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House Bill 4288 (Substitute H-4 as passed by the House)
House Bill 4292 (Substitute H-4 as passed by the House)
Sponsor: Representative Frank Foster (H.B. 4288)
Representative Peter MacGregor (H.B. 4292)
House Committee: Tax Policy
Senate Committee: Finance

Date Completed: 2-12-14

CONTENT

House Bills 4288 (H-4) and 4292 (H-4) would amend the General Sales Tax Act and the Use Tax Act, respectively, to allow the Department of Treasury to assess sales or use tax based on an indirect audit procedure if a person failed to file a return or maintain sufficient records.

Under the Acts, a person liable for the tax is required to keep certain records in a form that the Department requires, and, if an exemption is claimed because a sale is for resale at retail, a record of the person's sales tax license number. These records must be kept for four years after the tax is imposed. If the taxpayer fails to file a return or to maintain proper records, or if the Department believes the records or returns are inaccurate or incomplete, the Department may make an assessment based on information that is available to the Department.

The bills would refer to "sufficient records", rather than "proper records". Each bill would define "sufficient records" as "records that meet the department's need to determine the tax due under this act".

If a taxpayer failed to maintain and preserve sufficient records, or failed to file a tax return, or the Department had reason to believe that the records and returns were inaccurate or incomplete, the Department could assess the amount due based on available information or based on an "indirect audit procedure". The bills would define "indirect audit procedure" as "an audit method that involves the determination of tax liabilities through an analysis of a taxpayer's business activities using information from a range of sources beyond the taxpayer's declaration and formal books and records".

The bills would require that an indirect audit be conducted in accordance with the revenue Act and the standards published by the Department under Section 21 of that Act (which provides for informal conferences on the question of liability for a tax assessment). The bills also would require that indirect audits include the following elements:

- A review of the taxpayer's books and records.
- An evaluation of the credibility of the evidence and the reasonableness of the conclusion before a determination on tax liability was made.
- Reasonable methods to reconstruct income, deductions, or expenses, including third-party records.

-- An investigation of all reasonable evidence proffered by the taxpayer to refute the computation.

The bills would allow the Department to use an indirect method to test the accuracy of the taxpayer's books and records.

The bills also would prohibit the Department from basing a tax deficiency assessment on an indirect audit if the taxpayer had filed all of the required returns and maintained and preserved sufficient records, unless the Department had a documented reason to believe that the returns or records were inaccurate or incomplete and that additional taxes were due.

In addition, in the language requiring a person to keep records, the bills would add, "in a paper, electronic, or digital format".

MCL 205.68 (H.B. 4288)
205.104a (H.B. 4292)

Legislative Analyst: Jeff Mann

FISCAL IMPACT

The bills would increase the operating costs of the Department of Treasury by an estimated \$125,000 annually. The Department of Treasury has indicated that the additional documentation required by the bills before the Department used an indirect audit method would increase audit hours and the time spent in litigation to defend audit results. This redirection of audit resources would possibly reduce the total number of audits performed, resulting in a reduction in State revenue of an unknown amount. Revenue from the sales tax is distributed primarily to the School Aid Fund and to constitutional revenue sharing. Use tax revenue is distributed two-thirds to the General Fund and one-third to the School Aid Fund.

Fiscal Analyst: Elizabeth Pratt

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This analysis was prepared by nonpartisan Senate staff for use by the Senate in its deliberations and does not constitute an official statement of legislative intent.