

CREATE FLOW-THROUGH ENTITY TAX

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Senate Bill 1170 as enrolled
Sponsor: Sen. Dave Hildenbrand
House Committee: Tax Policy
Senate Committee: Finance
Complete to 6-11-19

Analysis available at
<http://www.legislature.mi.gov>

(Vetoed by the Governor 12-28-18)

SUMMARY:

Senate Bill 1170 would modify the Income Tax Act by adding a new Part 4, Chapter 18 that would do all of the following:

- For tax years beginning on and after January 1, 2018, levy a flow-through entity tax equal to the individual income tax rate on every flow-through entity that elected to pay the new flow-through entity tax, unless otherwise prohibited by federal law.
- Specify that the flow-through entity tax would be imposed on the positive business income allocated or apportioned to Michigan subject to certain adjustments made prior to allocation or apportionment to Michigan.
- Require that the tax base established be apportioned in accordance with the allocation and apportionment provisions in Chapter 3 of the Act and specify when a taxpayer would be subject to tax in another state.
- Allow a flow-through entity allocated income as a member of flow-through entity to claim a credit against the flow-through entity tax in an amount equal to the taxpayer's allocated share of the flow-through entity tax as reported by the other flow-through entity.
- Authorize a flow-through entity to apply a credit against the total flow-through entity tax for the amount of an income tax imposed on the flow-through entity by another state, a political subdivision of another state, the District of Columbia, or a Canadian province, on income derived from certain sources outside Michigan.
- Require a flow-through entity that reasonably expected its tax liability to exceed \$800 to file an estimated return and pay an estimated tax for each quarter of the tax year.
- Prescribe how a flow-through entity electing to pay the tax must file its election and provide for other stipulations regarding the irrevocability and duration of the election.
- Authorize the Department of Treasury to extend the filing deadline for the annual return upon application of the flow-through entity and for good cause shown. Interest at the rate under Section 23(2) would be added to the amount of the tax unpaid for the period of the extension.
- Allow the Department of Treasury to require copies of or updates to federal income tax returns to be filed with the department.
- Require a flow-through entity that did not make the election to pay the flow-through entity tax to provide certain tax information to any member to which the provision of information is required by the Internal Revenue Code.

- Require an estate or trust that is a member of a flow-through entity electing to pay the flow-through entity tax to report to its beneficiaries their allocable share of the tax incurred by the estate or trust.
- Allow a unitary business group to file a combined return and require that all transactions between persons of a unitary business group be eliminated from the flow-through entity business income tax base and from the apportionment formulas.
- Authorize a person that is part of an affiliated group to elect, without the consent of the Department of Treasury, to have all of the persons in the affiliated group be treated as a unitary business group. This election would be irrevocable and binding for 10 years.
- Permit the Department of Treasury to promulgate rules to implement the provisions of the bill and require the Department of Treasury to administer the flow-through entity tax. The Department of Treasury would also be required to prepare and publish statistics that detail the distribution of tax receipts by type of business, legal form of organization, sources of tax base, timing of tax receipts, and types of deductions.
- Require that the percentage of gross collections of the flow-through entity tax, before refunds, that is equal to 1.012% divided by the tax rate levied under this part be deposited in the State School Aid Fund (SAF) and that the balance of the revenue collected be deposited in the general fund.
- Appropriate \$5.0 million in FY 2018-19 to the Department of Treasury to begin implementing the requirements of the bill and create a work project account so that any unexpended funds could be carried forward and spent in the following fiscal year.
- Require that a person that is a disregarded entity for federal income tax purposes be classified as a disregarded entity for purposes of the bill.

The bill would authorize a taxpayer who was either a member or indirect member of a flow-through entity that elected to file and pay the flow-through entity tax created under the bill to claim a credit against the Michigan individual income tax or Michigan corporate income tax in an amount equal to the member's allocated share of the tax as reported to the member by the flow-through entity. Any credit claimed would be refundable.

The bill would be retroactive and effective for tax years beginning on and after January 1, 2018.

MCL 206.254 et seq.

FISCAL IMPACT:

As written, the purpose of the bill is to allow the tax liability from flow-through income in Michigan to be paid in such a manner that the tax is deductible at the federal level on the corporation tax return (which doesn't cap deductions for state and local taxes), as opposed to a recipient's individual income tax return (on which the equivalent deduction has been capped at \$10,000 by the Tax Cuts and Jobs Act).

With respect to the Michigan individual income tax, because the revenue from the modified approach to taxing flow-through income would be distributed in the same way as other revenue collected under the individual income tax, there would be no impact on either total revenue or the amounts accruing to the SAF and general fund.

According to the Department of Treasury, the one-time costs associated with creating a new information technology system to implement the tax changes under the bill would be \$8.0 to \$10.0 million.

Vetoed 12-28-18:

In his veto message, Governor Snyder said, “I believe that this particular legislation has significant issues.” He also observed: “This substantial change to the state tax code was passed in little over a month. The passage of such a bill and implementation of a brand-new tax in such a limited time is inappropriate given the significance of such a change, and the risk of IRS action.”

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