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VOLUNTARY TAX DISCLOSURE

House Bill 5580 (Substitute H-2)
First Analysis (2-24-98)

Sponsor: Rep. Barbara Dobb
Committee: Tax Policy

THE APPARENT PROBLEM:

The term "nexus" is used by tax specialists to refer to the amount or level of presence in a state that is required before a company is subject to taxation by that state given the restrictions of the Commerce Clause of the United States Constitution. This is a complex and changing concept. It has been the subject of several recent influential court decisions. The Michigan Department of Treasury is poised to release a new revenue administrative bulletin (RAB) on the topic of single business tax (SBT) nexus standards. That bulletin, now expected to be issued the week of February 22-28, will provide the department's current interpretation of current law, taking into account, among other things, two 1993 Michigan Court of Appeals decisions and one 1997 decision on the subject. They in turn were based on a 1992 United States Supreme Court decision. The RAB, generally speaking, will explain when a company is considered subject to tax in Michigan and when a company is considered taxable in another state for purposes of making Michigan SBT calculations. (See Background Information.)

Legislation has been prepared in anticipation of the RAB. It would limit the impact of the bulletin on companies that have not filed single business tax returns but, based on the nexus standards in the new bulletin, should have.

THE CONTENT OF THE BILL:

The bill would amend the revenue act to allow the revenue commissioner to enter into a voluntary disclosure agreement with a "nonfiler" who 1) has a filing responsibility under nexus standards issued by the Department of Treasury after December 31, 1997; or 2) contests liability for a tax or fee administered under the revenue act as determined by the commissioner. All taxes and fees administered under the revenue act would be eligible for inclusion in a voluntary disclosure agreement. The term "nonfiler" would refer to a person that has never filed a return for the particular tax being disclosed. The term "person" would refer to an individual, firm, bank, financial institution, limited partnership, copartnership, partnership, joint venture, association, corporation, limited liability company, limited liability partnership, receiver, estate, trust, or other group or combination acting as a unit.

If a person satisfied the bill's requirements (as described later), the Department of Treasury could enter an agreement providing the following relief:

-- no assessment of any tax, delinquency for a tax, penalty, or interest covered under the agreement for any period before the "lookback period" identified in the agreement.

-- no assessment of any applicable discretionary or non-discretionary penalties for the lookback period.

-- complete confidentiality of the agreement, with no disclosure of any of the terms or conditions of the agreement to any tax authorities of any state or governmental authority or to anyone, except as required by certain specified exchange-of-information agreements, including the International Fuel Tax Agreement.

Further, the department could not bring a criminal action against a person for failure to report or to remit any tax covered by the agreement before or during the lookback period if the facts established by the department were not materially different from the facts disclosed by the person to the department.

The lookback period would be defined to refer to:

-- the most recent 48-month period as determined by the department or the first date the person subject to an agreement began doing business in the state, if that is less than 48 months;

-- for single business taxes, the four most recent completed fiscal or calendar years over a 48-month period or when a person began doing business in the state, if less than 48 months;

-- the most recent 36-month period if the taxpayer had filed tax returns in another state for a tax based on net income that included sales in the numerator of the apportionment formula that now must be included in the

numerator of the apportionment formula under the SBT and those sales increased the net tax liability of the taxpayer to that state; or

-- if there is doubt as to liability for the tax during the lookback period, another period as determined by the commissioner to be in the best interest of the state and to preserve equitable and fair administration of taxes.

To be eligible for a voluntary disclosure agreement, a person would have to meet all of the following requirements:

-- have had no previous contact by the department or its agents, including the multistate tax commission, regarding a tax covered by the agreement;

-- have had no notification of an impending audit by the department or its agents, including the multistate tax commission;

-- was not currently under audit by the department or under investigation by any state or local law enforcement agency regarding a tax covered by the agreement;

-- was not currently the subject of a civil action or a criminal prosecution involving any tax covered by the agreement;

-- had agreed to register, file returns, and pay all taxes due in accordance with all applicable laws of the state for all taxes administered under the revenue act for all periods after the lookback period;

-- had agreed to pay all taxes due for each tax covered under the agreement for the lookback period, plus statutory interest, within the period of time and in the manner specified in the agreement;

-- had agreed to file returns and worksheets for the lookback period as specified in the agreement; and

-- had agreed to all other terms and conditions specified by the commissioner, or his or her authorized representative, on behalf of the department, in the agreement.

A voluntary disclosure agreement would become effective when it was signed by the person subject to the agreement or that person's representative and returned to the department. The department could only provide the relief specified in the agreement. Any verbal or written communication by the department before the effective date of the agreement would not afford any penalty waiver, limited lookback period, or other benefit otherwise available under the bill.

A material misrepresentation of fact by an applicant relating to the applicant's current activity in the state would render an agreement null and void and of no effect. A change in the activities or operations of a person after the agreement's effective date would not be a material misrepresentation of fact and would not affect the agreement's validity.

