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 BILL ANALYSIS

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Senate Bills 650 through 681 (as introduced 9-15-11)  
Sponsor: Senator Jack Brandenburg (S.B. 650-657)  
Senator Mark C. Jansen (S.B. 658-663)  
Senator John Pappageorge (S.B. 664-669)  
Senator Dave Robertson (S.B. 670-675)  
Senator John Proos (S.B. 676-681)

Committee: Finance

Date Completed: 9-21-11

### **CONTENT**

Each of the bills except Senate Bill 658 would amend the Income Tax Act to make changes in Part 1 (individual income tax), Part 2 (corporate income tax), or Part 3 (withholding requirements).

**Senate Bills 661 to 664 and 681** would amend Part 1 to do the following:

- Revise the definitions of "total household resources" and "income".
- Refer to a senior citizen with total household resources of \$21,000 or less, for purposes of the homestead property tax credit.
- Change the date on which the single-factor apportionment of business income begins.

**Senate Bills 650 to 657, 659, 660, 665 to 669, 671 to 676, and 678** would amend Part 2 to do the following regarding the corporate income tax (CIT):

- Provide for the recapture of credits previously granted under the Single Business Tax Act or the Michigan Business Tax Act (MBT), in the event of a taxpayer's noncompliance.
- Require gross receipts of a flow-through entity to be imputed to each member based on the member's proportionate share of distributive income.
- Extend disqualification for the small business credit to a unitary business group.

- Define substantial nexus for a financial institution.
- Add sourcing provisions concerning the benefit of services.
- Provide for the sourcing of leased prewritten computer software for apportionment purposes.
- Revise the time for submitting a final liability.
- Make changes regarding estimated tax payments and returns.
- Revise provisions concerning a foreign person's tax base and sales factor.
- Require a person that was a disregarded entity for Federal tax purposes to be treated as a disregarded entity for purposes of Part 2.
- Require a taxpayer computing the CIT for a portion of a year to use the method the taxpayer used to compute the MBT for the other portion of the year.
- Specify the tax year for a person joining or leaving a unitary business group except at the end of the person's Federal tax year.
- Redefine "gross receipts".
- Define "actively solicits".
- Revise the definitions of "business income", "business loss", "corporation", "financial institution", "foreign operating entity", "person", "shareholder", and "United States person".

**Senate Bills 670, 677, 679, and 680** would amend Part 3 to:

- **Revise withholding requirements that apply to a person that disburses pension or annuity payments.**
- **Provide that taxes withheld by a flow-through entity would accrue on the 15<sup>th</sup> of April, June, September, and January, and require withholding for each period to be equal to one-fourth of the total expected for the tax year.**
- **Require a flow-through entity that withheld tax to file an annual reconciliation return.**
- **Authorize the Department of Treasury to require a flow-through entity to file an annual business income information return.**
- **Revise the withholding requirement that applies when a person whose income is subject to withholding fails or refuses to provide information.**
- **Delete reference to a trust in the definition of "flow-through entity".**

**Senate Bill 658** would amend the Michigan Business Tax Act to:

- **Require separate returns for short period tax years.**
- **Require a fiscal year taxpayer with two short period tax years to use the same method of computing the tax for each short period tax year.**
- **Require a U.S. person disregarded for Federal income tax purposes to be treated as a disregarded entity for purposes of the MBT Act.**
- **Require the MBT return of a unitary business group to include all the people in the group.**
- **Require a taxpayer with a certificated credit for a multiphase brownfield project to continue to file a return and pay the MBT until the credit was used up.**
- **Disallow a deduction for a business loss for a prior year in which the taxpayer was not subject to the MBT Act.**
- **Allow a taxpayer claiming a credit for health care benefits to report the aggregate costs of employer-sponsored benefits.**

All of the bills would take effect on January 1, 2012.

(Public Act 38 of 2011 amended the Income Tax Act to revise sections providing for the income tax on individuals, which it designated Part 1 of the Act, and to create Part 2 to establish the CIT. The amendments to the individual income tax eliminate a number of deductions, exemptions, and credits; provide for the taxation of pension income; and alter the tax rate levied in future years.

The CIT provisions in Part 2 largely mirror the income tax portion of the Michigan Business Tax Act (which is being eliminated) but levy the tax only on businesses organized as traditional corporations under Federal tax rules. Sole proprietorships and pass-through entities, such as partnerships and S-corporations, will not be subject to the CIT. Financial institutions remain subject to a franchise tax in lieu of the CIT, and insurance companies are taxed on gross direct premiums written on property or risk located or residing in the State. The CIT also retains unitary filing requirements for corporations under common control (unitary business groups).

Public Act 38 also added Part 3, which prescribes tax withholding requirements that apply to flow-through entities, employers, people who disburse pension or annuity payments, casino licensees, and others.

Except for the amendments to the individual income tax rate, which take effect on October 1, 2011, Public Act 38 will take effect on January 1, 2012.

As described below, Public Act 39 of 2011 amended the MBT Act and provides for its eventual repeal.)

The following is a detailed description of the bills, categorized by those that would amend Part 1, Part 2, or Part 3 of the Income Tax Act, followed by a description of Senate Bill 658.

