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Senate Bill 367 (as enacted)
Sponsor: Senator Jack Brandenburg
Senate Committee: Finance
House Committee: Tax Policy

PUBLIC ACT 266 of 2013

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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 suggested that Michigan 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 amended 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 incorporates a definition of "affiliated group" found in the Internal Revenue Code, but adopts a more-than-50%-ownership test for membership in a group.

The bill took effect on December 30, 2013, and is effective for tax years beginning after December 31, 2012.

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 person that is part of an affiliated group may elect to have all of the people that are included in that group treated as a unitary business group, without the consent of the Department. The taxpayer must compute its tax under Part 2 in accordance with all other provisions of the part that apply to a unitary business group.

Each person included in the affiliated group will be considered to have agreed to be bound by the election made under these provisions and any renewal of that election, and to have waived any objection to its inclusion in that group and treatment as a unitary business group. Each person that subsequently enters the affiliated group after the tax year for which the election is made will be deemed to have consented to the application of and will be bound by the election, and to

have waived any objection to its inclusion in the group and treatment as a unitary business group.

The election is irrevocable and binding for and applicable to the tax year for which it is made and for the next nine tax years. The election must remain in effect for the time period in which the ownership requirements are met regardless of whether a Federal consolidated group to which the unitary business group belongs discontinues the filing of a Federal consolidated return or whether the common parent changes due to a reverse acquisition or acquisition by a related person.

When the election expires after having been in effect for 10 tax years, it may be renewed for another 10 tax years, without the Department's consent. If an election is not renewed, however, a new election may not be made in any of the following three tax years.

An election or renewal must be made 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 must be filed with the annual return after the completion of a 10-year period for which an election is 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 includes in the definition an affiliated group that makes the election to be treated, and to file, as a unitary business group, as provided above.

The bill defines "affiliated group" as that term is defined in Section 1504 of the Internal Revenue Code, except that the bill's definition includes all United States persons that are corporations, insurance companies, or financial institutions, other than a foreign operating entity, 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 interests 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 retained 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 "piggybacks" on the Federal compliance requirement, and allows corporate taxpayers to report income under the CIT based on a similar affiliated group concept, subject to modifications that align it with common State reporting requirements (such as use of a more-than-50% ownership threshold). An affiliated group election will 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 will 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 will reduce State General Fund revenue by an unknown amount beginning with tax year 2013. The actual amount of the reduction will depend on how many taxpayers make the election and the specific characteristics of those taxpayers. Depending on the taxpayers, the reduction in revenue may be significant. Taxpayers that would experience higher liabilities are not expected to elect to file under the provisions of the bill.

The bill will reduce the administration costs of the Department of Treasury by an unknown amount, by simplifying tax return review and audits in some cases.

Fiscal Analyst: Elizabeth Pratt

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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.