

## **MBT: CANCELLATION OF DEBT INCOME; ITC ASSET CALCULATION; REN ZONES; DOCK SALES**

Mary Ann Cleary, Director  
Phone: (517) 373-8080  
<http://www.house.mi.gov/hfa>

**Senate Bill 156 (Substitute S-3)**  
**Sponsor: Sen. Jack Brandenburg**  
**House Committee: Tax Policy**  
**Senate Committee: Finance**

**Complete to 5-27-14**

### **A SUMMARY OF SENATE BILL 156 (S-3) AS PASSED BY THE SENATE 5-14-14**

Senate Bill 156 (S-3) would make a number of amendments to the Michigan Business Tax (2007 PA 36) concerning the treatment of cancelled debt in determining a taxpayer's gross receipts, the sourcing of "dock sales," the recapture of the investment tax credit, and calculation of the renaissance zone credit.

[Public Act 38 of 2011 replaced the Michigan Business Tax with a corporate income tax, but the MBT will not be fully repealed until all available credits are exhausted; this means that some businesses still pay the MBT. Further, there are still outstanding MBT issues from tax years prior to repeal.]

#### **Modified Gross Receipts Tax – Cancellation of Debt (COD) Income**

Among other things, the MBT imposes a modified gross receipts tax of 0.8% on a firm's gross receipts "from any activity whether in intrastate, interstate, or foreign commerce carried on for direct or indirect gain, benefit, or advantage to the taxpayer or to others," subject to numerous adjustments. While the definition of "gross receipts" excludes the proceeds from the original issue of debt instruments (e.g., a loan), it does not also explicitly exclude income received through the cancellation of debt.<sup>1</sup>

Senate Bill 156 (S-3) would amend the MBT's definition of "gross receipts" to specifically exclude the amounts attributed to the taxpayer under a discharge of indebtedness as described under Section 61(a)(12) of the federal Internal Revenue Code (26 USC 61), including the forgiveness of a nonrecourse debt.<sup>2</sup>

---

<sup>1</sup> See, for example, *DHG Associates LP v. Michigan Department of Treasury*, MTT Docket No. 449632, final opinion and judgment, March 7, 2014, [https://www.michigan.gov/documents/taxtrib/449632\\_449926\\_7.pdf](https://www.michigan.gov/documents/taxtrib/449632_449926_7.pdf). The final opinion notes, "the cancellation of the requirement to repay [the loan] is not similarly excluded by the statute. More specifically, there is no exclusion from the definition of gross receipts in the state for the cancellation of debt. The ALJ found that 'when the duty to repay the loan was extinguished, the taxpayer realized a 'gain, benefit, or advantage' from that amount.' The 'gain, benefit, or advantage' was not in the form of cash but rather in the intangible form of debt cancellation. Petitioner did, in fact, receive an amount as it no longer as to repay the loan proceeds it originally received."

<sup>2</sup> 26 USC 61 generally states that "gross income" means all income from whatever source derived, including, among others, income from discharge of indebtedness. There are exceptions to the inclusion of cancelled debt income under 26 USC 108. A nonrecourse debt does not allow the lender to pursue collection of the debt other than the collateral used as security.

### **Sales Factor Apportionment – Dock Sales**

The MBT apportions the business income tax and the modified gross receipts tax based on the sales factor – i.e., Michigan sales vs. total sales everywhere. Generally, the MBT provides that sales are "sourced" to Michigan based on the location of the purchaser or where the good or service is used. A sale is in Michigan if the property is shipped or delivered to a purchaser within Michigan based on the *ultimate destination* at the point the property comes to rest regardless of the shipping terms or other conditions of the sale.

For "dock sales" – i.e., sales where the purchaser arranges to pick up its purchased property at the seller's location – the property is generally sourced to the purchaser's destination state. If, however, the property is not picked up by the purchaser for at least 60 days, it is deemed to have come to rest at its ultimate destination in Michigan. Seemingly contradicting itself, the act then states that a property subject to a dock sale that is *not* picked before 60 days (i.e., not picked up for at least 60 days) is not deemed to have come to rest at its ultimate destination in Michigan.