**Income Tax Act Part 1**

**Senate Bill 661**

Part 1 uses the term "total household resources" in a number of provisions, including those related to the personal

exemption, the taxation of pension income, and the homestead property tax credit. "Total household resources" means all income received by all persons of a household in a tax year while members of a household, plus the following:

- Any net business loss after netting all business income and loss.
- Any net rental or royalty loss.
- Any deduction from Federal adjusted gross income (AGI) for a carryback or carryforward of net operating loss as defined in Section 172(b)(2) of the Internal Revenue Code (IRC).

The bill would define "total household resources", instead, as all income received by all persons of a household in a tax year while members of a household, increased by the following deductions from Federal gross income:

- Any net business loss after netting all business income and loss.
- Any net rental or royalty loss.
- Any carryback or carryforward of net operating loss as defined in Section 172(b)(2) of the IRC.

#### **Senate Bill 662**

Part 1 defines "income" as the sum of Federal adjusted gross income as defined in the IRC plus all income specifically excluded or exempt from the computations of the Federal AGI, except that a deduction for a carryback or carryover of a net operating loss may not exceed Federal modified taxable income as defined in Section 172(b)(2) of the IRC. The bill would delete that exception.

#### **Senate Bill 663**

Part 1 allows certain taxpayers to claim a credit for an amount of property taxes paid on their homestead. The credit is based on the amount by which property taxes exceed a percentage of total household resources.

Under one provision, for a senior citizen with total household resources of \$21,000 or less, the credit amount is equal to 100% of the difference between the property taxes and 3.5% of total household resources. Under another provision, for a taxpayer who is a senior citizen or a paraplegic, hemiplegic, or quadriplegic, or who is totally

and permanently disabled or deaf, the percentage ranges from 0.0% to 3.5% based on a range of total household resources (from \$3,000 or less to over \$6,000). In that provision, the bill would refer to a senior citizen with total household resources of \$21,000 or less.

Also, the credit for a senior citizen claimant with total household resources of \$21,000 or less would be the same as the credit otherwise provided for a senior citizen or a disabled person.

#### **Senate Bill 664**

Part 1 provides for the apportionment of business income, for purposes of the individual income tax. Before January 1, 2011, the apportionment formula is based on property, payroll, and sales. After December 31, 2010, business income must be apportioned based only on the sales factor.

Under the bill, the three-factor apportionment would apply before January 1, 2012, and the single-factor apportionment would apply after December 31, 2011.

#### **Senate Bill 681**

Currently, an individual must be allowed a credit against the income tax for the amount withheld from his or her compensation under Section 351. The bill would refer to Section 703 instead of Section 351.

(Section 703 requires employers to deduct and withhold a tax on individuals' compensation. Section 351 contains comparable provisions and will be repealed on January 1, 2012.)

#### **Income Tax Act Part 2**

#### **Senate Bill 650**

The CIT applies to a taxpayer that has substantial nexus in the State. Under Section 621 (which Senate Bill 669 would amend) a taxpayer has substantial nexus in Michigan if it has a physical presence in the State for more than one day during the tax year; if the taxpayer actively solicits sales in the State and has gross receipts of \$350,000 or more sourced to the State; or if the taxpayer has an ownership interest or a

beneficial interest in a flow-through entity, directly, or indirectly through one or more flow-through entities, that has substantial nexus in this State.

Section 653 provides for the franchise tax on a financial institution with nexus in the State as determined under Section 621. The franchise tax is imposed on the financial institution's tax base, after allocation or apportionment to this State, at the rate of 0.29%.

The bill would refer to a financial institution with "substantial nexus" in this State, rather than nexus as determined under Section 621.

The bill provides that, for purposes of Section 653, a financial institution has substantial nexus in this State if it satisfies any of the following:

- Has a physical presence in this State for a period of more than one day during the tax year.
- Actively solicits sales in this State and has gross receipts of \$350,000 or more sourced to the State.
- Has an ownership interest in or a beneficial interest in a flow-through entity, directly or indirectly through one or more other flow-through entities, that has substantial nexus in this State as provided under Section 621 or 653 .

"Actively solicits" would mean that term as defined under Section 621.

### **Senate Bill 651**

Section 665(1) prescribes criteria under which sales are considered to be in this State. Section 665(2) applies to sales from the performance of services.

Under Section 669, all other receipts not otherwise sourced must be sourced based on where the benefit to the customer is received or, if that cannot be determined, to the customer's billing address.

The bill would amend Section 669 to provide that, for purposes of Section 665(2), the benefit of a service would be considered received in and attributable to this State as described below.

Under any of the following circumstances, 100% of the benefit would be received in this State:

- The service related to real property that was located entirely in Michigan.
- The service related to tangible personal property that was either owned or leased by the purchaser and located in Michigan at the time the service was received or to tangible personal property that was delivered to the purchaser or the purchaser's designee in Michigan.
- The service was provided to a purchaser who was an individual physically present in Michigan at the time the service was received.
- The services were received in Michigan and were in the nature of personal services, such as consulting, counseling, training, speaking, and providing entertainment, that are typically conducted or performed first-hand, on a direct, one-to-one or one-to-many basis.
- The service was provided to a purchaser that was engaged in a trade or business in Michigan and related only to the trade or business of that purchaser in Michigan.
- The service related to the use of intangible property such as computer software other than prewritten computer software, licenses, designs, processes, patents, and copyrights, that was used entirely in this State.
- The services provided were professional in nature, such as legal or accounting services, and were provided to a purchaser who was an individual domiciled in Michigan, or to a purchaser with business operations only in Michigan.

