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BILL ANALYSIS

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Senate Bill 369 (as introduced 5-10-11)
Sponsor: Senator Jack Brandenburg
Committee: Finance

Date Completed: 10-26-11

CONTENT

The bill would amend the Michigan Business Tax (MBT) Act to do the following:

- **Exclude from "business income" income from investment activity that was not in the regular course of the person's trade or business, in the case of a person organized exclusively to conduct investment activity.**
- **Modify the definition of "business income" for an individual, estate, or partnership organized exclusively for estate or gift planning purposes.**
- **Exclude from "gross receipts" receipts from investment activity other than receipts from transactions or activities in the regular course of the person's trade or business, in the case of a person organized exclusively to conduct investment activity.**
- **Revise several adjustments to the business income tax base.**
- **Disallow a personal property tax credit claimed for property that was classified but not included, and allow the credit for property that was included but not classified, as industrial personal property under the General Property Tax Act before the bill's effective date.**
- **Require members of a unitary business group to be treated as a single person for purposes of exemptions, deductions, subtractions, credits, and the filing threshold.**
- **Amend the definition of various terms.**

The bill states that it "is curative and intended to clarify the original intent of 2007 PA 36" (the MBT Act).

Business Income

The Act defines "business income" as that part of Federal taxable income derived from business activity, and includes specific provisions for various kinds of taxpayers.

Under the bill, for a person that is organized exclusively to conduct investment activity and that does not conduct investment activity for any person other than an individual or a group of individuals and for a common trust fund established under the Collective Investments Funds Act, business income would exclude income derived from investment activity unless the activity were in the regular course of the person's trade or business.

Currently, for an individual, estate, partnership organized exclusively for estate or gift planning purposes, or trust, business income is that part of Federal taxable income derived from transactions, activities, and sources in the regular course of the taxpayer's trade or business, including specific categories of income and gains or losses. The bill would delete the reference to a partnership in this and related provisions, and refer instead to another person organized for estate or gift planning purposes.

The Act excludes from the business income of these taxpayers personal investment activity, including interest, dividends, and gains from a personal investment portfolio or retirement account. The bill, instead, would exclude income from investment activity, including interest, dividends, royalties, and gains from an investment portfolio or retirement account, if the investment activity were not part of the person's trade or business.

The business income for these taxpayers currently includes income derived from the sale of a business. The bill would refer to income derived from the sale of an interest in a business that constitutes an integral part of the person's regular trade or business. The bill also would include income derived from the lease or rental of real property.

Gross Receipts

The Act's definition of "gross receipts" refers to the entire amount received by the taxpayer from any activity in intrastate, interstate, or foreign commerce carried on for direct or indirect gain, benefit, or advantage to the taxpayer or to others, except for specified amounts, proceeds, and receipts.

Among the exclusions are receipts derived from investment activity by a person that is organized exclusively to conduct investment activity and that does not conduct investment activity for any person other than an individual or a person related to that individual or by a common cash fund. Under the bill, this exclusion would apply to receipts derived from investment activity other than receipts from transactions, activities, and sources in the regular course of the person's trade or business. The bill also would refer to a "group of individuals", rather than "a person related to that individual".

In addition, the bill would exclude from gross receipts amounts received pursuant to a discharge of indebtedness as described under Section 61(a)(12) of the Internal Revenue Code (IRC), including forgiveness of a nonrecourse debt. (That section defines "gross income" and includes income from the discharge of indebtedness.)

Business Income Tax Base

Under the Act, a taxpayer's business income tax base is the taxpayer's business income subject to specified adjustments before allocation or apportionment, as well as several adjustments after allocation or adjustment.

The adjustments made before allocation or apportionment include a deduction for net earnings from self-employment of the taxpayer or a partner or limited liability company member of the taxpayer, except to the extent those net earnings represent a reasonable return on capital. The bill would delete that exception. Currently, this adjustment applies to the extent the earnings are included in Federal taxable income. The bill would allow the deduction to the extent the earnings were included in business income. The bill would require the net earnings to be reported to the taxpayer or a partner or limited liability company member on a specific form as self-employment earnings for Federal income tax purposes.

The adjustments made before allocation or apportionment also include a deduction for a percentage of the "book-tax difference" for qualifying assets, for 15 tax years beginning with the 2015 tax year. The bill would allow a taxpayer to file an amended return if the amount of this deduction changed from the amount originally reported and filed.

