Legislative Analysis

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REVENUE ACT: PENALTIES AND AFFILIATE NEXUS

House Bill 5095 (Substitute H-1)
Sponsor: Rep. Paul Condino
Committee: Tax Policy

Complete to 8-29-05

A SUMMARY OF HOUSE BILL 5095 (SUBSTITUTE H-1)

The substitute bill would amend the Revenue Act to, generally speaking, return to the penalty system for unpaid taxes that existed prior to the passage of Public Act 657 of 2002, and establish an out-of-state affiliate nexus standard. The introduced version of the bill included a provision establishing a tax amnesty period, which is not included in this substitute. The other provisions in the substitute have not changed.

Out-of-State Affiliate Nexus

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. 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 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-closing" 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

The bill would revise the penalty structure for failing to file a return or pay a tax by generally returning to the penalty system that had been in place prior to Public Act 657 of 2002. The penalties would apply to notices of intent to assess issued after September 30, 2005, and 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.]

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:

Returning to the penalty system for unpaid taxes that existed prior to Public Act 657 of 2002 would increase penalty revenue, all of which is deposited into the GF/GP, by an estimated $20.0 million annually.

Creating an "affiliate nexus" standard for taxes administered under the Revenue Act would generate, according to the Department of Treasury, an estimated $10.0 million in SBT revenue and $15.0 million in use tax revenue. This provision would increase GF/GP revenue by an estimated $20.0 million and School Aid Fund revenue by an estimated $5.0 million.

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