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BILL ANALYSIS

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Senate Bill 156 (as enrolled) **PUBLIC ACT 282 of 2014**
Sponsor: Senator Jack Brandenburg
Senate Committee: Finance
House Committee: Tax Policy

Date Completed: 9-10-14

CONTENT

The bill would amend the Michigan Business Tax (MBT) Act to do the following:

- **Allow an adjustment to the modified gross receipts tax base for amounts attributable to the taxpayer pursuant to a discharge of indebtedness.**
- **Revise the calculation of the investment tax credit with respect to the recapture of revenue when assets eligible for the credit are sold.**
- **Revise the calculation of the renaissance zone credit for a taxpayer located and conducting business in a renaissance zone before December 1, 2002.**
- **Revise a provision concerning a dock sale, for purposes of apportionment.**

The bill also would require a taxpayer to claim a refund in 2015 if, as a result of the bill's amendments, the taxpayer had an overpayment of the tax for a tax year between 2010 and 2014; and would allow the Department of Treasury to assess the taxpayer for an amount claimed that exceeded the overpayment. The bill would appropriate $1.0 million to the Department to implement these provisions.

Further, the bill would repeal Public Act 343 of 1969, which enacted the Multistate Tax Compact, retroactive to January 1, 2008, and express legislative intent regarding Section 301 of the MBT Act (which specifies how a multistate taxpayer must apportion its tax base to this State), and "the intended effect of that section to eliminate the election provision" in Section 1 of Public Act 343 (discussed below).

In addition, the bill would make the amendments to the MBT Act retroactive for tax years beginning on and after January 1, 2010.

Modified Gross Receipts Tax

The Act imposes a modified gross receipts tax on taxpayers with nexus. The modified gross receipts tax base is a taxpayer's gross receipts less purchases from other firms before apportionment.

The bill would exclude from the definition of "gross receipts" amounts attributable to the taxpayer pursuant to a discharge of indebtedness as described in Section 61(a)(12) of the Internal Revenue Code, including forgiveness of a nonrecourse debt. (That section of the Code includes in the definition of "gross receipts" income from discharge of indebtedness.)

Investment Tax Credit

Section 403 of the Act allows a taxpayer to claim a credit for a percentage of compensation paid in this State, and for a percentage of the cost of tangible assets in which the taxpayer invested (the investment tax credit, or ITC), and imposes a limit on the total combined credit under this section.

The size of the ITC is based on the cost of the assets, subject to a reduction for the adjusted proceeds (asset basis) the taxpayer received from selling or otherwise disposing of depreciable tangible assets eligible for the credit; the result of that calculation is multiplied by 2.32% for the 2008 tax year and 2.9% for the 2009 and subsequent tax years.

The calculation of the amount to be recaptured depends on whether the assets were eligible for the ITC under the former Single Business Tax (SBT) Act or the MBT Act. If the credit applied against the SBT, the recapture is based on the rate of the ITC when it was (or could have been) claimed and the extent to which the credit was used. If assets were eligible for the credit under the MBT Act, however, the recapture calculation is based on rate of the ITC at the time the property was sold or disposed of, and does not take into account the extent to which the credit was used, i.e., whether it had actually reduced the taxpayer's liability or prevented it from increasing by reducing the taxpayer's SBT investment tax credit recapture. (The ITC might not be totally used, for example, because the taxpayer claimed the alternate tax credit or because compensation eligible for the compensation credit amounted to the maximum combined credit amount under Section 403.)

Under the bill, if the ITC were claimed against the MBT, adjusted proceeds from the sale or other disposition of eligible depreciable tangible assets would be recaptured to the extent that the credit was used and would be based on the ITC rate in effect when the credit was claimed.

Renaissance Zone Credit

The bill would revise the calculation of the renaissance zone credit for a taxpayer located and conducting business activity in a renaissance zone before December 1, 2002. Under the bill, the credit would be based on either the current calculation for those taxpayers, or the calculation allowed for other business taxpayers in a renaissance zone, whichever was greater.

