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BILL ANALYSIS

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Senate Bill 650 (as enacted)	**PUBLIC ACT 183 of 2011**
Senate Bill 653 (as enacted)	**PUBLIC ACT 306 of 2011**
Senate Bills 654, 655, and 660 (as enacted)	**PUBLIC ACTS 184-186 of 2011**
Senate Bill 666 (as enacted)	**PUBLIC ACT 307 of 2011**
Senate Bills 669, 670, 671, and 672 (as enacted)	**PUBLIC ACTS 187-190 of 2011**
Senate Bill 673 (as enacted)	**PUBLIC ACT 308 of 2011**
Senate Bills 674 and 677 (as enacted)	**PUBLIC ACTS 191 & 192 of 2011**
Senate Bill 678 (as enacted)	**PUBLIC ACT 309 of 2011**
Senate Bills 679 and 680 (as enacted)	**PUBLIC ACTS 193 & 194 of 2011**
Senate Bill 807 (as enacted)	**PUBLIC ACT 310 of 2011**

Sponsor: Senator Jack Brandenburg (S.B. 650 & 653-655)
Senator Mark C. Jansen (S.B. 660)
Senator John Pappageorge (S.B. 666 & 669)
Senator Dave Robertson (S.B. 670-674 & 807)
Senator John Proos (S.B. 677-680)
Senate Committee: Finance
House Committee: Tax Policy

Date Completed: 1-17-12

RATIONALE

Legislation was enacted in May 2011 to restructure the way businesses are taxed on their income and expand the taxation of individuals' income. Public Act 38 of 2011 amended the Income Tax Act to revise sections providing for the income tax on individuals, which it designated Part 1 of the Act, and to create the Corporate Income Tax (CIT) in a new Part 2. The individual income tax amendments eliminated a number of deductions, exemptions, and credits; provide for the taxation of pension income; and altered the tax rate levied in future years. The CIT provisions largely mirror the income tax portion of the Michigan Business Tax (MBT) Act but levy the tax only on businesses organized as traditional corporations under Federal tax rules. Sole proprietorships and pass-through entities, such as partnerships and S-corporations, are not subject to the CIT. Financial institutions remain subject to a franchise tax in lieu of the CIT, and insurance companies are taxed on gross direct premiums written on property or risk located or residing in the State. The CIT also retains unitary filing requirements for corporations under common control (unitary business groups). A new Part 3 of the Act prescribes withholding requirements that apply to flow-through entities, employers, people who disburse pension or annuity payments, casino licensees, and others.

Public Act 39 of 2011 amended the MBT Act to eliminate the MBT for most taxpayers effective January 1, 2012, and allow certain taxpayers to continue to claim "certificated" credits. The Act will be repealed when all certificated credits have been exhausted.

Except for the amendments to the individual income tax rate, which took effect on October 1, 2011, Public Act 38 took effect on January 1, 2012. Although Public Act 39 took effect on May 25, 2011, the amendments generally apply to tax years beginning after December 31, 2011.

When Public Acts 38 and 39 were enacted, it was anticipated that "cleanup" amendments would be necessary because of the scope and complexity of the measures. A work group consisting of staff from the Department of Treasury, the Governor's office, and the Legislature met over the summer of 2011 to examine the legislation, with input from interested parties. As a result of this process, a number of amendments were suggested.

CONTENT

Senate Bills 650, 653, 654, 655, 660, 666, 669, 671 to 674, 678, and 807 amended Part 2 of the Income Tax Act to do the following:

- **Require gross receipts of a flow-through entity to be imputed to each member based on the member's proportionate share of distributive income.**
- **Exclude a disregarded entity from the definition of "flow-through entity".**
- **Require a person that is a disregarded entity for Federal tax purposes to be treated as a disregarded entity for purposes of Part 2.**
- **Revise the tax base apportionment for a taxpayer that has an ownership or beneficial interest in a flow-through entity that is unitary with the taxpayer.**
- **Extend a disqualification for the small business credit to a unitary business group.**
- **Define substantial nexus for a financial institution.**
- **Define "actively solicits".**
- **Revise the time for submitting a final liability.**
- **Make changes regarding estimated tax payments and returns.**
- **Require a taxpayer computing the CIT for a portion of a year to use the method the taxpayer uses to compute the MBT for the other portion of the year.**

