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INCOME TAX: WITHHOLDING FOR FLOW-THROUGH ENTITIES

House Bills 4558 and 4559
Sponsor: Rep. Paul Condino

House Bills 4560 and 4562
Sponsor: Rep. Paula K. Zelenko

House Bill 4561
Sponsor: Rep. William J. O'Neil

House Bills 4563 and 4565
Sponsor: Rep. Barbara Farrah

House Bill 4564
Sponsor: Rep. Jack Minore

Committee: Tax Policy
Complete to 4-28-03

A SUMMARY OF HOUSE BILLS 4558-4565 AS INTRODUCED 4-10-03

House Bill 4561 would amend the Income Tax Act (MCL 206.351) to extend the withholding requirements that are currently imposed on employers so that they would apply to 1) distributions made by flow-through entities to nonresident members; 2) winnings reportable under federal tax law by casinos licensed under the Michigan Gaming Control and Revenue Act; and 3) winnings reportable under federal tax law by race meeting licensees and track licensees operating under the Horse Racing Law of 1995. The bill would take effect October 1, 2003.

[Note: With regard to flow-through entities, generally speaking, any income, gain, loss, deduction, or credit is not taxed to the entity itself, but rather “flows through” to the individual partner’s or member’s tax return. Flow-through entities include S corporations, partnerships, limited liability partnerships, and limited liability companies. The term is defined for the purposes of this package in House Bill 4565, described later. The Michigan Gaming Control and Revenue Act does not, generally speaking, apply to gaming conducted in the state under the federal Indian Gaming Regulatory Act.]

The other bills in the package are all tie-barred to House Bill 4561, meaning that they cannot take effect unless House Bill 4561 takes effect, and each bill would amend a separate section of the Income Tax Act essentially to implement the withholding requirements of House Bill 4561. Each bill would have an effective date of October 1, 2003.

Under the Income Tax Act, employers are required to withhold a tax on the compensation of an individual in an amount equal to the product of the rate set forth in Section 51 of the act (4 percent for the 2003 tax year, 3.9 percent for the 2004 tax year and subsequent years) and the compensation (less an amount for any personal and dependency exemptions).

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House Bill 4561 would amend the act to require flow-through entities to withhold a tax in an amount based on the same method for employers, as stated above. If the flow-through entity is a nonresident member of a separate flow-through entity in this state, the entity in this state would withhold the tax on behalf of the nonresident flow-through entity and all nonresident members of the nonresident flow-through entity.

In addition, every casino licensee licensed under the Michigan Gaming Control and Revenue Act would be required to withhold a tax in an amount equal to the product of the rate set in section 51 and the winnings reportable by a casino licensee in accordance with the federal Internal Revenue Code. Further, every race meeting licensee or track licensee licensed under the Horse Racing Law of 1995 would be required to withhold a tax in an amount equal to the product of the rate set in section 51 and the payoff price on a winning ticket reportable under the Internal Revenue Code. The bill would also delete a provision pertaining to the failure of a corporation to pay the tax or file a return. That provision, however, is substantially similar to a provision in the revenue act [MCL 205.27A(5)] that would be amended by House Bill 4567.

Finally the bill would extend other requirements for employers when withholding a tax to the flow-through entities, casinos, and race meeting/track licensees. More specifically, the flow-through entity, casino, or race meeting/track licensee would be required to pay the tax within 15 days of the end of the month; hold the amount as a trustee for the state, and be liable for the payment to the state (though not liable to any individual); and provide copies of any exemption certificates whereby a nonresident member or individual subject to the casino or race meeting withholding claims more than nine personal or dependency exemptions, claims a status that exempts that individual, or elects to pay the tax.

House Bill 4558 would amend the definition of “tax” under the Income Tax Act (MCL 206.22) so that “tax” would include any taxes required to be withheld by a flow-through entity on nonresident members’ share of income available for distribution.

House Bill 4559 would amend the definition of “taxpayer” under the Income Tax Act (MCL 206.26) to include any flow-through entity required to withhold taxes on a nonresident member’s share of income available for distribution.

House Bill 4560 would amend the Income Tax Act (MCL 206.315) to permit a nonresident member who has income in the state from a flow-through entity to elect to be included in the composite income tax return of a flow-through entity of which the nonresident member is a member. Similarly, the bill would permit a flow-through entity to file a composite income tax return on behalf of electing nonresident members and report and pay the tax due based on the electing nonmembers’ shares of income available for distribution from the flow-through entity for doing business in, or deriving income from, sources within the state. Further, a nonresident member that has been included in a composite tax return and that files an individual income tax return for the same taxable period would be permitted to claim a credit on the individual income tax return for the amount of taxes paid on behalf of the nonresident member by the flow-through entity on the composite return. A composite income tax return would be due on or before April 15th of each year and include information required by the department for the immediately preceding calendar year.

House Bill 4562 would amend the Income Tax Act (MCL 206.355) to extend all provisions pertaining to the administration, collection, and enforcement of the act to flow-through entities, casino licensees under the Michigan Gaming Control and Revenue Act, and race meeting/track licensees licensed under the Horse Racing Law of 1995 required to withhold taxes. Further, the bill would add that if the Department of Treasury has reason to believe that a flow-through entity, casino licensee, or race meeting/track licensee will not pay taxes withheld, or in order to provide a more efficient administration, the department could require the flow-through entity, casino licensee, or race meeting/track licensee to make the return and pay the taxes withheld at other than monthly periods, or require the flow-through entity, casino licensee, or race meeting/track licensee to deposit the tax in an approved bank, in trust and payable to the department. [Note: the provisions described above currently apply to an employer. This bill would extend those provisions to flow-through entities, casino licensees, and race meeting/track licensees.]

House Bill 4563 would amend the Income Tax Act (MCL 206.365) to require flow-through entities, casino licensees, and race meeting/track licensees to provide a statement of the tax withheld. Under the act, every employer required to withhold taxes is also required to furnish employees with a statement of the amount of compensation and the amount of taxes withheld. The bill would require flow-through entities to provide nonresident members with a statement of the share of income available for distribution and the amount of tax withheld; casino licensees to provide a person with winnings with a statement of the amount of winnings and the amount of tax withheld; and race meeting/track licensees to provide to each payoff on a winning ticket a statement of the amount of the payoff and any tax withheld.

House Bill 4564 would amend the Income Tax Act (MCL 206.451) to require business entities other than a domestic corporation or foreign corporation (as they are already covered under current law) to request a tax clearance certificate, stating that taxes are not due, from the Department of Treasury if they submit a certificate of dissolution or request a certificate of withdrawal from the state.

House Bill 4565 would amend the Income Tax Act (MCL 206.12) to define “flow-through entity”, “member of a flow-through entity”, and “nonresident member” of a flow-through entity. Under the bill, a flow-through entity would mean an S corporation, partnership, limited partnership, limited liability partnership, or limited liability company. A member of a flow-through entity would be defined as a shareholder of an S corporation; a partner in a partnership or limited partnership; or a member of a limited liability company. A nonresident member would be an individual who is not domiciled in the state; a nonresident estate or trust; or a flow-through entity with a nonresident member.

Analyst: M. Wolf

■ This analysis was prepared by nonpartisan House staff for use by House members in their deliberations, and does not constitute an official statement of legislative intent.