The department could audit any of the taxes covered by the agreement within the lookback period or in any prior period if, in the department's opinion, an audit of a prior period was necessary to determine the person's tax liability for the tax periods during the lookback period or to determine another person's tax liability.

The bill would specify that any nonfiler who prior to the effective date of the bill received a letter of inquiry from the department, whether a final letter or otherwise, would qualify for a voluntary disclosure agreement if the nonfiler sent a written request for a voluntary disclosure agreement to the department within 180 days after the bill's effective date.

Nothing in the bill would permit or allow unjust enrichment. The term "unjust enrichment" would be defined to include the withholding of income tax and the collection of any other tax administered under the revenue act that had not been remitted to the department.

The bill is tie-barred to House Bill 4910, which would amend the Single Business Tax Act to eliminate the "throwback" rule. (See HLAS analysis dated 10-21-97.)

MCL 205.28

BACKGROUND INFORMATION:

Under the SBT, companies that do business in many states, whether headquartered in Michigan or elsewhere, arrive at their "apportioned tax base" by using a three-factor formula based on the proportion of Michigan payroll to total payroll, Michigan property to total property, and Michigan sales to total sales. The three factors were once weighted equally, but the sales factor has become increasingly important. For the 1997 and 1998 tax years, the sales factor counts for 80 percent and for tax years after that 90 percent. The sales factor is defined in the SBT Act as a fraction with the numerator equal to total sales in Michigan for the tax year and the denominator equal to total sales everywhere. The "throwback rule" in the SBT Act says that a sale from Michigan into a state where the company making the sale is not taxable is considered a sale in Michigan. (House Bill 4910, which has passed the House, would repeal the throwback rule.)

So, nexus standards are important in several ways. If a company does not have sufficient presence in Michigan, it is not subject to the SBT. Also, with the throwback rule, if a company can establish that it is subject to tax in a state into which sales are made from Michigan (that is, that nexus exists in that state), it need not count those sales in the Michigan SBT base. Thus, in separate recent court cases, broadly speaking, one out-of-state company with sales into Michigan argued that the presence of 18 sales representatives in Michigan did not constitute sufficient nexus for tax purposes (the court disagreed) while another company selling from Michigan argued successfully that two weeks per year of visits from sales representatives to the other state and the presence there of independent sales representatives was a substantial enough presence to be considered taxable there.

FISCAL IMPLICATIONS:

According to estimates from the Department of Treasury, new nexus standards, in combination with the voluntary disclosure program created by House Bill 5580, are expected to bring in additional revenue of $20 million annually. This would offset an ongoing annual loss of $20 million from eliminating the throwback rule. Additionally, the department anticipates having to pay $27 million in refunds from two 1993 court cases on nexus, Guardian and Gillette. This is a one time cost. (Treasury estimates dated 2-19-98)

ARGUMENTS:

For:

The bill would create a voluntary disclosure program for those who have not filed tax returns with the state but should have under nexus standards issued by the Department of Treasury in 1998 and thereafter. Under the bill, a non-filer could come forward and enter into a voluntary disclosure agreement with the department over taxes and fees that are owed. The lookback period would be limited to four (or, in some cases, fewer) years; no penalties could be assessed for that period; confidentiality would be provided the taxpayer; and no criminal actions could be brought. Taxes and interest for the lookback period would be assessed. Without the bill, some non-filers might have tax liabilities going back to 1989 (or even beyond). The protections offered by the voluntary disclosure program will encourage non-filers to come forward.

Although it applies to other taxes as well, the bill is said to be part of a three-pronged approach to the issue of nexus and the single business tax. The other components are a Department of Treasury revenue administrative bulletin on single business tax nexus standards expected before the end of February and proposed legislation to

eliminate the so-called throwback rule (House Bill 4910, which has already passed the House). The bill anticipates the revenue administrative bulletin and would limit its application. Generally speaking, the nexus standards in the new bulletin are expected to reflect recent court decisions and require less of a presence by companies in order for them to be taxable than the standards in the department's 1986 bulletin. The department's view is that the 1986 bulletin was overruled by two 1993 state court of appeals decisions issued on March 1, 1993. Because of the impact nexus standards can have on single business tax liability, the court decisions (and the new bulletin) require the payment of refunds to some taxpayers and require some companies that have not filed returns with the state to pay taxes. The bill, by limiting the lookback period, would reduce the number of past years for which the department can seek tax payments from nonfilers.

Against:

Some people say the revenue bulletin about to be issued by the Department of Treasury should not have any retroactive application that would increase taxpayer SBT liability. To apply the "new" nexus standards retroactively is to make actions that were legal when they were performed illegal after the fact. This is not fair. The department has not up to now been enforcing these standards and it has never formally rescinded its 1986 bulletin on the subject. While this bill would provide limited relief to businesses from the new bulletin, it would be fairer if the bulletin only had prospective application.

Response:

Some supporters of this bill share the sentiments in the argument made above. However, as a practical matter, this bill may be the most protection that can be offered.

POSITIONS:

The Department of Treasury testified in support of the bill. (2-18-98)

Analyst: C. Couch

■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.