Senate Bills 670, 677, 679, and 680 amended Part 3 of the Act to:

- **Revise withholding requirements that apply to a person that disburses pension or annuity payments.**
- **Provide that taxes withheld by a flow-through entity accrue on the 15th of April, June, September, and January, and require withholding for each period to be equal to one-fourth of the total expected for the tax year.**
- **Require a flow-through entity that has withheld tax to file an annual reconciliation return.**
- **Revise the withholding requirement that applies when a person whose income is subject to withholding fails or refuses to provide information.**
- **Delete reference to a trust in the definition of "flow-through entity".**

All of the bills took effect on January 1, 2012.

Below is a detailed description of the bills, categorized by those that amended Part 2 and those that amended Part 3.

Part 2

Senate Bill 650

The CIT applies to a taxpayer that has substantial nexus in the State. Under Section 621 (which Senate Bill 669 amended) a taxpayer has substantial nexus in Michigan if it has a physical presence in the State for more than one day during the tax year; if the taxpayer actively solicits sales in the State and has gross receipts of $350,000 or more sourced to the State; or if the taxpayer has an ownership interest or a beneficial interest in a flow-through entity, directly, or indirectly through one or more flow-through entities, that has substantial nexus in this State.

Section 653 provides for the franchise tax on a financial institution. Previously, Section 653 referred to a financial institution with nexus in the State as determined under Section 621.

Senate Bill 650 refers to a financial institution with "substantial nexus" in this State, rather than nexus as determined under Section 621.

The bill provides that, for purposes of Section 653, a financial institution has

substantial nexus in this State if it satisfies any of the following:

- -- Has a physical presence in this State for a period of more than one day during the tax year.
- -- Actively solicits sales in this State and has gross receipts of $350,000 or more sourced to the State.
- -- Has an ownership interest in or a beneficial interest in a flow-through entity, directly or indirectly through one or more other flow-through entities, that has substantial nexus in this State as provided under Section 621 or 653 .

"Actively solicits" means that term as defined under Section 621.

Senate Bills 653 and 678

Part 2 defines "flow-through entity" as entity that is treated as a subchapter S corporation under the Internal Revenue Code (IRC), a general or limited partnership, a trust, or a limited liability partnership or company, that for the tax year is not taxed as a corporation for Federal income tax purposes.

Senate Bill 653 amended the definition to exclude any entity disregarded under Section 699.

Senate Bill 678 added Section 699 to state that, notwithstanding any other provision of the Act, a person that is a disregarded entity for Federal income tax purposes under the IRC must be classified as a disregarded entity for purposes of Parts 2 and 3 of the Income Tax Act.

Senate Bill 654

Part 2 requires an annual or final return to be filed by the last day of the fourth month after the end of the taxpayer's tax year. Previously, any final liability had to be remitted with that return. Under the bill, any final liability must be remitted by the annual due date of the taxpayer's annual or final return, excluding any extension of time.

A taxpayer does not need to file a CIT return or pay the tax imposed under Part 2 if the taxpayer's apportioned or gross receipts are less than $350,000.

The bill requires the apportioned or allocated gross receipts of a flow-through entity to be imputed to each of its members based upon the same percentage that each member's proportionate share of distributive income is to the total distributive income of the flow-through entity.

If a taxpayer has apportioned or allocated gross receipts for a tax year of less than 12 months, the bill requires the threshold amount of $350,000 to be multiplied by a fraction whose numerator is the number of months in the tax year and whose denominator is 12.

Senate Bill 655

Section 671 allows a credit (called the small business credit) for taxpayers with gross receipts that do not exceed $20.0 million and adjusted business income minus the loss adjustment that does not exceed $1.3 million, subject to certain disqualifications and reductions.

A corporation is disqualified if compensation and directors' fees of a shareholder or officer exceed $180,000 or if those fees plus certain other amounts exceed $180,000. Under the bill, this disqualification also applies to a unitary business group.