Currently, except for a taxpayer located and conducting business activity in a renaissance zone before December 31, 2002, the credit is equal to the lesser of the following (referred to below as the first calculation):

-- The tax liability attributable to business activity conducted within a renaissance zone in the tax year.
-- 10% of the adjusted services performed in a designated renaissance zone.

For a taxpayer located and conducting business activity in a renaissance zone before December 31, 2002, the credit is equal to the product of the following (referred to below as the second calculation):

-- The renaissance zone credit claimed under the former SBT Act for the tax year ending in 2007.
-- The ratio of the taxpayer's payroll in this 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.

Under the bill, the first calculation would apply to a taxpayer located and conducting business in a renaissance zone after November 30, 2002. For a taxpayer located and conducting business in a renaissance zone before December 1, 2002, the greater of the first calculation or the second calculation would apply.

Apportionment: Dock Sale

The Act requires the apportionment of a taxpayer's tax base based on the sales factor, which is the total sales of the taxpayer in this State divided by the total sales of the taxpayer everywhere during the tax year. Sales of the taxpayer in this State include sales of tangible personal property that is shipped or delivered to any purchaser within this State based on the ultimate destination at the point that the property comes to rest, regardless of the free on board point or other conditions of the sales.

The Act provides that property stored in transit for 60 days or more before receipt by the purchaser or the purchaser's designee, or in the case of a dock sale not picked up for 60 days or more, must be deemed to have come to rest at this ultimate destination. Property stored in transit for fewer than 60 days before receipt by the purchaser or the purchaser's designee, or in the case of a dock sale not picked up before 60 days, is not deemed to have come to rest at this ultimate destination for purposes of this provision.

In the last provision, concerning a dock sale, the bill would refer to "picked up before 60 days" (rather than *not* picked up before 60 days).

Refund; Assessment; Appropriation

If a taxpayer had an overpayment of tax for any tax year beginning after 2009 through the tax year beginning after 2013, as a result of the bill's amendments, the taxpayer would have to file a claim for a refund during 2015, using a form, process, or format prescribed by the Department of Treasury. The claim would be limited to the determination of any tax liability and any overpayment resulting from the amendments. The claim would have to be filed, and interest would have to be paid, in accordance with provisions of the revenue Act. A refund would have to be paid in equal annual installments over six years beginning in 2016.

The Department could assess the taxpayer for any amount determined after audit or investigation to have exceeded the proper and correct amount of overpayment resulting from the bill's amendments. The assessment could not be issued more than four years after the date the taxpayer filed its claim for a refund, and would be limited to the changes enacted by the bill.

The bill would appropriate to the Department, for the 2014-15 fiscal year, $1.0 million to begin implementing these requirements. Any portion of the amount appropriated that was not spent in the 2014-15 fiscal year would not lapse to the General Fund, but would be carried forward in a work project account for the following State fiscal year.

Repeal of Public Act 343 of 1969; Apportionment

Public Act 343 of 1969 enacted the Multistate Tax Compact, which provides for the determination of tax liability of taxpayers with business activity or income in multiple state jurisdictions. Under Section 1 of the Act, as originally enacted, if a taxpayer's income is subject to apportionment and allocation under the laws of a state belonging to the Compact, the taxpayer may elect to apportion and allocate its income in the manner provided by that state's laws or according to a three-factor apportionment formula in the Compact, which is based on sales, property, and payroll. As amended by Public Act 40 of 2011, beginning January 1, 2011, Section 1 requires a taxpayer that is subject to the Michigan Business Tax Act or the Income

Tax Act, for purposes of that Act, to apportion and allocate its income according to the provisions of the MBT Act or the Income Tax Act.

(Public Act 40 was enacted in conjunction with Public Acts 38 and 39 of 2011. Public Act 38 amended the Income Tax Act to create the Corporate Income Tax, as well as make a number of changes applicable to the individual income tax. Public Act 39 amended the MBT Act to provide for its repeal but allow certain taxpayer to continue filing under the Act in order to claim select credits.)

