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VIEWPOINT ON PUBLIC ISSUES

March 9, 2021

Michigan Should Use the Powers of (Tax) Deduction for Business Equipment

By James M. Hohman

Summary

Lawmakers should change the state corporate income tax code to let businesses deduct the cost of equipment purchases in the year they make them, rather than require them to stretch out those deductions over time.

Main text word count: 523

Michigan policy can encourage job growth with a simple change to how its corporate income tax system treats the cost of equipment.

When the state taxes a business based on how much income it earns, state administrators have to figure out how the business should account for its expenses when it calculates its tax obligation. A business only has income if it earns a profit, and profits are what a business earns above its costs. So if a restaurant sells a $10 sandwich that costs it $7 to make, then it pays taxes on the $3 of profit.

Accounting for costs can be a difficult question, especially when it comes to equipment. Standard accounting practices recommend that the costs of a piece of equipment be recorded not when it is purchased, but rather, extended over its useful life.

So when a business buys its equipment — the $4.5 billion Fiat-Chrysler Automobiles will spend to upgrade metro Detroit assembly lines, for instance — the costs are spread out over the expected useful lives of the upgrades. When FCA earns its income, it gets to subtract from its sales numbers its costs, including the cost of its equipment, again, spread out over time.

Changing the way businesses calculate their tax obligations would help the economy grow.

This practice can make accounting sense. But it also discourages investment in equipment, which in turn discourages businesses from hiring people. If lawmakers let businesses apply the costs of equipment quickly instead of over years, they will encourage them to put more money into business expansion. More expansion means better products, more jobs, higher incomes and a boost to state economic prosperity.

Michigan lawmakers typically follow federal rules for defining what constitutes business income and expenses. It makes things simpler: Accountants determine the company's profit, and the business pays 21% of it to the federal government and 6% to Michigan. But federal and state tax laws differ on how equipment is accounted for. Federal policy currently lets businesses quickly write off equipment expenses, also known as full expensing. Michigan policy does not.

Even if the state used full expensing, it would collect the same amount of tax revenue over the long term as it does now, since the cost of equipment will be acknowledged in the tax code either way.

No. 2021-8 ISSN 1093-2240

Available online at Mackinac.org/v2021-8

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Some lawmakers may hesitate to move to full expensing because it would mean that the corporate income tax couldn't collect as much in taxes over the short term. The state will collect $1.1 billion from the tax this fiscal year, down in part due to the pandemic, and full expensing will lower this amount in the year after lawmakers adopt it. But it can afford to make the change, and doing so would generate more money for the state treasury over time, as businesses invest more in the state and employ more people.

Michigan lawmakers have levied a business tax to raise money to operate state government. This requires them to define expenses in order to determine a business's taxable income. Changing the rules to allow full expensing would encourage economic growth in Michigan and increase state tax collections over the long term while being affordable to the state budget over the short term.

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