A portion of the benefits of a service would be in Michigan and attributable to this State as described below.

If the service related to real property that was located in Michigan and in one or more other states, the benefit of the service would be received in Michigan to the extent that the real property was located in this State.

If the service related to tangible personal property that was owned or leased by the purchaser and located in Michigan and in one or more other states at the time the service was received, or to tangible personal property that was delivered to the purchaser

or the purchaser's designee in Michigan and in one or more other states, the benefit of the service would be received in Michigan to the extent that the property was located in this State, or was delivered to the purchaser or the purchaser's designee in Michigan.

If the service were provided to a purchaser that was engaged in a trade or business in Michigan and in one or more other states, and the service related to the purchaser's trade or business in Michigan and in one or more other states, the benefit of the service would be received in Michigan to the extent that it related to the purchaser's trade or business in this State.

If the service related to the use of intangible property such as computer software other than prewritten computer software, licenses, designs, processes, patents, and copyrights, that was used in Michigan and in one or more other states, the benefit of the service would be received in Michigan to the extent that the intangible property was located in this State.

If the services provided were professional in nature, and were provided to a purchaser with business operations in Michigan and in one or more other states, and the services related to the purchaser's operations both in Michigan and in one or more other states, the benefit of the services would be received in Michigan to the extent that they related to the purchaser's Michigan operations.

### **Senate Bill 652**

The definition of "financial institution" under Part 2 includes a bank holding company, a national bank, a State-chartered bank, an office of thrift supervision chartered bank or thrift institution, a savings and loan holding company other than a diversified savings and loan holding company, and a federally chartered farm credit system institution.

The bill would delete the references to an office of thrift supervision chartered bank or thrift institution and a savings and loan holding company other than a diversified savings and loan holding company. Instead, the bill would refer to a federally chartered savings association.

### **Senate Bill 653**

The definition of "gross receipts" in Part 2 excludes dividends and royalties received from a foreign operating entity, and the definition of "unitary business group" excludes a foreign operating entity.

"Foreign operating entity" means a United States person that would otherwise be part of a unitary business group that has at least one person included in the group that is taxable in this State, and meets other criteria. The bill would replace these references to "person" with "corporation".

### **Senate Bill 654**

Part 2 requires an annual or final return to be filed by the last day of the fourth month after the end of the taxpayer's tax year. Any final liability must be remitted with that return. Under the bill, any final liability would have to be remitted by the annual due date of the taxpayer's annual or final return, excluding any extension of time.

A taxpayer does not need to file a CIT return or pay the tax imposed under Part 2 if the taxpayer's apportioned or gross receipts are less than \$350,000.

The bill would require the apportioned or allocated gross receipts of a flow-through entity to be imputed to each of its members based upon the same percentage that each member's proportionate share of distributive income is to the total distributive income of the flow-through entity.

If a taxpayer had apportioned or allocated gross receipts for a tax year of less than 12 months, the threshold amount of \$350,000 would have to be multiplied by a fraction whose numerator was the number of the months in the tax year and whose denominator was 12.

### **Senate Bill 655**

Section 671 allows a credit (called the small business credit) for taxpayers with gross receipts that do not exceed \$20.0 million and adjusted business income minus the loss adjustment that does not exceed \$1.3 million, subject to certain disqualifications and reductions.

A corporation is disqualified if compensation and directors' fees of a shareholder or officer exceed \$180,000 or if those fees plus certain other amounts exceed \$180,000. Under the bill, this disqualification also would apply to a unitary business group.

Currently, for purposes of determining disqualification, an active shareholder's share of business income may not be attributable to another active shareholder. Also, under the bill, if the taxpayer were a unitary business group, the amount of all items paid or allocable by all people included in the group to any one individual who was a shareholder or officer of a single person included in the group would have to be combined.

Section 671 defines "compensation" as all wages, salaries, fees, bonuses, commissions, and other payments made in the tax year on behalf of or for the benefit of employees, officers, or directors of the taxpayer. Compensation for a real estate broker or salesperson or a real estate appraiser licensed under Article 25 or 26 of the Occupational Code includes payments to an independent contractor licensed under either article. The bill would delete this provision.

#### **Senate Bill 656**

As noted above, Section 665 provides for the sourcing of receipts from sales. Under this section, receipts from the lease or rental of tangible personal property are sales in this State to the extent that the property is used in Michigan.

The bill specifies that, for apportionment purposes only, prewritten computer software would be used in this State when the computer hardware accessing the software was physically located in Michigan.

#### **Senate Bill 657**

The bill would amend the definition of "tax year" to provide that a person included in a unitary business group that joined or departed the group other than at the end of the person's Federal tax year would have a tax year beginning with its Federal income tax period and ending on the date of joining or departing the group, and another tax year beginning on the date immediately after

joining or departing the group and ending with its Federal income tax period.

The bill also would amend the definition of "United States person" to exclude a foreign person disregarded for Federal income tax purposes.

#### **Senate Bill 659**

The bill would add Section 673 to provide for the recapture of certain credits earned under the former Single Business Tax (SBT) Act or the MBT Act.

