

TAX AMNESTY, AFFILIATE NEXUS, AND PENALTIES

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House Bill 5095

Sponsor: Rep. Paul Condino

Committee: Tax Policy

Complete to 8-24-05

A SUMMARY OF HOUSE BILL 5095 AS INTRODUCED 8-17-05

The bill would amend the Revenue Act to do the following.

- Generally speaking, the bill would return to the penalty system for unpaid taxes that existed prior to the passage of Public Act 657 of 2002. The penalties would apply to notices of intent to assess issued after September 30, 2005. The penalties include:
 - ** a penalty of 25 percent of taxes due for remitting a non-negotiable payment (e.g. insufficient funds check). This penalty is in addition to other penalties imposed by the act. [The current penalty is \$50.]
 - ** a penalty for failure to file or pay income tax withholding, sales taxes, and use tax liabilities of at least \$300 of \$10 or five percent of the tax due, whichever is greater, for the first month, and five percent for each additional month, up to a maximum of 50 percent. [The current penalty is five percent for the first two months and five percent for each additional month, up to a maximum of 25 percent.]
 - ** a maximum penalty of 50 percent for taxpayers who fail to pay state income tax withholding in the same manner as the federal withholding schedule (when required). [The current maximum penalty is 25 percent.]
- The bill would establish a tax amnesty period from January 1, 2006 to February 28, 2006, during which all criminal and civil penalties for failing to file a return, failing to pay a tax, or making excessive claims for a refund would be waived by the state treasurer.
- The bill would create an affiliate nexus standard for use in imposing single business, sales, and use taxes, as well as other taxes administered under the Revenue Act. An enterprise subject to a state tax and an out-of-state affiliate of that enterprise would be jointly and severally liable for any tax administered under the act if one or more specified criteria were met (as explained later). This would apply to tax years beginning on or after January 1, 2006, for taxes other than the use tax. For the use tax, it would apply to taxes collected beginning October 1, 2005.

The following is a more detailed description of the bill's provisions.

Tax Amnesty

The bill would establish a tax amnesty period from January 1, 2006 to February 28, 2006, during which all criminal and civil penalties for failing to file a return, failing to pay a tax, or making excessive claims for a refund would be waived by the state treasurer. To participate in the amnesty, taxpayers would have to make a written request for a waiver, file a return or amended return, and make full payment in a lump sum or in installments. For installment payments, individual taxpayers would have to submit \$10,000 or half of the total tax and interest due, whichever is greater, at the time of the waiver request, and pay the remaining balance in two equal installments due by February 15, 2006 and March 15, 2006. To pay in installments, business would have to submit \$100,000 or half of the total tax and interest due, whichever is greater, with the waiver request. The remaining balance would also be paid in two equal installments due by February 15, 2006 and March 15, 2006. The amnesty period would apply to taxes due on or before September 30, 2005. Except for various dates, the provisions are the same as provided for in the last amnesty period conducted in 2002 pursuant to Public Act 168 of 2001. The bill also deletes language from the 2001 act appropriating \$1.5 million from the money received under program for administration purposes.

Out-of-State Affiliate Nexus

As mentioned earlier, the bill would add a provision establishing an affiliate nexus standard in imposing the single business tax, sales tax, use tax, and other taxes administered under the revenue act. Specifically, the bill provides that a person (i.e., a business enterprise) subject to a state tax and an out-of-state affiliate of that enterprise would be jointly and severally liable for any tax administered under the act if one or more listed criteria were met. This would apply notwithstanding the form of business organization or the existence of an agency relationship or the lack of an agency relationship. The bill would apply for tax years beginning on or after January 1, 2006 for taxes administered under the Revenue Act, except for taxes collected under the Use Tax Act, to which the bill would apply to taxes collected beginning October 1, 2005. The criteria are:

- The person and the out-of-state affiliate use an identical or substantially similar name, trade name, trademark, or goodwill to develop, promote, or maintain sales.
- The person and the out-of-state affiliate pay for each other's services in whole or in part contingent on the volume or value of sales.
- The person and the out-of-state affiliate share or exchange value in the operation of their businesses.
- The person and the out-of-state affiliate substantially coordinate common business plans.

