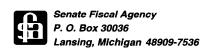
PUBLIC ACT 217 of 2012





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Senate Bill 1104 (as enacted) Sponsor: Senator Mark C. Jansen

Senate Committee: Reforms, Restructuring and Reinventing

House Committee: Tax Policy

Date Completed: 8-3-12

CONTENT

The bill amended Part 3 of the Income Tax Act, which prescribes withholding requirements for flow-through entities, employers, and people who disburse pension or annuity payments, to do the following:

- -- Exempt from withholding requirements a person who disburses annuity payments under the terms of a qualified charitable gift annuity.
- -- Provide that a flow-through entity that receives an exemption certificate from a corporation may not withhold a tax on the distributive share of the business income of that corporation, if the corporation pays the Corporate Income Tax on its distributive share and other conditions are met.
- -- Describe how a flow-through entity's business income must be apportioned to the State for purposes of calculating a \$200,000 business income threshold for the requirement to withhold tax on members' distributive shares.
- -- Change the dates on which taxes withheld by a flow-through entity accrue to the State.
- -- Exempt a flow-through entity from withholding requirements for a member that has certificated credits and chooses to file under the Michigan Business Tax Act.

The bill took effect on June 28, 2012.

Annuity Payments

The Income Tax Act requires a person who disburses annuity or pension payments to

withhold a tax, based on the individual income tax rate, 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.

Under the bill, this requirement does not apply to a person who disburses annuity payments pursuant to the terms of a qualified charitable gift annuity. The bill defines "qualified charitable gift annuity" as an annuity described in Section 501(m)(5) of the Internal Revenue Code and issued by an organization exempt under Section 501(c)(3) of the Code.

(In general terms, a charitable gift annuity is a contractual arrangement in which a charitable organization agrees to pay a fixed-sum annuity over the life of one or two people in exchange for an irrevocable gift of cash or property. When the beneficiary (annuitant) dies, the annuity payments terminate and the organization keeps the remaining assets.)

Flow-Through Entity

The Act requires every flow-through entity in the State to withhold a tax in an amount computed by applying the individual income tax rate to the distributive share of taxable income, reasonably expected to accrue after allocation and apportionment, of each nonresident member of the flow-through entity who is an individual, after deducting from that income the same proportion of the total amount of his or her personal and dependency exemptions allowed under the Act. (Flow-through entities include S

corporations, partnerships, and limited liability companies.)

In addition, every flow-through entity with business activity in this State that has more than \$200,000 of business income reasonably expected to accrue in the tax year after allocation or apportionment, must withhold a tax computed by applying the Corporate Income Tax rate to distributive share of the business income of each member that is a corporation or a flowthrough entity. As described below, the bill makes an exception to this requirement for a flow-through entity that receives an exemption certificate from a corporation.

The bill specifies that, for purposes of calculating \$200,000 withholding the threshold, the business income of a flowthrough entity must be apportioned to this State by multiplying the business income by the entity's sales factor, which is the total sales of the entity in this State during the tax year divided by the total sales of the entity everywhere during the tax year. (As used in this provision, "sales" and "sales in this state" mean those terms as defined in Part 2 of the Act, which governs the Corporate Income Tax.)

Under the bill, taxes withheld by a flow-through entity accrue to the State on the 15th of April, July, and October of the flow-through entity's tax year and January 15 of the following year. The Act previously referred to June and September, instead of July and October.

In addition, under the bill, a flow-through entity is not required to withhold taxes for a member that voluntarily elects to file a return and pay the Michigan Business Tax (MBT) under Section 680 of the Income Tax Act or Section 500 of the MBT Act. (Under those sections, if a taxpayer has certain certificated credits under the MBT Act, the taxpayer may choose to file a return and pay a tax under that Act, in lieu of the Corporate Income Tax.)

<u>Flow-Through Entity with Exemption</u> <u>Certificate</u>

Under the bill, notwithstanding the requirement for flow-through entities to withhold a tax on each member's distributive share of business income, if a flow-through entity receives an exemption

certificate from a corporation, the entity may not withhold a tax on the distributive share of the business income of that corporation, if all of the conditions described below are met.

The corporation must complete the exemption certificate in the form and manner prescribed by the Department of Treasury, and certify that the corporation will do all of the following:

- -- File the returns required under Part 2 of the Act (Corporate Income Tax).
- -- Pay the tax required under Part 2 on the distributive share of the business income received from any flow-through entity in which the corporation is a member or in which it has an ownership or beneficial interest, directly or indirectly through one or more other flow-through entities.
- Submit to the taxing jurisdiction of this State for purposes of collection of the tax under Part 2, together with related interest and penalties under the revenue Act imposed on the corporation with respect to the distributive share of its business income.

The corporation must file the exemption certificate with the Department and give a copy to the flow-through entity. The flow-through entity must attach a copy of the certificate to the annual reconciliation return as required under Part 3. If the flow-through entity is entirely exempt from the distributive share withholding requirement due to this exemption, it must furnish a copy of the certificate in a manner prescribed by the Department.

The corporation and the flow-through entity must retain a copy of the exemption certificate and make it available to the Department upon request. Any copy must be maintained in a format and for the period required by the revenue Act.

The Department may revoke the election provided for in the bill if it determines that the corporation or a flow-through entity is not abiding by the terms of the exemption certificate or the bill's requirements. If it revokes the election option, the Department must notify the affected flow-through entities that withholding is required on the corporation, beginning 60 days after the notice is received.

Legislative Analyst: Suzanne Lowe

FISCAL IMPACT

The bill will have a negligible impact on State revenue by changing the timing of when certain tax payments are made by affected taxpayers. The amount of revenue affected by the changes is unknown but generally will not affect many of the State's largest taxpayers, which account for a substantial portion of State withholding tax revenue.

Fiscal Analyst: David Zin

 $\underline{\text{S1112} \text{\sc s1104es}}$ 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.