Specifically, a taxpayer that had claimed a credit under either of those Acts that included a provision allowing for a reduction in the credit amount, a termination of the credit, or a percentage of the credit amount previously claimed to be added back to the taxpayer's tax liability if the taxpayer failed to comply with any terms of the agreement or other conditions of that credit, or if the taxpayer sold or otherwise moved the property for which a credit was claimed less than five years after the year in which it originally was claimed under the SBT Act or the MBT Act, would have a percentage, or the entire amount, of the credit amount previously claimed added back to the taxpayer's tax liability under the Income Tax Act in the year that the taxpayer failed to satisfy or breached the conditions of the credit set forth under the SBT or MBT Act.

In addition, a taxpayer that had claimed a credit under Section 35a of the SBT Act (which provided for an investment tax credit) or Section 403 of the MBT Act (which provides for a compensation and depreciation credit) for a tangible asset that the taxpayer had sold, transferred out of the State, or otherwise disposed of during the current tax year, would have to have an amount added back to the taxpayer's liability under the Income Tax Act to the extent the credit was used and at the rate at which it was used under the SBT or MBT Act. The amount would have to be calculated as prescribed in the bill.

#### **Senate Bill 660**

Section 681 requires a taxpayer to file an estimated return and pay an estimated tax for each quarter of the taxpayer's tax year if the taxpayer reasonably expects liability for the tax year to exceed \$800. Under the bill,

this would be required except as otherwise provided in Section 681.

As a rule, the estimated payment made with each quarterly return must be for the estimated corporate income tax base for the quarter or 25% of the estimated annual liability. The bill would delete reference to the corporate income tax base and refer, instead, to the tax base applicable to the taxpayer under Chapter 11, 12, or 13. (Chapter 11 provides for the CIT, and Chapters 12 and 13 provide for a tax on insurance companies and financial institutions, respectively.)

Currently, with respect to a taxpayer filing an estimated tax return for the taxpayer's first tax year of less than 12 months, the amounts paid with each return must be proportional to the number of payments made in the first tax year. Under the bill, a taxpayer with a tax year of less than four months would not be required to file an estimated tax return or remit estimated payments.

#### **Senate Bill 665**

Part 2 defines "business income" as Federal taxable income. For a taxpayer that is a mutual or cooperative electric company exempt under Section 501(c)(12) of the IRC, business income equals the organization's excess or deficiency of revenue over expenses as reported to the Federal government by those organizations exempt from the Federal income tax, less capital credits paid to members of that organization, less income attributable to equity in another organization's net income, and less income resulting from a charge approved by a State or Federal regulatory agency that is restricted for a specified purpose and refundable if not used for that purpose.

The bill would delete the provision for such a mutual or cooperative electric company.

#### **Senate Bill 666**

Part 2 defines "corporation" as a taxpayer that is required or has elected to file as a C corporation as defined under Section 1361(a)(2) and Section 7701(a)(3) of the IRC. The bill would refer to a "person", rather than a "taxpayer".

#### **Senate Bill 667**

Part 2 defines "person" as an individual, firm, bank, financial institution, insurance, limited partnership, limited liability partnership, copartnership, partnership, joint venture, association, corporation, subchapter S corporation, limited liability company, receiver, estate, trust, or any other group or combination of groups acting as a unit.

The bill would include a flow-through entity, and delete references to a firm, limited partnership, limited liability partnership, copartnership, partnership, joint venture, subchapter S corporation, and limited liability company.

Part 2 defines "shareholder" as a person who owns outstanding stock in a corporation or is a member of a business entity that files as a corporation for Federal income tax purposes. An individual is considered the owner of the stock owned by or for family members as defined by a section of the IRC. Under the bill, an individual also would be considered the owner of the equity interest in a business entity that files as a corporation for Federal income tax purposes, owned by or for family members.

#### **Senate Bill 668**

The corporate income tax is imposed on the CIT base, after allocation or apportionment to this State, at the rate of 6.0%. The CIT base is a taxpayer's business income subject to a number of adjustments before allocation or apportionment, and an adjustment after allocation or apportionment.

One of the adjustments to be made before allocation or apportionment is the addition of all taxes on or measured by net income and the tax imposed under Part 2 to the extent that the taxes were deducted in arriving at Federal income tax. The bill would refer to all taxes on or measured by net income "including" the tax imposed under Part 2.

The adjustment to be made following allocation or apportionment is the deduction of any available business loss incurred after December 31, 2011. "Business loss" means a negative business income taxable amount after allocation or apportionment. The business loss must be carried forward to the

year following the loss year as an offset to the allocated or apportioned CIT base, then successively to the next nine taxable years or until the loss is used up, whichever occurs first, "but not for more than 10 taxable years after the loss year". The bill would delete the language in quotations.

### **Senate Bill 669**

As noted above, a taxpayer has substantial nexus in this State and is subject to the tax under Part 2 if the taxpayer actively solicits sales in Michigan and has gross receipts of \$350,000 or more sourced to the State (or meets other criteria). The bill would delete a requirement that "actively solicits" be defined by the Department of Treasury through written guidance that must be applied prospectively.

The bill would define "actively solicits" as either of the following:

- Speech, conduct, or activity that is purposefully directed at or intended to reach people within this State and that explicitly or implicitly invites an order for a purchase or sale.
- Speech, conduct, or activity that is purposefully directed at or intended to reach people within this State that neither explicitly nor implicitly invites an order for a purchase or sale, but is entirely ancillary to requests for an order for a purchase or sale.