Senate Bill 156 (S-3) clarifies that property subject to a dock sale has not reached its ultimate destination in Michigan if it is picked up before 60 days.<sup>3</sup>

### **Investment Tax Credit Recapture**

The MBT provides for a combined compensation and investment tax credit of up to 52% of a firm's tax liability, prior to the imposition of the 21.99% (generally) surcharge. The act provides that this combined credit must be taken before any other credit under the act. Generally the investment credit portion of the combined credit is equal to 2.9% of net depreciable assets.

The ITC is subject to the recapture of tax revenue when the property subject to the credit is sold. This recapture does not take into consideration whether the credit actually reduced the taxpayer's liability. (The MBT limits that amount of the combined compensation and investment tax credit.)

Senate Bill 156 (S-3) provides that that the ITC would be subject to recapture only to the extent that the credit was actually used to reduce the taxpayer's liability.

### **Renaissance Zone Credit Calculation**

The MBT provides a credit to businesses located and conducting business in a renaissance zone to the extent and for the duration provided in the Michigan Renaissance Zone Act (1996 PA 376). Currently, under the standard calculation – for taxpayers except those located and conducting business activity in a renaissance zone before December 31, 2002 – the credit is equal to the lesser of the following:

- The tax liability attributable to business activity conducted within a renaissance zone; or

---

<sup>3</sup> Similar provisions were recently added to the apportionment provisions of the Corporate Income Tax Act (MCL 206.665) following the enactment of 2014 PA 13 (HB 5008).

- 10% of "adjusted services" performed in the renaissance zone.

Senate Bill 156 (S-3) provides that this standard calculation would apply to taxpayers located and conducting business activity in a renaissance zone after November 30, 2002.

The MBT provides for an alternate calculation for taxpayers located and conducting business activity in a renaissance zone before December 31, 2002, in which the credit is equal to the product of the following:

- The renaissance zone credit claimed under the former Single Business Tax (SBT) Act for the tax year ending in 2007.
- The ratio of the taxpayer's payroll in the state in the tax year divided by the taxpayer's payroll in the state in its tax year ending in 2007 under the SBT Act.
- The ratio of the taxpayer's renaissance zone business activity factor for the tax year divided by that factor for the taxpayer's tax year ending in 2007 under the SBT Act.

Senate Bill 156 (S-3) provides that this calculation would apply to taxpayers located and conducting business activity in a renaissance zone before December 1, 2002 (rather than December 31, 2002).

Additionally, the bill provides that for these taxpayers, the renaissance zone credit would be the lesser of the standard calculation or the alternate calculation.

### **Tax Liability Changes – Refund Claims**

The bill provides that if a taxpayer has an overpayment for any tax year beginning after December 31, 2009, through the tax year beginning after December 31, 2013, the taxpayer may file a claim for a refund in the 2015 calendar year, in a manner specified by the department. The Department of Treasury could audit refund claims, and issue assessments, where appropriate, within four years after the refund claim is filed. (The audit and assessment time requirements and the statute of limitations specified in the Revenue Act would not apply to these refund claims.)

### **Appropriation**

The bill would appropriate \$1.0 million to the Department of Treasury in FY 2014-15 to carry out the requirements of the bill. The department could carryforward any unexpended amounts as a work project appropriation in subsequent years.

### **FISCAL IMPACT:**

As written, the bill could reduce state General Fund revenues by an unknown amount. According to the Department of Treasury, the change in the definition of "gross receipts" could reduce state revenue by \$2 million per year, along with a potential \$10 million in near-term reductions due to refunds for overpayments resulting from the passage of this

legislation. Treasury also estimated the cost of recalculating renaissance zone credits at \$4.4 million per year, and potentially \$22 million due as refunds for previous overpayments. Refunds resulting from the retroactivity of the bill would likely impact fiscal years 2013-14 and 2014-15. The potential fiscal impacts of the changes to the sales factor apportionment related to "dock sale," and the changes to investment tax credit recapture are unknown at this time. Further analysis into these issues is ongoing.

Senate Bill 156 would impose certain administrative and operational costs on the Department of Treasury. Any costs would be offset by the \$1.0 million GF/GP work project appropriation included in the bill.

Legislative Analyst: Mark Wolf  
Fiscal Analyst: Adam Desrosiers  
Ben Gielczyk

---

■ This analysis was prepared by nonpartisan House staff for use by House members in their deliberations, and does not constitute an official statement of legislative intent.