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BILL



ANALYSIS

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Senate Bill 219 (as reported without amendment)  
Sponsor: Senator John Paggageorge  
Committee: Finance

(as enrolled)

Date Completed: 6-10-09

### **RATIONALE**

An issue concerning the treatment of royalty and income payments under the Michigan Business Tax Act has been raised. Essentially, if a taxpayer pays a royalty or interest to a person that is related to the taxpayer by ownership or control, such as a subsidiary or parent company, the amount of the payment must be added to the taxpayer's business income tax base (to the extent that the payment was deducted in determining Federal taxable income), if the related person is a foreign corporation. On the other hand, if the subsidiary or parent company is a domestic corporation, the royalty or interest payment is not included in the taxpayer's business income tax base. Some people are concerned that this disparity could place a tax burden on Michigan businesses that have subsidiaries or parent companies in a foreign country, and it has been suggested that royalty or interest payments made to a related person should not be subject to the business income tax, regardless of whether the recipient is a domestic corporation or a foreign company.

### **CONTENT**

**The bill would amend the Michigan Business Tax Act to exclude from the business income tax base royalty and interest payments to a person organized under the laws of a foreign nation having a comprehensive tax treaty with the United States.**

The Act imposes a business income tax on every taxpayer with business activity in this State. The tax is imposed on the business income tax base, after allocation or apportionment to the State, at a rate of

4.95%. The business income tax base is a taxpayer's business income subject to various adjustments. "Business income" means that part of Federal taxable income derived from business activity, as defined in the Act.

Under the current adjustments, to the extent deducted in arriving at Federal taxable income, a taxpayer must add any royalty, interest, or other expense paid to a person related to the taxpayer by ownership or control for the use of an intangible asset, if the person is not included in the taxpayer's unitary business group (defined below). The addition of a royalty, interest, or other expense is not required, however, if the taxpayer can demonstrate that the transaction has a nontax business purpose other than tax avoidance, is conducted with arm's-length pricing and rates and terms as applied in accordance with the Internal Revenue Code, and satisfies one of the following criteria:

- It is a pass through of another transaction between a third party and the related person with comparable rates and terms.
- It results in double taxation.
- It is unreasonable as determined by the State Treasurer, and the taxpayer agrees that the addition would be unreasonable based on its facts and circumstances.

The bill would add a fourth criterion: The related person recipient of the transaction is organized under the laws of a foreign nation that has in force a comprehensive income tax treaty with the United States.

(The Act defines "unitary business group" as "a group of United States persons, other than a foreign entity, 1 of which owns or controls, directly or indirectly, more than 50% of the ownership interest with voting rights or ownership interests that confer comparable rights to voting rights of the other United States persons, and that has business activities or operations that result in a flow of value between or among persons included in the unitary business group or has business activities or operations that are integrated with, are dependent upon, or contribute to each other".

"United States person" means that term as defined in Section 7701(a)(30) of the Internal Revenue Code, i.e., a citizen or resident of the United States; a domestic partnership; a domestic corporation; an estate (other than a foreign estate); or a trust subject to the supervision of a court within the United States and the control of one or more United States persons.)

MCL 208.1201

## **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**

The bill would prevent the unequal treatment of taxpayers that pay royalties, interest, or other expenses to foreign subsidiaries or parent companies. Requiring taxpayers to include these payments in their business income tax base could inhibit economic activity in Michigan by discouraging foreign corporations from establishing subsidiaries in this State, or discouraging Michigan-based companies from establishing subsidiaries in foreign countries. Business relationships between Michigan firms and foreign companies represent a large part of the State's economy. In Oakland County alone, there evidently are 853 businesses representing 700 foreign-owned firms from 35 countries.

Apparently, the disparate tax treatment under the Act has not been implemented. By bringing the statute into conformity with current practice and policy, the bill would ensure that royalties, interest, and other expenses paid to related foreign companies

were not subject to the business income tax in the future.

Legislative Analyst: Suzanne Lowe

## **FISCAL IMPACT**

The bill's proposed changes to the MBT would clarify and make technical changes to business income involving royalty, interest, and other expenses incurred in certain foreign transactions. As a result, this bill would have no fiscal impact.

Fiscal Analyst: Jay Wortley

### **A0910\S219a**

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.