



MOODY, FAMIGLIETTI & ANDRONICO

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State & Local Tax Alert

Subject:

Disregarded Entities May Be Required to File Michigan Single Business Tax Returns

Summary

A significant case has recently been decided relating to the repealed Michigan Single Business Tax (“SBT”).¹ The case dealt with the proper SBT treatment of entities that are disregarded for federal income tax purposes. In the past, the Michigan department of Treasury (“Treasury”) issued Revenue Administrative Bulletin (“RAB”) 1999-9 that required entities treated as disregarded entities for federal income tax purposes to file using the same methodology for SBT purposes. However, in a 2009 case,² the Michigan Court of Appeals found that this RAB was invalid and, therefore, entities disregarded for federal income tax purposes should have been regarded for SBT purposes and considered separate “persons” under the SBT.³ After the Michigan Supreme Court denied leave to appeal the decision,⁴ Treasury recently distributed guidance for taxpayers on how to address the retroactive implications of this case (go to www.michigan.gov/taxes for a complete copy of the notice from Treasury).

Taxpayers Affected

Any SBT taxpayer that included one or more disregarded entities in any of its SBT returns since 1997 might have additional filing responsibilities.

Actions To Be Taken

Owner of one or more disregarded entities: Amended returns must be filed by September 30, 2010, for all open taxable years, removing the impact of all disregarded entities that were originally included within the owner’s SBT (i.e., items of tax base, apportionment factors, tax credits, etc.). Note that the general statute of limitations for SBT purposes is four years from the later of the date the return was filed or the due date of the return (including extensions). The September

If you would like to discuss the content of this State and Local Tax Alert, please call:

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¹ The Single Business Tax was applicable to business activity through December 31, 2007, and was replaced with the Michigan Business Tax, which is applicable to business activity after December 31, 2007.

² *Kmart Michigan Property Services, LLC v Dep’t of Treasury (“Kmart”)*, 283 Mich. App. 647, 770 N.W.2d 915 (2009).

³ Treasury’s position is that, not only is RAB 1999-9 invalid, but RAB 2000-5 is also invalid even though RAB 2000-5 was not at issue in the Kmart decision. RAB 2000-5 deals with the SBT treatment of qualified subchapter S subsidiaries.

⁴ *Kmart Michigan Property Services LLC v Dep’t of Treasury (“Kmart”)*, 283 Mich. App. 647 (2009), lv. den. 772 N.W.2d 421 (S. Ct. Mich. 2009).

30, 2010, filing deadline is only applicable to the waiver of penalties on additional tax that may be owed as a result of the removal of the disregarded entities from a previously-filed SBT. The September 30, 2010, due date is not relevant if the taxpayer is expecting a refund from the removal of disregarded entities. Instead, the expiration date of the statute of limitations is the critical date.

Disregarded entities: If a disregarded entity that was previously included within another taxpayer's SBT has nexus in Michigan independent of its parent and meets the filing threshold, SBT returns must be filed for all taxable years by September 30, 2010, to have any failure-to-file penalties waived. Note that, because no returns have been filed by the disregarded entities, it is Treasury's position that the period of limitations has not expired. RAB 1999-9 applied beginning on January 1, 1997 (the effective date of the federal regulations), so returns could be required for taxable years back to 1997. Disregarded entities might also be required to register with Treasury before filing any returns.

Issues To Consider

There are several issues to consider for taxpayers affected by this notice:

- What is the impact on the financial statements? Although for most taxpayers this is not an issue to which Financial Accounting Standards Board Accounting Standards Codification 740, Income Taxes ("FASB ASC 740"),⁵ will apply because the SBT was not typically considered an income tax, it at least should be considered under FASB ASC 450, Contingencies,⁶ for all taxpayers that keep their books consistent with generally accepted accounting principles ("GAAP").
- Do both the SBT filer and its disregarded entity (or entities) have SBT nexus and meet the filing threshold? Because the entities are now considered separate "persons," it is possible

that one or more of the entities will not be required to file.

- When does the earliest open SBT taxable year close for any taxpayer that included disregarded entities on its SBT return? It is critical that taxpayers determine the expiration dates of the statute of limitations on any SBT returns that were filed including disregarded entities because, if the removal of those disregarded entities will produce refunds, those refunds will be time barred if refund claims are not filed prior to the expiration of the statute.
- Can taxpayers net amounts due/refundable with respect to taxable years that are open for the previous SBT taxpayer? For example, does the disregarded entity get credit for payments made by its owner, or will the two taxpayers be treated separately? The answer will affect the deficiency interest calculations.
- If a disregarded entity owes tax in a prior taxable year in which the originally-filed SBT (filed by the owner of the disregarded entity) is closed under the statute of limitations, will the disregarded entity get credit for any payments made by the taxpayer on the originally filed return(s)?

Impact On The Michigan Business Tax

Even though the Kmart decision only applied to taxable years under the SBT, the rationale contained within the case may also apply to the Michigan Business Tax ("MBT"). The MBT incorporates a very similar definition of "person" that was at issue in the Kmart case and also lacks an explicit adoption of Treas. Reg. § 301.7701-3 (commonly referred to as the "check-the-box" rules). This means that disregarded entities could be considered regarded entities for MBT purposes. For most taxpayers this may not have a significant impact on a taxpayer's overall MBT liability because the MBT Act requires mandatory combined reporting, and

because certain mechanics of the MBT cause the overall tax to be unchanged irrespective of whether or not an entity is considered to be regarded or disregarded (e.g., the adoption of Finnigan). Even though for most situations the overall calculation of tax will be unchanged whether an entity is regarded or disregarded, there are certain limited situations/transactions that may result in a change in tax if a federally disregarded entity is treated as regarded for MBT purposes. If a taxpayer has disregarded entities that are included within an MBT filing, a review of those entities is important to identify whether any material tax ramifications could occur with a change in the manner of treating the entity for MBT purposes.

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⁵ Formerly Financial Accounting Standards Board ("FASB") Statement No. 109, *Accounting for Income Taxes*, including FASB ASC 740-10, formerly FASB Interpretation No. 48 ("FIN 48"), *Accounting for Uncertainty in Income Taxes*.

⁶ Formerly FASB Statement No. 5, *Accounting for Contingencies*.