For purposes of determining disqualification, an active shareholder's share of business income may not be attributable to another active shareholder. Also, under the bill, if the taxpayer is a unitary business group, the amount of all items paid or allocable by all people included in the group to any one individual who is a shareholder or officer of a single person included in the group must be combined.

Section 671 defines "compensation" as all wages, salaries, fees, bonuses, commissions, and other payments made in the tax year on behalf of or for the benefit of employees, officers, or directors of the taxpayer. The bill deleted a provision under which compensation for a licensed real estate broker or salesperson or a real estate appraiser included payments to an independent contractor.

Senate Bill 660

Section 681 requires a taxpayer to file an estimated return and pay an estimated tax for each quarter of the taxpayer's tax year if the taxpayer reasonably expects liability for

the tax year to exceed $800. Under the bill, this is required except as otherwise provided in Section 681.

Previously, as a rule, the estimated payment made with each quarterly return had to be for the estimated corporate income tax base for the quarter or 25% of the estimated annual liability. The bill, instead, requires the estimated payment to be for the estimated tax base applicable to the taxpayer under Chapter 11, 12, or 13 for the quarter, or 25% of the estimated annual liability. (Chapter 11 provides for the CIT, and Chapters 12 and 13 provide for a tax on insurance companies and financial institutions, respectively.)

Under Part 2, with respect to a taxpayer filing an estimated tax return for the taxpayer's first tax year of less than 12 months, the amounts paid with each return must be proportional to the number of payments made in the first tax year. Under the bill, a taxpayer with a tax year of less than four months is not required to file an estimated tax return or remit estimated payments.

Senate Bill 666

The bill deleted the definition of "disregarded entity", which referred to a qualified subchapter S subsidiary under a specific section of the IRC or a single member limited liability company that has not elected to be classified as a corporation under a particular Federal regulation.

Senate Bill 669

As noted above, a taxpayer has substantial nexus in this State and is subject to the tax under Part 2 if the taxpayer actively solicits sales in Michigan and has gross receipts of $350,000 or more sourced to the State (or meets other criteria). The bill deleted a requirement that "actively solicits" be defined by the Department of Treasury through written guidance that had to be applied prospectively.

The bill defines "actively solicits" as either of the following:

-- Speech, conduct, or activity that is purposefully directed at or intended to reach people within this State and that explicitly or implicitly invites an order for a purchase or sale.
-- Speech, conduct, or activity that is purposefully directed at or intended to reach people within this State that neither explicitly nor implicitly invites an order for a purchase or sale, but is entirely ancillary to requests for an order for a purchase or sale.

Senate Bill 671

Under Section 667, as amended by the bill, if the apportionment provisions of Part 2 do not fairly represent the extent of a taxpayer's business activity in Michigan, the taxpayer may petition for, or the State Treasurer may require, certain actions with respect to the taxpayer's business activity. Previously, this provision referred to the "treasurer".

Senate Bill 672

If a taxpayer's tax year to which Part 2 applies ended before December 31, 2012, the taxpayer may compute the tax imposed by Part 2 for the portion of that tax year to which Part 2 applies according to one of two methods prescribed in the Act.

The bill specifies that the method chosen by the taxpayer must be the same as the method the taxpayer uses when computing the tax imposed under the MBT Act for the other portion of the same tax year.

Senate Bills 673 and 807

Under the Income Tax Act, the tax base of a multistate taxpayer must be apportioned to this State by multiplying the tax base by the sales factor calculated under Section 663. That section provides that the sales factor is a fraction whose numerator is the total sales of the taxpayer in this State during the tax year and whose denominator is the total sales of the taxpayer everywhere during the tax year.

Senate Bill 673 amended Section 663 to require a taxpayer's numerator to include the taxpayer's proportionate share of the total sales in this State of a flow-through entity that is unitary with the taxpayer. The denominator must include the taxpayer's proportionate share of the total sales everywhere of a flow-through entity that is unitary with the taxpayer.