The adjustments made after allocation or apportionment include the deduction of any available business loss incurred after December 31, 2007. Under the bill, for this purpose, a taxpayer that acquired the assets of another corporation in a transaction described in Section 381(a)(1) or (2) of the IRC could deduct any business loss attributable to that distributor or transferor corporation. (That section pertains to carryovers in certain corporate transactions, and contains a general rule when the assets of one corporation are acquired by another in certain distributions or transfers.)

Personal Property Tax Credit

The Act allows a taxpayer to claim a credit for a percentage of property taxes paid on eligible personal property. "Eligible personal property" means personal property that is classified as industrial personal property under Section 34c of the General Property Tax Act, or, in the case of personal property subject to the former Single Business Tax Act, is situated on land classified as industrial real property. The bill would refer to personal property that is "included", rather than classified, as industrial personal property under Section 34c of the General Property Tax Act, and would delete the provision for industrial real property.

Under the bill, if this credit were claimed in connection with property that was classified but not included as industrial personal property under the General Property Tax Act before the bill's effective date, the credit would have to be disallowed and an amount equal to the credit amount previously claimed would have to be added back to the taxpayer's tax liability in the following year.

If a personal property tax credit were not claimed in connection with property that was included but not classified as industrial personal property before the bill's effective date, the credit would have to be allowed and the taxpayer could file an amended return to claim a refund for that credit to the extent allowed under the revenue Act.

Unitary Business Group

The Act requires a unitary business group to file a combined return that includes each United States person, other than a foreign operating entity, that is included in the group. Each United States person that is included in a unitary business group or in a combined return must be treated as a single person and all transactions between the people in the group must be eliminated from the business income tax base, modified gross receipts tax base, and the apportionment formula under the Act.

The bill also would require the people in the group to be treated in this manner for purposes of the exemptions, deductions, subtractions, or credits, and for determining the filing threshold under the Act.

Other Definitions

The Act defines "officer" as an officer of a corporation other than a subchapter S corporation, including the chairperson of the board; the president, vice-president, secretary, or treasurer of the corporation or board; and people performing similar duties. The bill would refer to people performing similar duties, including making major decisions and taking on major responsibilities.

The bill would amend the definition of "person" to provide that, except for a foreign person as defined in Section 207(8)(d), a person disregarded as an entity separate from its owner pursuant to the Internal Revenue Code and Federal regulations would have to be treated in the same manner for purposes of the Act.

Section 207(8)(d) defines "foreign person" as either of the following:

-- An individual who is not a United States resident, whether or not the individual is subject to taxation under the IRC.
-- A person formed under the laws of a foreign country or a political subdivision of a foreign country, whether or not the person is subject to taxation under the IRC.

In the second category, the bill would add, "and whether or not the person is disregarded pursuant to the internal revenue code and federal regulations".

The Act defines "United States person" as that term is defined in a section of the IRC. The bill would exclude a foreign person as defined in Section 207(8)(d).

The Act's definition of "purchases from other firms" includes materials and supplies, including repair parts and fuel, to the extent not included in inventory or depreciable property. Under the bill, for the purpose of this provision, "material and supplies" would mean tangible personal property expensed by the taxpayer and not capitalized for Federal income tax purposes.

Other Provisions

The bill would do the following:

-- Revise a provision under which sales of tangible personal property are determined to be in this State.
-- Require the compensation credit and the research and development credit to be taken before any unused carryforward from the former Single Business Tax Act.
-- Revise the calculation of the renaissance zone credit for a taxpayer conducting business activity in a zone before December 1, 2002.
-- Require any final liability to be remitted by the last day of the fourth month after the end of the taxpayer's tax year, rather than with the annual or final return.

MCL 208.1105 et al. Legislative Analyst: Suzanne Lowe

FISCAL IMPACT

The bill would reduce General Fund revenue by an unknown amount. The provisions of the bill generally would: 1) exclude certain income and receipts from the tax base, and 2) reduce the tax base by increasing the value of certain deductions. The magnitude of the exclusions is unknown, and would be partially offset by the reduction of some credits that are limited or based on tax liability before the application of credits.

The bill also would increase revenue by an unknown, and likely minimal amount, by altering the order in which certain credits and carry-forward losses are applied. These increases are not expected to meaningfully offset the revenue losses from the other provisions.

In addition, the bill would make changes to the credit for personal property taxes to reflect issues where differences occurred in whether property was classified as industrial personal property and was or was not included in calculating the credit. These changes could either increase or decrease revenue depending on the relative magnitude of how different taxpayers would be affected by the changes.

The bill would not affect local unit revenue or expenditures.

Fiscal Analyst: David Zin

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