Section 301 of the MBT Act requires a multistate taxpayer to apportion its tax base by multiplying the tax base by the sales factor. Section 115 of the Income Tax Act also requires a taxpayer to apportion its business income based on the sales factor, beginning January 1, 2011.

Senate Bill 156 would repeal Public Act 343 of 1969 (1969 PA 343) retroactively to January 1, 2008 (the effective date of the MST Act). The bill states, "It is the intent of the legislature that the repeal of 1969 PA 343…is to express the original intent of the legislature regarding the application of section 301 of the Michigan business tax act…and the intended effect of that section to eliminate the election provision included within section 1 of 1969 PA 343…, and that the 2011 amendatory act that amended section 1 of 1969 PA 343…was to further express the original intent of the legislature regarding the application of section 301 of the Michigan business tax act…and to clarify that the election provision included within section 1 of 1969 PA 343…is not available under the income tax act…".

MCL 208.1111 et al.

BACKGROUND

The Michigan Supreme Court recently addressed the compatibility of the Multistate Tax Compact and the Michigan Business Tax Act with respect to the apportionment of income for the 2008 tax year, in *IBM Corp.* v *Department of Treasury* (Docket No. 146440, 7-14-14).

The Supreme Court held that the taxpayer was entitled to use the Compact's three-factor apportionment formula for its 2008 Michigan taxes, and was not required to apportion its income using the sales-factor formula in the Michigan Business Tax Act (which the Court referred to as the "BTA"). The Court stated, "[T]he Court of Appeals erred by holding otherwise on the basis of its erroneous conclusion that the Legislature had repealed the Compact's election provision by implication when it enacted the BTA."

The Supreme Court also held that the taxpayer could use the Compact's apportionment formula for that portion of its tax base subject to the modified gross receipts tax of the MBT Act.

Legislative Analyst: Suzanne Lowe

FISCAL IMPACT

Based on estimates from the Department of Treasury, the bill would reduce General Fund revenue by approximately $32.0 million, cause the State to forego approximately $5.0 million to $10.0 million in future tax assessments that would be directed to the General Fund, and prevent the State from paying approximately $1.1 billion in MBT refunds (which would reduce General Fund revenue if paid) as a result of a recent Michigan Supreme Court decision. The provisions of the bill generally would: 1) exclude certain income and receipts from the tax base, 2) alter the calculation for computing or applying certain credits, and 3) retroactively prohibit the application of alternative ways to apportion taxable business activity between states. The bill also would appropriate $1.0 million to the Department of Treasury to implement the requirements of the bill concerning refunds.

The first two types of changes would result in approximately $32.0 million in MBT refunds, and the bill would require that those refunds be paid over a period of six years, with interest. The applicable interest is expected to change over the payment period, but on average refunds would total approximately $6.3 million per year.

The first enacting section of the bill would retroactively repeal the State's enactment of the Multistate Tax Compact, effective January 1, 2008. As a result, taxpayers filing under the MBT would not be allowed to use alternative apportionment calculations provided under the Compact when computing a Michigan tax base. While the Department of Treasury has not allowed taxpayers to use these alternative calculations, the Michigan Supreme Court's recent decision in *IBM Corp.* v *Department of Treasury* may enable certain taxpayers to use these calculations, and the Department estimates that approximately $1.1 billion in refunds would be paid as a result. Because MBT revenue is directed to the General Fund, these refunds would reduce General Fund revenue, and the bill would prevent a reduction in General Fund revenue of $1.1 billion. The majority of these refunds would likely be paid during FY 2014-15 and FY 2015-16. At this time, it is unknown if repealing Michigan's participation in the Multistate Tax Compact would have any additional fiscal impact.

The second enacting section would make the other changes retroactive to January 1, 2010. As a result, the loss of revenue would likely be substantially greater than if the bill were not retroactive. The bill's changes also would reduce future revenue, but by a significantly smaller magnitude than the impact from the retroactivity of the bill.

The bill would not affect local unit revenue or expenditure.

Fiscal Analyst: David Zin

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