

Senate Fiscal Agency
P. O. Box 30036
Lansing, Michigan 48909-7536

SFA**BILL ANALYSIS**

Telephone: (517) 373-5383
Fax: (517) 373-1986
TDD: (517) 373-0543

Senate Bill 872 (as enrolled)
Sponsor: Senator Joanne G. Emmons
Senate Committee: Finance
House Committee: Finance

PUBLIC ACT 493 of 1998

Date Completed: 2-25-99

RATIONALE

In February 1998, the Department of Treasury issued new single business tax (SBT) "nexus" standards that determine whether a taxpayer is subject to tax under Michigan's SBT or is subject to tax in another state for purposes of apportionment under the SBT Act. Since the new standards are retroactive to 1989, this meant that some taxpayers could incur substantial penalties for single business taxes they owed for past years. Therefore, Public Act 221 of 1998 amended the revenue Act to encourage these firms to pay their taxes. Under Public Act 221, a qualified person and the Department of Treasury may enter into a voluntary disclosure agreement under which the person must pay all taxes for a "lookback period" (generally a 48-month period) and the Department may not assess a penalty for the lookback period or impose any tax, delinquency, or interest for a previous period. At the same time, Public Act 225 of 1998 amended the SBT Act to eliminate a so-called "throwback rule", under which a sale of personal property was considered to be a sale in Michigan (and taxed under the SBT) if the property was shipped from a location in this State and the taxpayer was not taxable in the state of the purchaser.

Since Public Act 221 was enacted, several changes beneficial to taxpayers were suggested.

CONTENT

The bill amended the revenue Act to extend the deadline for entering into a voluntary disclosure agreement; revise the criteria for an eligible person; impose additional conditions upon a person entering into an agreement; and require, rather than permit, the Department to enter into an agreement if a person satisfies all of the criteria.

Under the bill, the Department may enter into a voluntary disclosure agreement with a nonfiler (someone who has never filed a return for the tax

being disclosed) if the nonfiler 1) has a filing responsibility under nexus standards issued by the Department after December 31, 1997, and/or 2) has a reasonable basis to contest liability for a tax or fee administered under the Act. (Previously, the second criterion referred to a nonfiler who "contests" liability for a tax or fee.)

To be eligible for a voluntary disclosure agreement, a person must meet certain requirements, including having had no previous contact by the Department or its agents regarding a tax covered by the agreement. Previous contact does not include a letter of inquiry (stating the Department's opinion that the taxpayer needs to furnish further information or owes taxes) sent to a nonfiler, if the nonfiler sends a written request to the Department to enter into a voluntary disclosure agreement. Originally, the request had to be sent within 180 days after the enactment of Public Act 221 (that is, by December 28, 1998). Under the bill, the request must be sent by June 30, 1999. (The bill also redefined "previous contact", which originally had meant any notification of an impending audit, review, or any type of notice or assessment. Under the bill, "previous contact" means any notification of an impending audit, review, notice of intent to assess, or assessment.)

In addition, the bill provides that a person must agree not to file a protest or seek a refund of taxes paid to the State for the lookback period based on the issues disclosed in the agreement or based on the person's lack of nexus or contacts with this State.

Under the bill, if a person satisfies all of the eligibility requirements, the Department must enter into a voluntary disclosure agreement. Previously, the Department was permitted to do so.

The bill also prohibits the Department from requiring a person who enters into a voluntary disclosure agreement to make any filings that are

additional to those otherwise required by law.

MCL 205.30c

BACKGROUND

The term “nexus” refers to the connection a person has with a state. As a rule, for a state’s tax to be constitutional, a taxpayer must have sufficient nexus with the state imposing the tax. In 1992, a U.S. Supreme Court opinion addressed the nexus requirement and indicated that a degree of physical presence is necessary (*Quill Corp. v North Dakota*, 504 US 298). Subsequent Michigan Court of Appeals holdings applied this decision to cases involving multistate firms’ liability under the SBT Act (*The Gillette Co. v Michigan Department of Treasury*, 198 Mich App 303 (1993); *Guardian Industries Corp. v Michigan Department of Treasury*, 198 Mich App 363 (1993); and *Magnetek Controls, Inc. v Michigan Department of Treasury*, 221 Mich App 400 (1997)).

The SBT is based upon a measure of business activity in Michigan. A firm that conducts all of its activities in this State must include all of those activities in its tax base. A multistate firm must determine how much of its business activity is attributable to Michigan. This is accomplished by using a weighted formula that calculates the ratio of the firm’s property, payroll, and sales in Michigan to its entire property, payroll, and sales, and apportioning the firm’s tax base accordingly.

In regard to the sales factor, the Act also had specified that a sale of personal property was attributable to Michigan if the taxpayer was not taxable in the state where the property was purchased. Referred to as the “throwback rule”, this applied to situations in which property was shipped from a location in Michigan to a purchaser in another state. The Court of Appeals decisions were relevant to the throwback rule because, if a single business taxpayer had sufficient nexus within another state where sales were made, the rule did not apply (and the sale was not attributable to Michigan).

According to the Department of Treasury, the Court of Appeals decisions invalidated the Department’s reliance on Federal law with respect to nexus. Consequently, the Department issued new nexus standards in Revenue Administrative Bulletin 98-1. The new standards were approved on February 24, 1998, and apply to “all open tax periods ending on or after January 1, 1989”. Subsequently, Public Act 221 of 1998 was enacted to allow voluntary disclosure agreements, and Public Act 225 of 1998 eliminated the throwback rule.

(For more information about the nexus requirement and the Court of Appeals decisions, please see the Senate Fiscal Agency’s First Analysis of Senate Bills 872 and 890, dated 2-25-98.)

ARGUMENTS

(Please note: The arguments contained in this analysis originate from sources outside the Senate Fiscal Agency. The Senate Fiscal Agency neither supports nor opposes legislation.)

Supporting Argument

Because the Department of Treasury’s new nexus standards are retroactive through 1989, there was concern that some firms could incur sizeable penalties for single business taxes they owed for past years. By eliminating the penalties that otherwise may be assessed for late payment of taxes, Public Act 221 was designed to help encourage these taxpayers to come forward and disclose their prior-year tax liabilities under the new standards. At the same time, the Act also saves the Department’s audit resources. Senate Bill 872 will enhance these benefits by expanding the opportunity for taxpayers to take advantage of the voluntary disclosure program, as well as requiring the Department to enter into an agreement if the eligibility criteria are met. In addition, the bill ensures that a nonfiler entering into an agreement will not file a protest or seek a refund for the lookback period.

Legislative Analyst: S. Lowe

FISCAL IMPACT

Fiscal information is not available.

Fiscal Analyst: J. Wortley

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