### **Senate Bill 671**

Under Section 667, if the apportionment provisions of Part 2 do not fairly represent the extent of a taxpayer's business activity in Michigan, the taxpayer may petition for, or the treasurer may require, certain actions with respect to the taxpayer's business activity. The bill would refer to the "state treasurer".

(The actions include separate accounting; the inclusion of one or more additional or alternative factors that will fairly represent the taxpayer's business activity in Michigan; and the use of any other method to effectuate an equitable allocation and apportionment of the taxpayer's tax base. An alternative method may be used only if approved by the Department of Treasury.)

### **Senate Bill 672**

Currently, if a taxpayer's tax year to which Part 2 applies ends before December 31, 2012, the taxpayer may compute the tax imposed by Part 2 for the portion of that tax year to which Part 2 applies according to one of two methods prescribed in the Act.

The bill specifies that the method chosen by the taxpayer would have to be the same as the method the taxpayer used when computing the tax imposed under the MBT Act for the other portion of the same tax year.

### **Senate Bill 673**

Section 661 (which Senate Bill 674 would amend) provides for the apportionment of the tax base established under Part 2. The tax base of a taxpayer whose business activities are confined solely to Michigan must be allocated to this State. The tax base of a taxpayer whose business activities are subject to tax both within and outside of Michigan must be apportioned to this State by multiplying the tax base by the sales factor calculated under Section 663.

Under that section, except as otherwise provided, the sales factor is a fraction whose numerator is the total sales of the taxpayer in this State during the tax year, and whose denominator is the total sales of the taxpayer everywhere during the tax year.

Section 663 also states a legislative intent that the tax base of a taxpayer be apportioned to this State by multiplying the tax base by the sales factor multiplied by 100% and that apportionment not be based on property, payroll, or any other factor. Under Senate Bill 673, this would apply except as otherwise provided under Section 667 (the section that Senate Bill 671 would amend).

### **Senate Bill 674**

Under Section 661, for a taxpayer that has a direct, or indirect through one or more other flow-through entities, ownership interest or beneficial interest in a flow-through entity that has business activity in this State, the taxpayer's business income that is directly attributable to the business activity of the flow-through entity must be apportioned to Michigan using an apportionment factor

determined under Section 663 based on the business activity of the flow-through entity.

The bill would delete the phrase "that has business activity in this state".

### **Senate Bill 675**

Currently, except as otherwise provided, the corporate income tax base of a foreign person is subject to all adjustments and other provisions of Part 2, but does not include proceeds from sales where title passes outside the United States. Under the bill, a foreign person's CIT base would not include net income from sales of tangible personal property where title passes outside the U.S.

The sales factor for a foreign person is a fraction whose numerator is the taxpayer's total sales in Michigan where title passes inside the United States during the tax year and whose denominator is the taxpayer's total sales in the U.S. where title passes inside the U.S. during the tax year. The bill would delete the phrases "where title passes inside the United States". The bill specifies that, for purposes of this provision, for sales of tangible personal property, only those sales where title passes inside the United States would be used in the sales factor, and sales of property other than tangible personal property would have to be apportioned in accordance with Chapter 14 (which provides for the apportionment of a taxpayer's tax base).

### **Senate Bill 676**

Part 2 defines "gross receipts" as the entire amount received by the taxpayer as determined by using the taxpayer's method of accounting used for Federal income tax purposes, less any amount deducted as bad debt for Federal income tax purposes from any activity whether in intrastate, interstate, or foreign commerce carried on for direct or indirect gain, benefit, or advantage to the taxpayer or to others, except proceeds, amounts, and other items specified in the definition.

The bill would define "gross receipts", instead, as the entire amount received by the taxpayer from any activity whether in intrastate, interstate, or foreign commerce carried on for direct or indirect gain, benefit, or advantage to the taxpayer or to others,

except for specified proceeds, amounts, and other items.

### **Senate Bill 678**

The bill provides that a United States person that was a disregarded entity for Federal income tax purposes under the IRC would have to be treated as a disregarded entity for income tax purposes under Part 2. A person other than a United States person that was a disregarded entity for Federal income tax purposes under the IRC could not be treated as a disregarded entity for income tax purposes under Part 2.

### **Income Tax Act Part 3**

#### **Senate Bill 670**

##### Retirement or Annuity Payments

Under Section 703, a person who disburses pension or annuity payments is subject to income tax withholding on the taxable part of payments from an employer pension, annuity, profit-sharing, stock bonus, or other deferred compensation plan, as well as from an individual retirement arrangement, an annuity, an endowment, or a life insurance contract. Under the bill, a person who disbursed pension or annuity payments, except as otherwise provided, would be required to withhold a tax in an amount computed by applying the rate prescribed in Section 51 on the taxable part of those payments. (Section 51 sets the rate of the individual income tax.)

Withholding would have to be calculated on the taxable disbursement after deducting from the taxable portion the same proportion of the total amount of personal and dependency exemptions of the individual allowed under the Act.

Currently, withholding is not required on any part of a distribution that is not expected to be includable in the recipient's gross income. Under the bill, withholding also would not be required on any part of a distribution that was deductible from adjusted gross income under Section 30(1)(e) or (f). (Section 30(1)(e) provides for the deduction, to the extent included in AGI, of compensation, including retirement benefits, received for services in the U.S. armed forces, and retirement or pension benefits under the Federal Railroad Retirement Act. Section

30(1)(f) provides for the deduction, to the extent included in AGI and subject to limitations for people born in 1946 or later, of retirement or pension benefits from a Federal, state, or local retirement system; Social Security benefits; retirement or pension benefits from another system or benefits from a retirement annuity policy, subject to a maximum dollar amount; and an amount eligible for a Federal credit for the elderly and totally and permanently disabled.)