The bill states that a flow-through entity is unitary with a taxpayer when the taxpayer owns or controls, directly or indirectly, more than 50% of the ownership interests with voting rights or ownership interests that confer comparable rights to voting rights of the flow-through entity, and that has business activities or operations that result in a flow of value between the taxpayer and the flow-through entity, or between the flow-through entity and another flow-through entity with the taxpayer, or has business activities or operations that are integrated with, are dependent on, or contribute to each other.

Section 663 provides that, for a taxpayer that is a unitary business group, sales include sales in this State of every person included in the unitary business group without regard to whether the person has nexus in this State. Sales between people included in a unitary business group must be eliminated in calculating the sales factor.

The bill also provides that sales between a taxpayer and flow-through entities unitary with the taxpayer, or between flow-through entities unitary with a taxpayer, must be eliminated in calculating the sales factor.

Senate Bill 807 amended Section 661, which provides that, for a taxpayer that has an ownership or beneficial interest in a flow-through entity that is unitary with the taxpayer, the taxpayer's business income that is directly attributable to the business activity of the flow-through entity must be apportioned to Michigan using an apportionment factor determined under Section 663 based on the business activity of the flow-through entity.

Under the bill, this does not apply if the flow-through entity is unitary with the taxpayer for apportionment purposes as provided under Section 663.

Senate Bills 674

As noted above, Section 661 contains an apportionment requirement for a taxpayer that has a direct, or indirect through one or more other flow-through entities, ownership interest or beneficial interest in a flow-through entity.

Previously, this language referred to an ownership or beneficial interest in a flow-through entity "that has business activity in this state". The bill deleted that phrase.

Part 3

Senate Bill 670

Retirement or Annuity Payments

Under Section 703, a person who disburses pension or annuity payments is subject to income tax withholding on the taxable part of payments from an employer pension, annuity, profit-sharing, stock bonus, or other deferred compensation plan, as well as from an individual retirement arrangement, an annuity, an endowment, or a life insurance contract.

The bill requires a person who disburses pension or annuity payments, except as otherwise provided, to withhold a tax in an amount computed by applying the rate prescribed in Section 51 on the taxable part of those payments. (Section 51 sets the rate of the individual income tax.) Withholding must be calculated on the taxable disbursement after deducting from the taxable portion the same proportion of the total amount of personal and dependency exemptions of the individual allowed under the Act.

Under Section 703, withholding is not required on any part of a distribution that is not expected to be includable in the recipient's gross income. Under the bill, withholding also not is required on any part of a distribution that is deductible from adjusted gross income (AGI) under Section 30(1)(e) or (f). (Section 30(1)(e) provides for the deduction, to the extent included in AGI, of compensation, including retirement benefits, received for service in the U.S. armed forces, and retirement or pension benefits under the Federal Railroad Retirement Act. Section 30(1)(f) provides for the deduction, to the extent included in AGI and subject to limitations for people born in 1946 or later, of retirement or pension benefits from a Federal, state, or local retirement system; Social Security benefits; retirement or pension benefits from another system or benefits from a retirement annuity policy, subject to a maximum dollar amount; and an amount eligible for a Federal credit for the elderly and totally and permanently disabled.)

Flow-Through Income

Section 703 requires every flow-through entity in the State to withhold a tax in an amount computed by applying the rate prescribed in Section 51 to the distributive share of taxable income after allocation and apportionment of each nonresident member who is an individual after deducting from that income the same proportion of the total amount of personal and dependency exemptions of the individual allowed under the Act. The bill refers to the distributive share of taxable income "reasonably expected to accrue" after allocation and apportionment.

The bill provides that all of the taxes withheld under Section 703 accrue to the State on April 15, June 15, and September 15 of the flow-through entity's tax year and January 15 of the following year, except a flow-through entity that is not on a calendar-year basis must substitute the appropriate due dates in its fiscal year corresponding to those in a calendar year. Withholding for each period must be equal to one-fourth of the total withholding calculated on the distributive share that is reasonably expected to accrue during the tax year of the flow-through entity.

