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BILL ANALYSIS

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House Bill 5937 (as passed by the House)  
Sponsor: Representative Andrew Kandrevas  
House Committee: Tax Policy  
Senate Committee: Finance

Date Completed: 3-23-10

### **CONTENT**

**The bill would amend the revenue Act to give direction to the Department of Treasury regarding the treatment of a taxpayer that filed a Single Business Tax return that included an entity disregarded for Federal income tax purposes, and the treatment of the disregarded entity.**

Specifically, for a taxpayer that filed a tax return under the former Single Business Tax (SBT) Act that included an entity disregarded for Federal income tax purposes under the Internal Revenue Code, both of the following would apply:

- The Department of Treasury could not assess the taxpayer an additional tax or reduce an overpayment because the taxpayer included the disregarded entity on its SBT return.
- The Department could not require the disregarded entity to file a separate tax return.

In addition, if a taxpayer filed an SBT return that included an entity disregarded for Federal income tax purposes, the taxpayer could not claim a refund based on the disregarded entity's filing a separate return as a distinct taxpayer.

The bill states the following: "This amendatory act is curative, shall be retroactively applied, and is intended to correct any misinterpretation concerning the treatment of an entity disregarded for federal income tax purposes under the internal revenue code under... [the former SBT Act] that may have been caused by the decision of the Michigan court of appeals in Kmart Michigan Property Services v Michigan Department of Treasury, No. 282058, May 12, 2009. However, this amendatory act is not intended to affect a refund resulting from a final order of a court of competent jurisdiction for which all rights of appeal have been exhausted prior to February 12, 2010 to a taxpayer who is a party to that proceeding."

MCL 205.27a

### **BACKGROUND**

*Kmart Michigan Property Services v Michigan Department of Treasury* (283 Mich App 647) addressed the tax treatment of Kmart Michigan Property Services (KMPS), which was a limited liability company wholly owned by Kmart Corporation. The Michigan Court of Appeals held that KMPS was entitled to file a separate Single Business Tax return even though it had elected to be disregarded as an entity separate from its owner for Federal tax purposes.

The issue arose after the Department of Treasury audited KMPS in connection with an audit of Kmart Corporation. The Department determined that KMPS should not have filed a separate SBT return, but should have submitted its income, deductions, credits, assets, and liabilities with those of Kmart for the tax year at issue.

KMPS would have been entitled to a refund for the tax year if the Department had allowed it to file a separate SBT return. A referee determined that KMPS was not entitled to a refund, and the company appealed to the State Tax Tribunal.

KMPS argued that it met the definition of "person" under the SBT Act (which required every person with business activity in the State to pay the SBT), and therefore qualified to file a separate return. The Department argued that KMPS had to file its SBT return as a disregarded entity, since it was a single-member limited liability company—in which case KMPS's income would have been attributed to its owner, and Kmart would have been responsible for paying all taxes due. The Tax Tribunal concluded that a limited liability company fit within the statutory definition of "person" whether it had one or more members.

The Department then contended that the decision of KMPS to be a disregarded entity for Federal tax purposes overrode its legal status as a person for State tax purposes. Under U.S. Treasury regulations, certain organizations that have a single owner may choose to be recognized or disregarded as entities separate from their owners. The parties agreed that KMPS had elected to be a disregarded entity for Federal tax purposes.

The Department relied on Revenue Administrative Bulletin (RAB) 1999-9, which required a taxpayer to file its SBT return on the same basis as its election for Federal taxation. The RAB also stated, "[I]f a single member entity is disregarded for federal income tax purposes, its activities are included as part of the owner's activities...". The Tax Tribunal noted, however, that the RAB did not have the force of a legal requirement.

The Court of Appeals agreed that KMPS was not legally required to follow the RAB and stated, "Neither the SBTA [Single Business Tax Act] nor federal regulations require an entity to be consistent in its self-classification with respect to its state and federal tax filings for a given year...[T]he SBTA does not support the requirement of RAB 1999-9 that an organization that is a disregarded entity for federal tax purposes for a given taxable period must also file as a disregarded entity for state tax purposes."

The Michigan Supreme Court denied leave to appeal.

Legislative Analyst: Suzanne Lowe

## **FISCAL IMPACT**

The bill would have an indeterminate effect on State revenue and no effect on local revenue or expenditure. Any impact on State revenue would affect the General Fund. Entities that were previously excluded could either exhibit liabilities or be due refunds. The impact of the bill would depend on the net impact of the additional returns that would be received absent the bill.

Fiscal Analyst: David Zin

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