### Flow-Through Income

Section 703 requires every flow-through entity in the State to withhold a tax in an amount computed by applying the rate prescribed in Section 51 to the distributive share of taxable income after allocation and apportionment of each nonresident member who is an individual after deducting from that income the same proportion of the total amount of personal and dependency exemptions of the individual allowed under the Act. The bill would refer to the distributive share of taxable income "reasonably expected to accrue" after allocation and apportionment.

The bill provides that all of the taxes withheld under Section 703 would accrue to the State on April 15, June 15, and September 15 of the flow-through entity's tax year and January 15 of the following year, except a flow-through entity that was not on a calendar year basis would have to substitute the appropriate due dates in its fiscal year corresponding to those in a calendar year. Withholding for each period would have to be equal to one-fourth of the total withholding calculated on the distributive share that was reasonably expected to accrue during the tax year of the flow-through entity.

Under Section 703, every flow-through entity with business activity in this State that has more than \$200,000 of business income in the tax year after allocation or apportionment must withhold a tax in an amount computed by applying the rate prescribed in Section 623 (the CIT rate) to the distributive share of the business income of each member that is a corporation or that is a flow-through entity. The bill would refer to business income "reasonably expected to accrue".

The bill provides that, for a partnership or S corporation, business income would include payments and items of income and expense attributable to business activity of the partnership or S corporation and separately reported to the members. Taxes would accrue on the 15<sup>th</sup> of April, June, September, and January (or a corresponding date in an entity's fiscal year) and withholding for each period would have to be one-fourth of the total expected for the year, as provided above for individual income withholding.

If a flow-through entity is subject to the withholding requirements, then a member of that entity that is itself a flow-through entity must withhold a tax on the distributive share of the business income of each of its members. The proposed accrual and withholding requirements would apply to such an entity, as well.

### Publicly Traded Partnership

The bill provides that every publicly traded partnership that had equity securities registered with the Securities and Exchange Commission under Section 12 of Title I of the Securities and Exchange Act would not be subject to withholding.

### **Senate Bill 677**

All provisions relating to the administration, collection, and enforcement of the Income Tax Act and the revenue Act apply to the employer, flow-through entity, eligible production company, casino licensee, race meeting licensee, or track licensee required to withhold taxes and to the taxes required to be withheld. The bill would refer to "all persons", rather than the employer, flow-through entity, eligible production company, etc.

The Department may take certain actions if it has reason to believe that an employer, flow-through entity, eligible production company, casino licensee, race meeting licensee, or track licensee will not pay taxes withheld to this State. The bill would refer to "a person required to withhold taxes under this part", instead of an employer, flow-through entity, etc.

### **Senate Bill 679**

An employer, flow-through entity, eligible production company, casino licensee, race

meeting licensee, and track licensee required by Part 3 to deduct and withhold taxes for a tax year on compensation, share of income available for distribution, winnings, or payoff on a winning ticket, must give each employee, member, or person with winnings or a payoff subject to withholding a statement of the total compensation, share of income available for distribution, winnings, or payoff on a winning ticket paid during the tax year and the amount deducted or withheld. The employer, flow-through entity, eligible production company, or licensee also must file a duplicate of the statement and an annual reconciliation return with the Department of Treasury.

The bill would refer to a "person" rather than an employer, flow-through entity, eligible production company, or licensee, and would delete the references to "share of income available for distribution".

Under the bill, a flow-through entity that had withheld taxes on distributive shares of business income reasonably expected to accrue would have to file an annual reconciliation return with the Department by the last day of the second month following the end of the entity's Federal tax year. The Department could require the flow-through entity to file an annual business income information return on the due date, including extensions, of its annual Federal information return.

Currently, every employer, flow-through entity, eligible production company, casino licensee, race meeting licensee, and track licensee required by Part 3 to deduct or withhold taxes from compensation, share of income available for distribution, winnings, or payoff on a winning ticket must make a return or report in form and content and at times as prescribed by the Department. Under the bill, this would apply, instead, to every person required by Part 3 to deduct or withhold taxes.

Currently, every employee, member, or person with winnings or a payoff on a winning ticket subject to withholding under Part 3 must give his or her employer, flow-through entity, eligible production company, casino licensee, race meeting licensee, or track licensee information required for it to make an accurate withholding. The bill also would require a person who received a

pension or annuity payment to furnish information to the person that disbursed the payment.

If an employee, member, or person with winnings or a payoff subject to withholding fails or refuses to furnish information, the employer, flow-through entity, eligible production company, or licensee must withhold the full rate of tax from the employee's total compensation, the member's share of income available for distribution, or the winnings. Under the bill, instead, if a person who received a retirement or annuity payment, employee, member, or person with winnings or a payoff failed or refused to furnish information, the person required by Part 3 to deduct and withhold taxes would have to withhold the full rate of tax from the person's retirement or annuity payment, the employee's total compensation, the member's distributive share of business income reasonably expected to accrue, or the winnings.

