April 1992



AA: Ann Arbor; BC: Battle Creek; BH: Benton Harbor; DET: Detroit; FT: Flint; GR: Grand Rapids; JK: Jackson; KZ: Kalamazoo; LEL: Lansing-East Lansing; MSK: Muskegon; SBM: Saginaw-Bay City-Midland.

SOURCES: *Automotive News*, Bureau of Labor Statistics, and Michigan Employment Security Commission.

Public Sector Consultants, Inc.
Knapp's Centre • 300 S. Washington Sq • Suite 401
Lansing, MI 48933-2134 • (517) 484-4954

Effects of the Supreme Court Decision on Mail Order Taxes

Background

In May the U.S. Supreme Court issued its opinion on *Quill Corp.* v. *North Dakota*, the case that many states had hoped would result in the overturning of previous rulings and allow them to require mail order firms to collect use taxes on purchases from out-of-state firms. The Court rejected states' claim that they have the right to force mail order companies to collect taxes on the grounds that the imposition of such a levy would interfere with interstate commerce; it did, however, overturn the precedent that such a duty would violate a firms' right to due process. The decision has left some states—which were relying on a favorable decision in order to boost state revenues—looking for other ways to impose the tax.

Due Process v. Interstate Commerce

Put simply, under the principle of due process a firm cannot be taxed if it does not receive benefits from the taxing jurisdiction; due process therefore relates to the fairness of government action. The interstate commerce clause is intended to provide a level playing field for and between firms doing business in several states; the clause is concerned mainly with the effect that state regulations have on the structure of the national economy.

Prior to the *Quill* decision, the Court did not expressly distinguish between the due process and commerce clauses in rulings regarding taxing jurisdictions. This distinction was expressly made, however, in *Quill* and could be the basis for action regarding the taxation of mail order sales. Earlier judgments, for example, stipulated that a firm must have a physical presence, or *nexus*, in a state before it could impose a tax. The *Quill* decision struck down that requirement, ruling that physical location of the firm in the state is not required for sufficient due process to be served and that such taxation would be fairly related to the activities provided by the state (such as banking, credit, and collection services from financial institutions). The decision stated that a systematic solicitation of residents was enough to establish the minimum nexus requirement for due process but not sufficient to meet the substantial nexus requirements for commerce clause purposes.

National Legislation

The ruling regarding due process is important because it opens the door for Congress—which has the authority to regulate interstate commerce but not to interfere in questions of due process—to pass legislation granting a national mail order sales tax. The states have attempted to induce Congress to pass such legislation for twenty years but have been unsuccessful. Impediments have been disagreement among the states over questions about how the revenues from such a tax would be apportioned among them and how "small" a small firm would have to be to be exempt from paying the tax, and distrust that the federal government would actually remit the revenues to the states. If legislation is to be passed at the federal level, there is clearly a need for increased cooperation among the states.

In addition, Alan Friedman, General Counsel of the Multistate Tax Commission, notes that the *Quill* decision grants states the right to request items such as books and records from mail order firms for audit purposes; he also suggests that a broad interpretation of *Quill* could be read to mean that other in-state taxes (such as income and franchise taxes) could be levied and not be in violation of the commerce clause.

PUBLICATIONS OF INTEREST

State Tax Commission, Michigan Department of Treasury, ***Assessed Valuations Approved by the Board of Review—1992*** (Lansing, Mich.: the Department, May 11, 1992).

Lists preliminary 1992 figures for assessments of property, by type of property, for 1992. Increases were held down by the assessment freeze in effect for 1992 (1992 assessments are calculated in 1991). Overall, the state equalized value (SEV) of total property rose 2.27 percent (versus a 1991 rate of increase of 7.63 percent), while residential SEV increased 1.99 percent (as compared to a 9.25-percent gain recorded in 1991).

Policy Analysis Section, Office of Planning, Budget, and Evaluation, Michigan Department of Social Services, ***Information Packet, March 1992*** (Lansing, Mich. the Department, May 12, 1992).

Provides information about the department's programs and clients and "is intended for the use with community groups, the press, and the public." For a copy, contact the Policy Analysis Section at 517/373-6830.

