



**Senate Fiscal Agency**  
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Senate Bill 367 (as passed by the Senate)  
Sponsor: Senator Jack Brandenburg  
Committee: Finance

Date Completed: 9-18-13

### **RATIONALE**

Michigan's Corporate Income Tax (CIT) was enacted in 2011 to replace the Michigan Business Tax. Although there are numerous differences between the two, the CIT retains the concept of unitary business group filing, which treats multiple businesses as a single taxpayer when they file as a unitary group. A unitary business group consists of two or more corporations, financial institutions, or insurance companies that satisfy both a "control test" and one of two "relationship tests" (described below). Evidently, applying these tests to determine the members of a unitary group requires a very fact-specific review, which can be difficult for taxpayers and time-consuming for auditors. To address this, some people believe that Michigan should allow taxpayers to choose to be treated as a unitary business group if they belong to an "affiliated group" according to Federal law.

### **CONTENT**

**The bill would amend Part 2 (Corporate Income Tax) of the Income Tax Act to allow a member of an affiliated group to elect to have all members of that group treated as a unitary business group, without the consent of the Department of Treasury, for a renewable 10-year period. The bill would incorporate a definition of "affiliated group" found in the Internal Revenue Code, but adopt a more-than-50%-ownership test for membership in a group.**

The Act requires a unitary business group to file a combined return that includes each U.S. person that is included in the unitary business group. Each U.S. person included in a unitary business group or included in a combined return is treated as a single person, and all transactions between the people included in the group must be eliminated from the Corporate Income Tax base and apportionment formulas under the Act.

Under the bill, a taxpayer that was part of an affiliated group could elect to have all of the members of that group treated as a unitary business group, without the consent of the Department. The taxpayer would have to compute its tax under Part 2 in accordance with all other provisions of the part that apply to a unitary business group.

Any member included in the affiliated group would be considered to have waived any objection to its inclusion in that group and treatment as a unitary business group.

The election would be binding for and applicable to the tax year for which it was made and for the next nine tax years. When the election expired after having been in effect for 10 tax years, it could be renewed for another 10 tax years, without the Department's consent. If an election were not renewed, however, a new election could not be made in any of the following three tax years.

A taxpayer would have to make the election or renewal on a form or in a format as prescribed by the Department, to be filed in a timely manner with the taxpayer's annual return. A renewal would have to be filed with the annual return after the completion of a 10-year period for which an election was in place.

The Act defines "unitary business group" as a group of U.S. persons that are corporations, insurance companies, or financial institutions, other than a foreign operating entity, one of which owns or controls more than 50% of the ownership interests with voting rights or comparable rights of the other members (the control test), and that has business activities or operations that 1) result in a flow of value between or among members included in the group or 2) are integrated with, are dependent upon, or contribute to each other (the alternative relationship tests). The bill also would include in the definition an affiliated group that made the election to be treated, and to file, as a unitary business group, as provided above.

"Affiliated group" would mean that term as defined in Section 1504 of the Internal Revenue Code, except that it would include all persons, other than a foreign operating entity, incorporated in the United States or formed under the laws of the United States, any state, the District of Columbia, or any territory or possession of the U.S., that are commonly owned, directly or indirectly, by any member of the affiliated group and other members of the group of which more than 50% of the ownership interest with voting rights or ownership interests that confer comparable rights is directly or indirectly owned by a common owner or owners.

(Section 1504 of the Internal Revenue Code defines "affiliated group" as follows:

- (A) One or more chains of includible corporations connected through stock ownership with a common parent corporation that is an includible corporation, but only if –
- (B) (i) the common parent directly owns stock meeting the requirements of an "80-percent voting and value test" in at least one of the other includible corporations, and
- (ii) stock meeting the requirements of the 80-percent voting and value test in each of the includible corporations (except the common parent) is owned directly by one or more of the other includible corporations.)

MCL 206.603 et al.

## **ARGUMENTS**

*(Please note: The arguments contained in this analysis originate from sources outside the Senate Fiscal Agency. The Senate Fiscal Agency neither supports nor opposes legislation.)*

### **Supporting Argument**

According to the Council On State Taxation, a nonprofit trade association, "The concept of a 'unitary business' is uniquely factual and universally poorly defined...In order to evaluate the taxpayer's determination of a unitary relationship, state auditors must look beyond accounting and tax return information. Auditors must annually determine how a taxpayer and its affiliates operate at a fairly detailed level to determine which affiliates are unitary...Determining the scope of the unitary group is a complicated, subjective, and costly process that...often results in expensive, time-consuming litigation."

In Michigan, the CIT retains the vagueness and uncertainty that were part of unitary group determinations under the Michigan Business Tax. Because determining the composition a unitary group is highly specific and subjective, this issue alone can extend an audit by several years, without reaching a resolution for future tax years. On the other hand, the Federal standard for determining an affiliated group is clear, certain, and predictable, and uses an objective measurement: ownership percentage.

The bill would "piggyback" on the Federal compliance requirement, and allow corporate taxpayers to report income under the CIT based on a similar affiliated group concept, subject to modifications that would align it with common State reporting requirements (such as use of a more-than-50% ownership threshold). An affiliated group election would provide more certainty

in the group composition, enhance the accuracy of filed returns, and reduce the time and expense spent on reviewing or auditing returns.

In addition, making the election binding for 10 years would protect against abuse and reduce the tendency of taxpayers and auditors to view unitary business indicators in terms of what will produce less, or more, revenue from a given return.

Legislative Analyst: Suzanne Lowe

### **FISCAL IMPACT**

The bill would reduce State General Fund revenue by an unknown amount. The actual amount of the reduction would depend on how many taxpayers made the election and the specific characteristics of those taxpayers. Depending on the taxpayers, the reduction in revenue could be significant. Taxpayers that would experience higher liabilities would not be expected to elect to file under the provisions of the bill.

Fiscal Analyst: David Zin