Legislative Analysis

CREATE FLOW-THROUGH ENTITY TAX

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House Bill 4288 (proposed substitute H-1)
Sponsor: Rep. Mark Tisdel
Committee: Tax Policy
Complete to 4-28-21

SUMMARY:

House Bill 4288 would amend the Income Tax Act by adding a new Part 4 that would do all of the following:

- For tax years beginning on and after January 1, 2021, 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. (If the tax credit exceeded the taxpayer's liability, the difference would be refunded.) The same would apply to a nonresident estate or trust, except that the credit would be adjusted to account for the current state income tax rate. [Sec. 254]
- Prescribe how a flow-through entity electing to pay the new tax must file its election with the Department of Treasury and stipulate that the election would be irrevocable for the next two tax years. [Sec. 791]
- 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. [Sec. 759]
- 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. [Sec. 761]
- Allow a taxpayer 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 that tax as reported by the other flow-through entity. [Sec. 771]
- Require a taxpayer 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. [Sec. 781]
- Provide a deadline of three months after the taxpayer's tax year for filing of the annual or final return for the flow-through entity tax, unless the taxpayer was granted an extension by the Department of Treasury, upon application 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. [Sec. 785]
- Allow the Department of Treasury to require copies of federal income tax returns and require amended returns to be filed with the department. [Sec. 787]
- Require a flow-through entity that did not make the election to pay the new tax to provide certain tax information to any member to which the information is required to be provided by the Internal Revenue Code. [Sec. 789]
- Require an estate or trust that is a member of a flow-through entity electing to pay the new tax to report to its beneficiaries their allocable share of the tax incurred by the estate or trust. [Sec. 789]

- Provide that the provisions of the bill would prevail if they were in conflict with provisions in 1941 PA 122, known as the revenue act. [Sec. 791]
- Permit the Department of Treasury to promulgate rules to implement the provisions of the bill and require the department to administer the flow-through entity tax. Treasury would also have to prepare and publish statistics from the records kept to administer the tax 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. [Sec. 791]
- 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 Part 4 of the act be deposited in the School Aid Fund (SAF) and that the balance of the revenue collected be deposited in the general fund. [Sec. 793]

The bill would authorize a taxpayer who was 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 refunded if it exceeded the taxpayer's tax liability. [Secs. 254 (Part 1: Individual Income Tax) and 675 (Part 2: Corporate Income Tax)]

The bill would be retroactive and effective for tax years beginning on and after January 1, 2021.

MCL 206.254 et seq.

BACKGROUND:

House Bill 4288 is a reintroduction of Senate Bill 1170 of the 2017-18 legislative session,[1] which was passed by both the House and Senate but vetoed by Governor Snyder. In his veto letter, the governor cited the substantial changes proposed in the bill and the short time frame in which it was considered.[2] Of note, that bill included an appropriation of $5.0 million in FY 2018-19 to the Department of Treasury to begin implementation of the bill's requirements and created a work project account so that any unexpended funds could be carried forward and spent in the following fiscal year. HB 4288 does not include an appropriation.

[1] http://www.legislature.mi.gov/documents/2017-2018/billanalysis/House/pdf/2017-HLA-1170-52E6BF89.pdf

[2] https://content.govdelivery.com/attachments/MIGOV/2018/12/28/file_attachments/1130290/Veto%20Letter%201170.pdf

FISCAL IMPACT:

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 does not 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 tax on flow-through entities in Part 4 would be distributed in the same way as revenue collected under the individual income tax in Part 1, there would be no impact on either total revenue or the amounts accruing to the SAF and the 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.

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