Under the bill, an out-of-state affiliate subject to a tax administered under the Revenue Act would be considered to have substantial nexus with Michigan for any tax administered under the act if the affiliate met one or more of the criteria cited above. This would be the case notwithstanding the form of business organization or the existence of an agency relationship or the lack of an agency relationship.

The term "out-of-state affiliate of a person subject to a tax administered under [the revenue act]" would mean any out-of-state person who directly, indirectly, or constructively owns or controls, is owned or controlled by, or is under common ownership or control with a person subject to a tax under the act.

The bill also would state that "Nothing in this section shall be interpreted to limit the taxing jurisdiction of this state under the constitution of the United States".

[Note: This provision was originally part of package of tax loophole bills developed by Governor Granholm as part of her FY 2004 Executive Budget Recommendation. The provision would have been added by House Bill 4571 of the 2003-2004 legislative session, introduced by then-Representative Jack Minore. At the time, the Department of Treasury argued that some large businesses have reorganized their divisions into separate legal entities located outside of Michigan, although the divisions continued to do business in Michigan as they did before. The problem, however, is that because they no longer have a sufficient connection ("nexus") with the state, it could be argued that the state would no longer be able to require them to pay taxes, including the SBT and sales tax. Representatives of the business community, however, questioned the constitutionality of the affiliate nexus standard given the due process and commerce clause nexus standards under the U.S. Supreme Court's decision in *Quill Corp. v. North Dakota*.]

Penalties

Under the revenue act, if a taxpayer fails to file a return or make a payment, or supplies insufficient information to make a determination on the tax due, the Department of Treasury first sends a letter of inquiry stating the amount of tax due and why it is due. If, after 30 days, the matter is not resolved, the department then must send a notice of its intent to assess the tax explaining the dispute, the appeals process, and the tax due. If, after 30 days, the matter is still not resolved the department must issue a bill for taxes due (final assessment). After 35 days, the department must take certain enforcement actions to collect payment.

FISCAL IMPACT:

The fiscal impact of House Bill 5095 would depend on public awareness of an amnesty program, taxpayer participation in the program, and the penalties imposed for noncompliance. In FY 2001-02, Michigan's tax amnesty generated new net revenue of \$30.2 million from 4, 225 taxpayers.

BACKGROUND INFORMATION:

Previous Amnesty Programs. In 2002, the state provided a tax amnesty period from May 15, 2002 to July 1, 2002. The amnesty program applied to the following taxes: individual income, single business, sales, use, withholding, estate, inheritance, tobacco, and motor fuel. According to the Department of Treasury, payments received under the amnesty program totaled \$81.9 million. Of that amount, \$31.7 million was paid by new (previously unidentified) taxpayers, and \$50.2 million was paid by taxpayers with existing tax assessments. Additionally, the department spent \$1.5 million and waived \$22.9 million in penalties that could have been collected in the future. According to a February 2003 report, the Department of Treasury estimated that the program increased FY 2002 revenue by \$48.7 million, including expenses, and decreased FY 2003 revenue by \$18.4 million. In all, 20,220 taxpayers filed 66,855 returns, indicating that many filed returns for multiple years. The Department of Treasury's report on the 2002 amnesty program is available at www.michigan.gov/documents/AmnestyReport_59671_7.pdf

Prior to 2002 amnesty program, the state offered a tax amnesty in between May 12, 1986 and June 30, 1986. In that year, a total of 128,218 tax returns were filed, generating \$109.8 million. Of that amount \$44.6 million was paid by new taxpayers, and \$65.2 million was paid by taxpayers with existing tax assessments. In 2002 dollars, the 1986 amnesty generated \$180.2 million, with \$73.2 million from new taxpayers and \$107.0 million from taxpayers with existing tax assessments.

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■ 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.