

CORPORATE INCOME TAX: AFFILIATED GROUPS

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Senate Bill 367 without amendment
Sponsor: Sen. Jack Brandenburg
House Committee: Tax Policy
Senate Committee: Finance

Complete to 12-3-13

A SUMMARY OF SENATE BILL 367 AS PASSED BY THE SENATE 5-21-13

Senate Bill 367 would amend the Corporate Income Tax provisions of the Income Tax Act, 1967 PA 261 (Part 2) to allow a member of an "affiliated group" to elect to have all members of that group be treated as a single unitary business group.

Generally speaking, an "affiliated group" is a group of several corporations that have a certain amount of joint ownership that permits the group, under the federal Internal Revenue Code, to elect to file a consolidated income tax return encompassing all members of the group – rather than each member filing a separate return – and subjecting the group to taxation based on its consolidated taxable income.

Currently, the Corporate Income Tax is applied to, among other types of taxpayers, unitary business groups, which are generally defined in the act as a group of United States corporations, insurance companies, or financial institutions, other than a foreign operating entity. The act imposes additional requirements on UBG's, imposing a "control test" and a "relationship test." Under the control test, one member of the unitary group must own or control, directly or indirectly, more than 50% of the ownership interest with voting rights (or comparable rights) of the other members of the unitary group.¹ Unitary groups must also meet one of two "relationship tests" in which the business activities or operations of the group (1) result in a flow of value between or among members of the unitary group, or (2) are integrated with, dependent upon, or contribute to each other.²

Apparently, the determination of whether a group of related entities meets the statutory definition of a "unitary business group" (especially the relationship test) is generally based on the characteristics specific to the taxpayer and its related entities. There appears to be no "bright line" test per se to determine whether the flow of value or level of integration among group members satisfies the relationship test for the group to be considered unitary.

¹ See, also, Department of Treasury, Revenue Administrative Bulletin 2010-1, *Michigan Business Tax Unitary Business Group Control Test*, http://michigan.gov/documents/treasury/RAB2010-1_310314_7.pdf. Prior to the CIT, the Michigan Business Tax (MBT) was imposed on unitary business groups. Given the similar definitions contained in the two acts, it would be likely that the Department of Treasury's stated position on the UBG control test under the MBT would be similar to its position under the CIT

² See, also, Department of Treasury, Revenue Administrative Bulletin 2010-2, *Michigan Business Tax Unitary Business Group Relationship Test*, http://michigan.gov/documents/taxes/RAB2010-2_312823_7.pdf.

Senate Bill 367 would expand the definition of unitary business group for CIT purposes to also include an "affiliated group," generally incorporating the definition of "affiliated group" as defined in the federal Internal Revenue Code (26 USC 1504).

Under the Internal Revenue Code, an "affiliated group" includes one or more chains of includable corporations that are connected through stock ownership with a common parent corporation. The IRC further imposes a 80% voting and value test that requires that (1) the common parent must own stock representing at least 80 percent total voting power and at least 80 percent of the total value in at least one other includable corporation, and (2) stock representing at least 80% of the total voting power and at least 80 percent of the total value in *each* of the includable corporations must be owned directly by one or more of the other includable corporations.³

The bill defines "affiliated group" as it is defined in the Internal Revenue Code, except that it would also include all persons, other than a foreign operating entity, incorporated in the U.S. or formed under the laws of the U.S., any state, the District of Columbia, or any territory or possession that are commonly owned, directly or indirectly, by any member of the affiliated group and other members of which more than 50% of the ownership with voting rights (or comparable rights) is directly or indirectly owned by a common owner or owners.

A taxpayer could elect (without the Department of Treasury's consent) to have all members of the affiliated group be treated as a unitary business group. The election to be treated as a unitary business group would have to be timely filed with the taxpayer's annual return. Any member of the group would be considered to have waived its objection to be included in the affiliated group and treatment as a unitary business group.

The election by an affiliated group to file as a unitary business group would be valid for 10 tax years, and subject to renewal every 10 tax years. If an election is not renewed, an affiliated group could not elect to file as a unitary business group for the following three tax years. The renewal would have to be timely filed with the taxpayer's annual return.

FISCAL IMPACT:

The bill would reduce state revenues by an unknown amount. It can be assumed that only taxpayers who will see their tax liabilities decrease would elect to change their filing status. The amount of the reduction depends on the number of taxpayers who make this election and their particular tax liabilities, so specific estimates cannot be made at this time.

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■ 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.

³ As defined in the Internal Revenue Code (26 USC 1504), "includable corporations" means any corporation except tax-exempt corporations under IRC Section 501, insurance companies (with some exceptions), foreign corporations, possessions corporations (IRC Section 936), regulated investment companies and real estate investment trusts, domestic international sales corporations (DISCs), and S-corporations.