### **Senate Bill 680**

Part 3 defines "flow-through entity" as an entity that for the applicable tax year is treated as an S corporation under the IRC, a general partnership, a limited partnership, a limited liability partnership, a trust, or a limited liability company, that for the applicable tax year is not taxed as a corporation for Federal income tax purposes. The bill would delete the reference to a trust.

The bill would define "partnership" as a taxpayer that is required to or has elected to file as a partnership for Federal income tax purposes.

The bill would define "publicly traded partnership" as that term is defined under Section 7704 of the IRC.

### **Michigan Business Tax Act**

#### **Senate Bill 658**

Public Act 39 of 2011 amended the MBT Act to provide for its eventual repeal and to allow certain taxpayers to continue to claim select credits. The Act eliminates the MBT for most taxpayers effective January 1, 2012, by including in the definition of "taxpayer" only a person or unitary business

group with a certificated credit that wishes to claim the credit and either is not subject to the corporate income tax or elects to file under the MBT rather than the CIT. The definition of "certificated credit" primarily includes credits related to a variety of MBT provisions that awarded a credit to a taxpayer that obtained a voucher or credit certificate under an agreement with the State, for agreements entered into before January 1, 2012. The Act will be repealed when all certificated credits have been exhausted.

The bill would amend the Act as described below.

#### Short Period Tax Years

Under the Act's definition of "tax year", except for the first return required by the Act, a taxpayer's tax year is for the same period as is covered by its Federal income tax return. Under the bill, a taxpayer with a fiscal tax year ending after December 11, 2011, would be considered to have two separate tax years: The first would be for the fractional part of the fiscal tax year before January 1, 2012, and the second would be for the fractional part of the fiscal tax year after December 31, 2011. Each short period tax return filed for each fractional part of the fiscal year would be considered an annual return under Section 505 (which contains annual or final return filing requirements).

#### Health Care Benefit Credit

The Act allows a taxpayer that is an authorized business to claim a credit for payroll and health care benefits attributable to employees who perform qualified new jobs or retained jobs, if the taxpayer receives a certificate issued by the Michigan Economic Growth Authority (MEGA). If MEGA requests the taxpayer to get a statement prepared by a CPA verifying that the actual number of new jobs created is the same number used to calculate the credit, the taxpayer must get the statement.

Under the bill, for compliance reporting purposes, a taxpayer claiming this credit for health care benefits could report to MEGA the aggregate cost of employer-sponsored coverage applicable to employees performing qualified new jobs and

employees performing retained jobs, as determined by MEGA.

#### Certificated Credits

Under Section 500 of the Act, if a taxpayer elects to file an MBT return and pay the MBT in order to claim a certificated credit or any unused carryforward, the taxpayer must continue to file a return and pay the tax until that credit and any carryforward from it are used up. If a person awarded a certificated credit is a member of a unitary business group, the group is required to file a return and pay the tax, if any, and claim the credit.

Under the bill, if the taxpayer that elected to file an MBT return and pay the MBT were a unitary business group, its return would have to include every person included in the group regardless of whether the person was incorporated.

If a taxpayer with a certificated credit for a multiphase brownfield project elected after the taxpayer's first tax year after December 31, 2011, to pay the MBT, the taxpayer would have to continue to file a return and pay the tax for each subsequent year until the certificated credit was complete and used up.

#### MBT Liability

For tax years beginning after December 31, 2011, a taxpayer's liability under the MBT Act, after application of all credits, deductions, and exemptions, is the greater of the following:

- The amount of the taxpayer's liability under the Act, notwithstanding the calculation required under Section 500, after application of all credits, deductions, and exemptions and any carryforward of any unused credit.
- An amount equal to the taxpayer's liability as computed under Part 2 of the Income Tax Act, after application of all credits, deductions, and exemptions under Part 2, as if the taxpayer were subject to the CIT, less the amount of the taxpayer's certificated credits, including any unused carryforward, that the taxpayer was allowed to claim for the tax year.

In calculating the amount under the second provision, a taxpayer that is a person or unitary business group that has a certificated credit but is not subject to the CIT, and elects to file a return under the MBT Act and pay the MBT, if any, may not include any business loss for any prior year in which the person was not subject to the MBT. Under the bill, instead, the taxpayer could not include a deduction for any business loss that was taken under Section 623(4) of the Income Tax Act for any prior year in which the taxpayer was not subject to the MBT Act. (Section 623 imposes the CIT on a taxpayer with business activity within the State or an ownership interest in a flow-through entity that has business activity within the State, and prescribes the taxpayer's CIT base, subject to various adjustments. Section 623(4) allows a deduction for business loss incurred after December 31, 2011.)

Also, for a partnership or an S corporation, business income would include payments and items of income and expense that were attributable to business activity of the partnership or S corporation and separately reported to the members.

#### Method of Computation; Short Period Returns

Under Section 503 of the MBT Act, if the first tax year of a taxpayer subject to the Act is less than 12 months, the taxpayer may elect to compute the tax for the first tax year according to one of two prescribed methods.

Under the bill, the method chosen by a taxpayer that was subject to the MBT and the CIT for a portion of the same tax year would have to be the same as the method the taxpayer used when computing the CIT for the other portion of the same tax year.

