Senate Fiscal Agency
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BILL ANALYSIS

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Senate Bill 1170 (Substitute S-1 as reported)
Sponsor: Senator Dave Hildenbrand
Committee: Finance

CONTENT

The bill would amend the Income Tax Act to create Part 4, Chapter 18, which would do the following:

-- Beginning January 1, 2018, and each tax year after 2018, levy and impose a flow-through entity tax equal to the individual income tax on every taxpayer with business activity in the State unless otherwise prohibited by Federal law.
-- For tax years beginning on and after January 1, 2018, allow a flow-through entity to elect to file a return and pay the flow-through entity tax.
-- Specify that the flow-through entity tax would be imposed on the positive business income tax base, subject to certain adjustments.
-- State that the tax base established under the bill would have to be apportioned in accordance with allocation and apportionment provisions in Chapter 3 of the Act.
-- List the circumstances under which a taxpayer would be subject to tax in another state.
-- Allow any taxpayer allocated income as a member of a flow-through entity by the 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 tax as reported by the other flow-through entity.
-- Allow a taxpayer a credit against the flow-through entity tax for the amount of an income tax imposed on the taxpayer for the tax year by another state, the District of Columbia, or a Canadian province, on income derived from certain sources outside of Michigan.
-- Beginning with the 2019 tax year, require a taxpayer that reasonably expected liability for the tax year to exceed $800 to file an estimated return and pay an estimated tax for each quarter of the tax year.
-- Require a flow-through entity that elected to pay the flow-through entity tax to either file an annual or final return or file an irrevocable election to pay the tax beginning January 1, 2018.
-- Allow the Department of Treasury to extend the date for filing the annual return upon application of the taxpayer and for good cause shown.
-- Require a taxpayer or a flow-through entity that did not make the election to file a return to provide certain information to any member to which the provision of information would be required by the Internal Revenue Code.
-- Require certain estates and trusts to report to its beneficiaries their allocable share of the flow-through entity tax.
-- Allow a unitary business group to elect to file a combined return.
-- Require the Department to administer the flow-through entity tax and allow it to promulgate rules for the maintenance of certain information.
-- Require the Department to prepare and publish statistics from the records kept to administer the flow-through entity tax.
-- Specify that the revenue collected under the bill would have to be distributed to the General Fund.

-- Specify that a person that was a disregarded entity for Federal income tax purposes under the Internal Revenue Code would have to be classified as a disregarded entity for the purposes of the bill.

In addition, the bill would allow a taxpayer who was either a member of a flow-through entity or an indirect member of a flow-through entity that elected to file under the bill to claim a credit against the individual income tax or Corporate Income Tax.

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

MCL 206.254 et al. Legislative Analyst: Drew Krogulecki

FISCAL IMPACT

While the bill would not affect total State revenue, the bill would reduce individual income tax revenue to the School Aid Fund, and increase General Fund revenue, by approximately $180.0 million per year, based on data from tax year 2016. However, to the extent that some taxpayers did not elect to file under the bill's provisions, the shift in revenue between the two Funds would be less. It is unknown how many taxpayers would elect to file under the bill's provisions. Furthermore, because business income tends to swing significantly from year to year, and can change substantially in reaction to changes in the economy, the impact of the bill could vary significantly from year to year.

Under the bill, a portion of the liability that is currently paid under the individual income tax effectively would be paid under a new tax created in a new Part 4 of the Income Tax Act. The new tax would be credited to the General Fund, while currently 23.8% of individual income tax revenue is distributed to the School Aid Fund.

The impact assumes that taxpayers would no longer make income tax withholding, or quarterly or annual payments, under the individual income tax for income covered by the bill's provisions. To the extent that taxpayers did make such payments, the reduction in School Aid Fund revenue would be less (and the gain in General Fund revenue would be less) than estimated because the School Aid Fund earmark is applied against gross collections (thus excluding any refunds).

Date Completed: 11-28-18 Fiscal Analyst: David Zin