Senate Fiscal Agency, ***Economic and Budget Update, FY 1991-92, FY 1992-93*** (Lansing, Mich.: SFA, May 20, 1992).

The SFA's quarterly report on state and national economic trends and estimates as to how they will affect revenues and spending patterns.

Inheritance Tax; Budget Targets; Enterprise Zones

Inheritance Tax

Introduced by Senator Nick Smith, Senate Bill (SB) 961 would eliminate the state's inheritance tax and leave only a pick-up provision in place. The bill was the senator's response to revisions to the state's inheritance tax law included in SB 1, recently passed as a part of the FY 1992 deficit reduction agreement (refer to last month's *Bulletin*). (SB 1 raised the inheritance exemption for non-spouse close relatives, expanded the definition of class A beneficiaries to include stepchildren and adopted children, and exempted transfers of family-owned businesses and farms from the levy beginning in 1993.) The legislation likely will languish in the Democratically controlled House, however, as House leaders have indicated their lack of interest in acting on the bill anytime soon.

Budget Targets

The legislative leadership and the Department of Management and Budget reached agreement on new targets for the FY 1992–93 budget. The new target of $8,000.4 million is $72.2 million above the governor's original recommendation of $7,928.2 million (later revised to $7,992 million). The agreement includes a freeze on revenue sharing payments that will save $45.5 million and a property tax credit accounting change that will boost revenue by $220 million. All appropriations bills will include language providing for a continuation of the current hiring freeze. We feel that the budget is still out of balance, possibly by as much as $250 million: $100 million in revenue shortfalls and the remainder in potential overexpenditures.

Enterprise Zones

Several bills pending in the legislature—SBs 662, 917, and 918—would alter the definition of enterprise zones (EZs) as specified in Public Act 244 of 1985 and create incentives for additional residential and commercial construction within the named areas. All three bills were introduced by Senator Jon Cisky (R-Saginaw); SB 662 was introduced with bipartisan co-sponsorship.

SB 662 would allow the creation of neighborhood enterprise zones. The bill would define qualified cities as those with (1) a population of 10,000 or more; (2) an average unemployment rate of 10.7 percent or more **or** a property tax of 84 or more mills; (3) a total millage rate of 65 or more mills **or** a city income tax; (4) a housing stock in which 60 percent or more of the units were constructed before 1960; (5) less than a 140-percent increase in the state equalized value (SEV) of property in the area between 1970 and 1990; and (6) a 5-percent or greater decline in population between 1970 and 1990. (Townships and villages with populations of 5,000 or more also are allowed to participate in the program if they meet additional, more stringent criteria.) No more than 10 percent of an area's total acreage could be designated as a neighborhood EZ.

Eligible owners of *new* buildings would pay taxes equal to half of the SEV of the structure times the statewide average millage rate, while those that made improvements to *existing* structures would be exempt from taxes on the structure resulting from any increase in its value resulting from those improvements. (Both would still be required to pay normal taxes on the land on which the building is located.) SB 662 was amended and passed by the House; the Senate may either approve the House's amended version or call for the designation of a conference committee.

SBs 917 and 918 would provide to businesses property tax cuts and credits against their state single business tax (SBT) liability. SB 917 would expand the definition of EZs to include all areas eligible under the same criteria included in SB 662, with one exception: In metropolitan statistical areas that have populations of 400,000 or more, the EZ would be designated as the largest city in the area and would only have to meet three of the six criteria listed above. The largest qualified localities may have up to three zones, while smaller areas are limited to one EZ; no more than 10 percent of the total land area may be designated as a zone.

Businesses eligible under the law would have a tax equal to the sum of (1) the increase in the total SEV of the property (both the land and the building) that occurs *after* the designation of the zone times half the statewide millage rate **plus** (2) the value of the property at the time the zone was designated times the total millage rate levied in the locality. SB 918 provides credits to businesses in the newly defined zones equal to 10 percent of wages paid to employees that are residents of the zone and a 5-percent credit for wages paid to employees that are nonresidents of the zone. Both SBs 917 and 918 were passed by the Senate; the former now awaits action by the House Committee on Economic Development and Energy, while the latter resides in the House Committee on Taxation.

Total general and school aid fund revenue declined 3.5 percent in May, but there were some bright spots. Overall, collections were slightly stronger than expected.