Under Section 703, every flow-through entity with business activity in this State that has more than $200,000 of business income in the tax year after allocation or apportionment must withhold a tax in an amount computed by applying the rate prescribed in Section 623 (the CIT rate) to the distributive share of the business income of each member that is a corporation or that is a flow-through entity. The bill refers to business income "reasonably expected to accrue".

The bill provides that, for a partnership or S corporation, business income includes payments and items of income and expense attributable to business activity of the partnership or S corporation and separately reported to the members. Taxes accrue on the 15th of April, June, September, and January (or a corresponding date in an entity's fiscal year) and withholding for each period must be one-fourth of the total expected for the year, as provided above for individual income withholding.

Under Section 703, if a flow-through entity is subject to the withholding requirements, then a member of that entity that is itself a flow-through entity must withhold a tax on the distributive share of the business income of each of its members. The bill's accrual and withholding requirements apply to such an entity, as well.

Publicly Traded Partnership

The bill provides that every publicly traded partnership that has equity securities registered with the Securities and Exchange Commission under Section 12 of Title I of the Securities and Exchange Act is not subject to withholding.

Senate Bill 677

Under the bill, all provisions relating to the administration, collection, and enforcement of the Income Tax Act and the revenue Act apply to "all persons" required to withhold taxes and to the taxes required to be withheld. Previously, this applied to the employer, flow-through entity, eligible production company, casino licensee, race meeting licensee, or track licensee required to withhold taxes, rather than "all persons".

The bill authorizes the Department to take certain actions if it has reason to believe that a person required to withhold taxes under Part 3 will not pay taxes withheld to this State. Previously, this provision referred to an employer, flow-through entity, eligible production company, casino licensee, race meeting licensee, or track licensee.

Senate Bill 679

Under the bill, a person required by Part 3 to deduct and withhold taxes for a tax year on compensation, winnings, or payoff on a winning ticket, must give each employee, member, or person with winnings or a payoff subject to withholding a statement of the total compensation, winnings, or payoff on a winning ticket paid during the tax year and the amount deducted or withheld. The person also must file a duplicate of the statement and an annual reconciliation return with the Department of Treasury.

Previously, these provisions referred to an employer, flow-through entity, eligible production company, casino licensee, race

meeting licensee, and track licensee, rather than a "person". The requirements also applied to someone required to withhold taxes on the share of income available for distribution.

Under the bill, a flow-through entity that has withheld taxes on distributive shares of business income reasonably expected to accrue must file an annual reconciliation return with the Department by the last day of the second month following the end of the entity's Federal tax year. The Department may require the flow-through entity to file an annual business income information return on the due date, including extensions, of its annual Federal information return.

Also, every person (rather than every employer, flow-through entity, eligible production company, casino licensee, race meeting licensee, and track licensee) required by Part 3 to deduct or withhold taxes must make a return or report in form and content and at times as prescribed by the Department.

Under Part 3, every employee, member, or person with winnings or a payoff on a winning ticket subject to withholding must give his or her employer, flow-through entity, eligible production company, casino licensee, race meeting licensee, or track licensee information required for it to make an accurate withholding. The bill also requires a person who receives a pension or annuity payment to furnish information to the person that disburses the payment.

Previously, if an employee, member, or person with winnings or a payoff subject to withholding failed or refused to furnish information, the employer, flow-through entity, eligible production company, or licensee had to withhold the full rate of tax from the employee's total compensation, the member's share of income available for distribution, or the winnings. Under the bill, instead, if a person who receives a retirement or annuity payment, employee, member, or person with winnings or a payoff fails or refuses to furnish information, the person required by Part 3 to deduct and withhold taxes must withhold the full rate of tax from the person's retirement or annuity payment, the employee's total compensation, the member's distributive share of business income reasonably expected to accrue, or the winnings.

Senate Bill 680

Part 3 defines "flow-through entity" as an entity that for the applicable tax year is treated as an S corporation under the IRC, a general partnership, a limited partnership, a limited liability partnership, or a limited liability company, that for the applicable tax year is not taxed as a corporation for Federal income tax purposes. Previously, this definition also included a trust; the bill deleted that reference.

The bill defines "partnership" as a taxpayer that is required to or has elected to file as a partnership for Federal income tax purposes.

