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House Bill 4288 (Substitute H-1 as reported without amendment)
Sponsor: Representative Mark Tisdell
House Committee: Tax Policy
Senate Committee: Finance

CONTENT

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

- Define various terms, including "flow-through entity" and "business income", for the purposes of Part 4.
- Define substantial nexus for the purposes of the flow-through entity tax.
- Beginning January 1, 2021, and each tax year after that, 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, 2021, 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 allocations adjustments.
- State that the tax base would have to be apportioned in accordance with allocation and apportionment provisions in Chapter 3 of the Act.
- Prohibit a taxpayer allocated income as a member of a flow-through entity by the entity from claiming a credit against the flow-through entity tax for the taxpayer's allocated share of the tax as reported by the other entity.
- Require a taxpayer that reasonably expected liability for the tax year to exceed \$800 to file an estimated return and pay a quarterly estimated tax.
- Require a flow-through entity that elected to pay the proposed tax to file an annual or final return by the last day of the third month after the end of the taxpayer's tax year.
- 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 (IRC).
- Require certain estates and trusts to report to its beneficiaries their allocable share of the flow-through entity tax.
- Require the Department to administer the flow-through entity tax and allow it to promulgate rules for the maintenance of certain information.
- Specify that the revenue collected under the bill would have to be distributed to the State School Aid Fund and the General Fund.
- Specify that a person that was a disregarded entity for Federal income tax purposes under the IRC would have to be classified as a disregarded entity for the purposes of the bill.

In addition, the bill would amend the Act to 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 states that it would be retroactive and is intended to apply retroactively for tax years beginning on and after January 1, 2021.

MCL 206.254 et al.

Legislative Analyst: Christian Schmidt

FISCAL IMPACT

The bill would have little to no impact on State revenue or local unit revenue but would impose additional operational costs on the Department of Treasury.

The bill would affect taxpayers that are flow-through entities, such as partnerships and S-corporation, but would not affect other types of businesses, such as sole proprietorships, that currently report their business income under the individual income tax. An affected taxpayer essentially would continue to report its business income under the individual income tax, but, if the taxpayer elected to pay the tax at the business level under proposed Part 4, it would receive a credit for its tax liability at the individual or corporate level (levied under Parts 1 or 2). Because the tax levied under proposed Part 4 would be at the same rate and distributed in the same manner as taxes paid under Part 1, the bill would have no effect on revenue nor on the distribution of any revenue across funds such as the General Fund and School Aid Fund.

The bill would allow affected firms to circumvent the current Federal limitation on deducting state and local taxes on Federal tax returns. Because taxpayers could be able to deduct a greater amount of State taxes at the Federal level, the bill would lower taxpayer's combined State and Federal tax liabilities.

The Federal IRS reported receiving approximately 144,000 S-corporation returns and approximately 105,000 partnership returns from Michigan in tax year 2019. In contrast, the IRS reported receiving approximately 50,000 traditional C-corporation returns from Michigan. These figures do not include returns that the State could receive by taxpayers who file from other states but have nexus with Michigan and must file a Michigan return. As a result, the Department of Treasury would need to design a new tax processing system for the new tax that could process potentially five times as many returns as are currently received under Michigan's Corporate Income Tax. The Department of Treasury estimates that the new system would cost between \$8.0 million and \$10.0 million to design and implement. These figures do not include any potential ongoing operational costs of the system for the proposed new tax.

Date Completed: 6-1-21

Fiscal Analyst: David Zin