Personal income tax withholding collections rose 10.7 percent. Adjusted for an extra payday and accelerated withholding, however, collections increased an estimated 6 percent. For reasons not yet clear, collections appear to be running ahead of economic activity in recent months. This may be because of incorrect estimates of the effect of accelerated withholding. It is possible that collections in the next few months may be weaker than expected. Quarterly and annual collections have been surprisingly weak this year. In the past three months, collections have declined 2.5 percent. The most recent consensus forecast was reduced $30 million to reflect this weakness.

Sales and use tax collections continued relatively weak except for motor vehicles. Total collections increased 5.7 percent, boosted by a 14.5-percent increase in motor vehicle collections from the depressed year-ago period. Excluding motor vehicles (and use tax collections), sales tax collections increased 3.4 percent.

Single business tax collections were quite strong in May, rising 6.1 percent. In the last three months collections have increased 12.9 percent. Most of this strength is the result of last year's court case involving the capital acquisition deduction. Many firms withheld payment until the case was resolved, depressing second-quarter collections last year. The increases are unlikely to be as large in the next few months.

Lottery sales rebounded in May after two down months, increasing 8.9 percent (preliminary) above the year-ago level. Year-to-date sales are up 1.8 percent. Nonetheless, although March sales also were up 1.8 percent, the profit to the school aid fund was down 2.2 percent (latest data available). The current consensus revenue estimate for lottery sales is $460 million, up 0.7 percent from FY 1990–91. If sales continue at the same rate for the remainder of the fiscal year, but the state's profit margin does not increase, revenue will fall about $20 million short of the FY 1991–92 estimate.

MONTHLY TAX COLLECTIONS (dollars in thousands)

Type of Revenue	Preliminary May 1992	% Change from Last Year	Past 3 Months' Collections	% Change from Last Year	FY 1991–92 Year-to-Date	% Change from Last Year
Personal Income Tax						
Withholding	$337,515	10.7%	$1,027,112	6.3%	$2,555,781	4.3%
Quarterly and Annual Payments	16,940	–64.5	340,173	–2.5	494,854	–5.4
Gross Personal Income Tax	354,455	0.5	1,367,285	4.0	3,050,635	2.6
Less: Refunds	–253,264	14.0	–893,056	16.4	–1,099,109	11.5
Net Personal Income Tax	101,191	–22.5	474,229	–0.1	1,951,526	–1.8
Sales and Use Taxes	267,791	5.7	745,682	4.4	1,803,383	1.1
Motor Vehicles	46,930	14.5	117,319	16.3	250,171	7.4
Single Business Tax	250,945	6.1	471,241	12.9	974,943	–5.3
Cigarette Tax	19,490	–7.9	57,649	–3.9	141,654	–2.7
Public Utility Taxes	–4	0.0	8	NM	72,578	1.3
Oil and Gas Severance	2,904	–27.6	10,273	–13.6	24,714	–18.3
Lottery[a]	40,253	8.9	120,683	–0.9	317,851	1.8
Penalties and Interest	455	–26.0	14,880	–22.1	44,728	–4.2
SUW—Annuals and Undistributed[b]	5,344	–18.6	21,474	3.3	25,350	–10.4
Other Taxes[c]	62,599	–29.4	216,593	–0.3	351,807	7.7
TOTAL TAXES (GF & SAF)[d]	$750,968	–3.5%	$2,132,712	0.1%	$5,708,534	–0.9%
Motor Fuel Tax[e]	$51,564	3.4%	$162,443	2.4%	$395,943	2.7%

SOURCE: Data supplied by Michigan Department of Treasury.
NM = Not meaningful
[a]The state share of lottery sales in 40.1 percent (FY 1991). The previous year's figures are adjusted to the current year's profit margin; the percentage change reflects the increase in ticket sales.
[b]These revenues are distributed to the sales, use, and withholding (SUW) accounts when final numbers for the month are reconciled.
[c]Includes intangibles, inheritance, foreign insurance premium, corporate organization, and industrial and commercial facilities taxes.
[d]Excluded are beer and wine, liquor, and horse racing taxes.
[e]The motor fuel tax is restricted to the Transportation Fund.

Printed on recycled paper.

 Public Sector Consultants, Inc.