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House Bill 5643 (Substitute S-1 as reported)  
 Sponsor: Representative Philip LaJoy  
 House Committee: Commerce  
 Senate Committee: Economic Development, Small Business and Regulatory Reform

Date Completed: 8-13-04

**RATIONALE**

Under the Single Business Tax Act, some firms may file a consolidated return if they meet certain criteria. For example, the firms must comprise an affiliated group of U.S. corporations, and each member of the group must maintain a relationship with one or more members that includes "intercorporate transactions of a substantial nature". In order to file a consolidated return, businesses first must file a request with the State Tax Commission before the date set for filing the annual SBT return, and must receive the Commission's approval. Some people believe that this requirement represents an unnecessary administrative burden for firms desiring to file on a consolidated basis.

-- The business activities of each member are subject to apportionment by a specific formula contained in the Act, which also applies to all other members of the group, and would apply to each member even if it were not a member of the affiliated group.

The bill would retain these criteria but permit a taxpayer to elect to file a consolidated or combined return.

The bill would take effect for tax years beginning after December 31, 2004.

(The Act defines "affiliated group" as two or more United States corporations, one of which owns or controls, directly or indirectly, 80% of more of the capital stock with voting rights of the other U.S. corporation or corporations. According to Revenue Administrative Bulletin (RAB) 1989-49, "Substantial intercorporate transactions are qualified transactions between a 'selling member' and a 'purchasing member' of the affiliated group. Intercorporate transactions are transactions giving rise to a business activity as defined in the SBTA and connected directly with the business conducted by the members. Intercorporate transactions must be substantial in nature as such transactions relate to the total business activity of the member." The RAB contains specific criteria, developed by the Treasury Department, for determining whether a member corporation has substantial intercorporate transactions.)

MCL 208.77

**CONTENT**

The bill would amend the Single Business Tax Act to allow a taxpayer that is an affiliated group of United States corporations to file a consolidated or combined return, if the taxpayer met the criteria in the Act.

Currently, the Commission may require or permit an affiliated group of U.S. corporations to file a consolidated or combined return if all of the following conditions exist:

- All members of the consolidated group are Michigan taxpayers.
- Each member maintains a relationship with one or more members of the group that includes intercorporate transactions of a substantial nature other than control, ownership, and/or financing arrangements.

## **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**

Businesses should have the prerogative to file their single business tax returns in the way they consider most advantageous. If this means filing a consolidated return with affiliated taxpayers, they should be allowed to do so without prior consent of the State Tax Commission. Presumably, businesses and their accountants know what they are doing and what is best for the companies. Presently, however, taxpayers must complete a form that requires them to list reasons for requesting consolidated or combined filing, and give pertinent information to support the request. Then, the taxpayers must wait for the Treasury Department to determine whether they meet the criteria for consolidated filing. The bill would streamline the filing process for some taxpayers by cutting this red tape and eliminating the waiting time.

At the same time, the bill would retain the Act's stringent criteria for consolidated filing. The Department still would have the authority to reject a consolidated return that did not meet the statutory requirements. If a consolidated filing were contested, however, Treasury would have to bear the burden of proving the taxpayer's ineligibility.

### **Opposing Argument**

According to a spokesperson for the Department of Treasury, the Department rejects 60% of the applications for consolidated filing because the taxpayers do not meet the statutory criteria. A request might be rejected, for example, because the affiliated businesses do not have the same accounting period, are not subject to the same apportionment formula, or do not all have a connection with Michigan. Also, the requirement for "intercorporate transactions of a substantial nature" is complex. In many cases, the taxpayers simply do not know what the criteria are or do not understand them. Given the high proportion of applications that currently are rejected, every taxpayer filing a consolidated return would be a likely candidate for an audit, if businesses did not have to obtain prior approval from the State Tax Commission.

The Department then would have to take measures to pursue ineligible taxpayers.

Furthermore, even if a taxpayer did not have to obtain prior permission, the business still would have to compute what its tax liability would be if it filed separately as well as if it filed a consolidated return, and decide which method to use before filing. Rather than finding out in advance whether it met the statutory criteria, however, the business would likely undergo an audit after filing. Unqualified taxpayers who filed a consolidated return could realize a temporary tax cut, and then have to repay the State after being audited, potentially with interest and penalties. It is unclear how this would ease an administrative burden.

### **Opposing Argument**

The bill could cost the State up to \$20 million in SBT revenue due to the anticipated increase in consolidated returns, according to the Department of Treasury. Many of these filings no doubt would be legitimate but, based on the current percentage of rejections, it is likely that a high percentage would not. While the State eventually could recover some of the lost revenue through repayments, the Department's auditors probably would not be able to discover all of the consolidated returns that did not meet the statutory criteria. If the auditors did devote the necessary resources to examining all consolidated filings, then they would not have the personnel to audit other types of returns. While the auditing staff was increased recently to address the existing workload, the bill would create one more potential area of noncompliance to investigate.

Furthermore, taxpayers have a four-year window to amend previously filed returns. According to the Department, if businesses chose to amend their returns and file on a consolidated basis, the bill could cost the State \$40 million to \$80 million in refunds.

This proposal comes at time when the State is struggling to balance the budget for both the current and the upcoming fiscal years. The single business tax, which already is being phased out, represents 26% of the General Fund. By reducing single business tax revenue, the bill would erode the State's ability to provide services to its residents.

These services not only improve people's quality of life, but also make Michigan an attractive place to live and do business, which in turn can lead to economic development.

Legislative Analyst: Suzanne Lowe

### **FISCAL IMPACT**

This bill would reduce single business tax revenue by an unknown and potentially significant amount. Under current law, a business must receive permission from the State Treasurer in order to file a consolidated return, and as a result, fewer than 300 businesses are currently allowed to file a consolidated return. The bill would reduce single business tax revenue because the major reason that businesses want to file a consolidated return is to reduce their single business tax liability. The Senate Fiscal Agency does not have access to the data needed to estimate the impact of this bill. The loss in single business tax revenue that would result from the provisions in this bill would affect the General Fund budget.

Fiscal Analyst: Jay Wortley

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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.