A taxpayer that was subject to the MBT and required to file two separate short period annual returns encompassing a fractional part of the taxpayer's same fiscal tax year would have to elect to compute the MBT for each short period return for each respective portion of the same fiscal tax year using the same method as provided in Section 503. A taxpayer that filed two separate short period annual returns for a fractional part of the same year as provided in this provision and Section 117(4) would have to calculate and claim its credits based on actions taken or

payments made during the period represented on each short period return of those parts of the tax year. (Section 117(4) contains the definition of "tax year", and provides that if a return is made for a fractional part of a year, tax year means the period for which the return is made.)

#### Disregarded Entity

The bill specifies that a United States person that was a disregarded entity for Federal income tax purposes under the IRC would have to be treated as a disregarded entity for income tax purposes under the MBT Act. A person other than a United States person that was a disregarded entity for Federal income tax purposes under the IRC could not be treated as a disregarded entity for income tax purposes under the MBT Act.

- MCL 206.653 (S.B. 650)
- 206.669 (S.B. 651)
- 206.651 (S.B. 652)
- 206.607 (S.B. 653)
- 206.685 (S.B. 654)
- 206.671 (S.B. 655)
- 206.665 (S.B. 656)
- 206.611 (S.B. 657)
- 208.107 et al. (S.B. 658)
- Proposed 206.673 (S.B. 659)
- MCL 206.681 (S.B. 660)
- 206.508 (S.B. 661)
- 206.510 (S.B. 662)
- 206.522 (S.B. 663)
- 206.115 (S.B. 664)
- 206.603 (S.B. 665)
- 206.605 (S.B. 666)
- 206.609 (S.B. 667)
- 206.623 (S.B. 668)
- 206.621 (S.B. 669)
- 206.703 (S.B. 670)
- 206.667 (S.B. 671)
- 206.683 (S.B. 672)
- 206.663 (S.B. 673)
- 206.661 (S.B. 674)
- 206.625 (S.B. 675)
- 206.607 (S.B. 676)
- 206.705 (S.B. 677)
- Proposed 206.699 (S.B. 678)
- MCL 206.711 (S.B. 679)
- 206.701 (S.B. 680)
- 206.251 (S.B. 681)

Legislative Analyst: Suzanne Lowe

## **FISCAL IMPACT**

The bills would generally have one of three types of impact on State General Fund revenue:

- 1) Little or no fiscal impact, largely because the bill represents technical clarifications or corrections.
- 2) A zero or minimal fiscal impact, generally of an unknown magnitude, but no fiscal impact relative to the estimates made when the statute was amended in May 2011. (In these cases, the language adopted in May 2011 was assumed to be consistent with the revenue estimates, but now it has been realized that certain adjustments need to be made to the language.)
- 3) A fiscal impact relative to the prior estimates.

The following bills fall under the first category, and are not expected to have a fiscal impact:

- SB 651 (codifies rules issued under a revenue administrative bulletin)
- SB 652 (corrects reference to Federal agency)
- SB 656 (clarifies apportionment issue regarding software)
- SB 658 (primarily clarifies provisions in the MBT Act regarding certificated credits and the transition to the corporate income tax)
- SB 660 (clarifies references to tax base and required estimated payments)
- SB 661 (clarifies definition of household resources)
- SB 662 (clarifies definition of income)
- SB 664 (corrects effective date of apportionment changes)
- SB 666 (corrects circular reference in definition of corporation)
- SB 667 (clarifies definitions of person and shareholder)
- SB 668 (clarifies definitions of net income and business loss)
- SB 669 (codifies definition issued under revenue administrative bulletin)
- SB 671 (clarifies reference to the State Treasurer)
- SB 672 (clarifies computation methods across shortened tax years)
- SB 673 (clarifies legislative intent statement regarding apportionment)

- SB 674 (clarifies applicability of apportionment formula to certain entities)
- SB 675 (clarifies apportionment provisions regarding certain export sales)
- SB 677 (clarifies description of persons required to make withholding payments)
- SB 680 (clarifies description of persons required to make withholding payments)
- SB 681 (corrects reference in statute)

The following bills fall under the second category. These bills potentially have a fiscal impact relative to the language currently in statute (and adopted in May 2011), although many do not, and when such a fiscal impact may be present it is not an impact relative to the revenue estimates made when the May 2011 changes were adopted:

- SB 650 (regarding nexus provisions)
- SB 653 (regarding the definition of members of flow-through entities)
- SB 654 (regarding calculating gross receipts for filing threshold purposes)
- SB 655 (regarding small business credit disqualifications)
- SB 657 (regarding partial year membership in unitary business groups and inclusion of certain foreign taxpayers)
- SB 663 (regarding computing the homestead property tax credit for seniors with incomes over \$21,000)
- SB 665 (regarding computing business income for mutual or cooperative electric companies)
- SB 670 (regarding withholding requirements, which could affect the timing of when the State receives certain payments)
- SB 676 (regarding the definition of gross receipts, which is now used only for determining requirements to file a return)
- SB 678 (regarding the treatment of foreign entities disregarded for Federal income tax purposes)
- SB 679 (regarding withholding requirements, which could affect the timing of the State's receipt of certain payments)

Senate Bill 659 is an example of a bill described under the third category, and is expected to increase General Fund revenue

by approximately \$15.0 million to \$20.0 million per year.

The bills would have no impact on local unit revenue or expenditure.

Fiscal Analyst: David Zin

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This analysis was prepared by nonpartisan Senate staff for use by the Senate in its deliberations and does not constitute an official statement of legislative intent.