The bill defines "publicly traded partnership" as that term is defined under Section 7704 of the IRC.

MCL 206.653 (S.B. 650)
206.607 (S.B. 653)
206.685 (S.B. 654)
206.671 (S.B. 655)
206.681 (S.B. 660)
206.605 (S.B. 666)
206.621 (S.B. 669)
206.703 (S.B. 670)
206.667 (S.B. 671)
206.683 (S.B. 672)
206.663 (S.B. 673)
206.661 (S.B. 674)
206.705 (S.B. 677)
206.699 (S.B. 678)
206.711 (S.B. 679)
206.701 (S.B. 680)
206.661 (S.B. 807)

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

Public Acts 38 and 39 of 2011 significantly altered the way in which individuals and businesses will be taxed on their income. It is not unusual for such comprehensive legislation to need a certain amount of "cleanup" after it has been enacted. This was anticipated when Public Acts 38 and 39 were enacted, and the recently enacted amendments are a product of work group meetings that took place over the summer of 2011. The bills make largely technical changes, correcting errors and clarifying language. In many cases, the amendments codify what had been believed to be in the

original legislation, on which revenue estimates were based. In addition to these Senate bills, a number of House bills (which became Public Acts 170-182 and 311, 312, and 313 of 2011) made cleanup amendments to Parts 1 and 2 of the Income Tax Act and the MBT Act. Combined, these changes will enable the Department of Treasury to implement Public Acts 38 and 39 and administer the amended statutes.

Legislative Analyst: Suzanne Lowe

FISCAL IMPACT

Most of the bills will generally have one of two types of impact on State General Fund revenue:

1) Little or no fiscal impact, largely because the bill represents technical clarifications or corrections.
2) A zero or minimal fiscal impact, generally of an unknown magnitude, but no fiscal impact relative to the estimates made when the statute was amended in May 2011.

(In the second case, the language adopted in May 2011 was assumed to be consistent with the revenue estimates, but subsequently it was realized that certain adjustments needed to be made to the language.)

The following bills fall under the first category, and are not expected to have a fiscal impact:

-- SB 660 (clarifies references to tax base and required estimated payments)
-- SB 669 (codifies definition issued under revenue administrative bulletin)
-- SB 671 (clarifies reference to the State Treasurer)
-- SB 672 (clarifies computation methods across shortened tax years)
-- SB 674 (clarifies applicability of apportionment formula to certain entities)
-- SB 677 (clarifies description of persons required to make withholding payments)
-- SB 680 (clarifies description of persons required to make withholding payments)

The following bills fall under the second category. These bills potentially have a fiscal impact relative to the language statutory enacted in May 2011, although many do not, and when such a fiscal impact may be present it is not an impact relative to the revenue estimates made when the May 2011 changes were adopted:

-- SB 650 (regarding nexus provisions)
-- SB 654 (regarding calculating gross receipts for filing threshold purposes)
-- SB 655 (regarding small business credit disqualifications)
-- SB 670 (regarding withholding requirements, which could affect the timing of when the State receives certain payments)
-- SB 679 (regarding withholding requirements, which could affect the timing of the State's receipt of certain payments)

Senate Bills 653, 666, and 678 will have an indeterminate effect of unknown magnitude on General Fund revenue, although any potential change in revenue is likely already reflected in the revenue estimates for the Corporate Income Tax. The bills will affect the treatment of corporations disregarded for Federal income tax purposes.

Senate Bills 673 and 807 also will have an indeterminate impact of unknown magnitude on General Fund revenue, and the effect on specific taxpayers will vary based on the particular characteristics of each taxpayer. For some taxpayers, particularly where a flow-through entity may be located in another state and have little or no sales, the bills may result in a tax increase—given certain assumptions on the relative magnitudes of sales and income between the flow-through entity and other members of the group. Conversely, for a Michigan-only flow-through entity, the bills may result in a tax decrease given similar assumptions on the relationship between the entity and other members of the group.

The bills will have no impact on local unit revenue or expenditure.

Fiscal Analyst: David Zin

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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.