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BILL



ANALYSIS

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Senate Bill 1104 (as introduced 4-26-12)
Sponsor: Senator Mark C. Jansen
Committee: Reforms, Restructuring and Reinventing

Date Completed: 5-1-12

CONTENT

The bill would 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:

- **Make an exception to the withholding requirements for a person who disbursed annuity payments under the terms of a qualified charitable gift annuity.**
- **Provide that a flow-through entity that received an exemption certificate from a corporation could not withhold a tax on the distributive share of the business income of that corporation, if the corporation paid the Corporate Income Tax or Michigan Business Tax on its distributive share and other conditions were met.**
- **Describe how a flow-through entity's business income would be apportioned to the State for purposes of calculating a \$200,000 business income threshold.**
- **Change the dates on which taxes withheld by a flow-through entity accrue to the State.**

Annuity Payments

Section 703 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. The withholding must be calculated as prescribed in the Act.

Under the bill, these requirements would not apply to a person who disbursed annuity payments pursuant to the terms of a qualified charitable gift annuity. "Qualified charitable gift annuity" would mean 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

Section 703 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 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.

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 apportion a tax computed by applying the Corporate Income Tax rate to the distributive share of the business income of each member that is a corporation or a flow-through entity.

Under the bill, these requirements would apply except as provided in Section 704 (described below) for a flow-through entity with an exemption certificate.

The bill specifies that, for purposes of calculating the \$200,000 withholding threshold, the business income of a flow-through entity would have to be apportioned to this State by multiplying the business income by the entity's sales factor, which would be 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.

Currently, taxes withheld under Section 703 accrue to the State on the 15th of April, June, and September of the flow-through entity's tax year and January 15 of the following year. The bill would refer to July and October, instead of June and September.

Flow-Through Entity with Exemption Certificate

The bill would add Section 704 to provide that, notwithstanding the withholding requirements for flow-through entities under Section 703, if a flow-through entity received an exemption certificate from a corporation, the entity could not withhold a tax on the distributive share of the business income of that corporation, if all of the conditions described below were met.

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

- File the returns required under Part 2 of the Act (Corporate Income Tax) or under the Michigan Business Tax (MBT) Act.
- Pay the tax required under Part 2 or under the MBT Act on the distributive share of the business income received from any flow-through entity in which the corporation was a member or in which it had 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 or under the MBT Act, 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 would have to file the exemption certificate with the Department and give a copy to the flow-through entity. The flow-through entity would have to attach a copy of the certificate to the annual reconciliation return as required under Part 3. If the flow-through entity were entirely exempt from the withholding requirements of Section 703 due to this exemption, it would have to furnish a copy of the certificate in a manner prescribed by the Department.

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

The Department could revoke the election provided for in Section 704 if it determined that the corporation or a flow-through entity was not abiding by the terms of the exemption certificate or the requirements of the section. If it revoked the election option, the Department would have to notify the affected flow-through entities that withholding was required on the corporation under Section 703, beginning 60 days after the notice was received.

MCL 206.703 et al.

Legislative Analyst: Suzanne Lowe

FISCAL IMPACT

The bill would 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 would not affect many the State's largest taxpayers, which account for a substantial portion of State withholding tax revenue.

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.