



State and Local Tax Alert: 2010-02

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Michigan Filing Requirements for Disregarded Entities Under Michigan SBT

On February 5, 2010 the State of Michigan Department of Treasury released its position on ***Kmart Michigan Property Services LLC v Dep't of Treasury*** (283 Mich App 647 (2009)). ([View Here](#)) The impact of this decision is that entities normally disregarded for federal income tax purposes are not disregarded for Michigan Single Business Tax (SBT) or Michigan Business Tax (MBT). If a taxpayer filed a Michigan SBT return that included disregarded entities, Treasury's position is that the taxpayer needs to amend all open years (potentially four years) removing the operating results and any related information for each disregarded entity. The disregarded entities would then need to prepare information to determine the years for which each entity exceeded the SBT filing threshold. As an example, if the disregarded entity had been in "existence" for ten years, and it exceeded the filing threshold for each of the ten years based on its separate operating results, SBT returns would be due for each year.

With Kmart, the entity at issue for Michigan tax purposes was a Single Member Limited Liability Company that was disregarded for federal income tax. This issue would also apply to a Qualified Subchapter S Subsidiary that is disregarded for federal income tax.

Is this a benefit or detriment to Michigan taxpayers?

Each taxpayer's situation, Michigan-based or not, will be unique. Without actually preparing the returns it may be impossible to determine the benefit or the cost to the taxpayer. Some taxpayers may end up with net refunds after paying the tax on all open years for the disregarded entities. Others may owe additional tax and interest going back to the original due date of the return as a result of this decision. In addition, the cost to comply with this decision, including information gathering and return preparation, will likely be significant. Filing separate SBT returns for each of the disregarded entities could impact credits, business losses, nexus and apportionment for each of the entities, including the "member" that was required to amend its SBT returns. Keep in mind that each taxpayer's operating results will stand on their own, there will be no inter-company (or entity) eliminations for the SBT filings.

What is the timing for addressing this issue?

Each taxpayer that filed an SBT return that included a disregarded entity must determine the tax years that are open to amendment. As an example, a calendar year filer that submitted their 2005 SBT return on time would have until **April 30, 2010** to amend that return. If a refund would be due for the amended 2005 SBT return, the taxpayer would need to respond quickly to submit that return. With regard to avoidance of penalty for any of the returns required as a result of the Kmart decision, Treasury has indicated that **September 30, 2010** is the deadline to submit the returns to avoid penalty (not interest).

However, Treasury's position does not take into account the Voluntary Disclosure Act (Public Act 221 of 1998) that authorizes the State Treasurer to enter into voluntary disclosure agreements with non-filing entities organized outside of Michigan. Voluntary Disclosure not only limits the years to be filed but the penalties associated with those filings as well. In addition, Treasury's position does not take into account the Taxpayer Initiated Disclosure process documented in RAB 2005-03 that waives penalties for each of the years filed in certain instances without regard to a deadline. Keep in mind both Voluntary Disclosures and Taxpayer Initiated Disclosures are based on the fact that the taxpayer has not been contacted by Treasury and other certain criteria. Due to Treasury's position on this issue, it is advisable that the taxpayer determine whether they qualify under either program prior to registering the previously disregarded entity as Treasury suggests on page 2 of the notice.

Is there a chance this position will be changed or overturned?

The Michigan Supreme Court denied leave to appeal the decision of the Michigan Court of Appeals (chose not to hear the case) that lead to Treasury's position. In fact, Treasury is now bound by the decision in that case. There is currently a movement to address the negative impact of this case on business filers through legislation and thus limit the decision to Kmart. Beene Garter LLP, the MACPA and other business groups are currently working to find a more equitable solution to this issue. There are many legal questions to be resolved since the SBT has been repealed. Any attempt to limit the decision to Kmart will require the cooperation of the State House, Senate and the Governor in a timely manner. Keep in mind that retroactively changing or correcting the law is complicated and could lead to further challenges in the future on this issue.

If amended SBT returns are filed, will Treasury offset any refunds against additional tax due for the disregarded entities that are now required to file separate SBT returns?

Treasury has indicated that it will not offset any refunds from amended SBT returns against the tax liabilities of the disregarded entities required to file SBT returns because each is deemed to be a separate taxpayer. This could be a significant hardship to many taxpayers because refunds, even for current returns, have been slow in coming. A taxpayer that owes significant amounts of tax as a result of filing the "delinquent" SBT returns for the disregarded entities may have to pay the additional tax prior to receiving the refunds to offset the "out of pocket" costs associated with the compliance.

Will Treasury allow any additional tax due to be paid over time?

This issue is unclear at the moment. Nothing in the Notice from Treasury specifically addresses payment plans. Although the address to which all returns and amended returns are to be sent includes the line "With or Without Payment", one of the requirements for penalty relief is that the returns must be filed and tax paid by **September 30, 2010**.

What are the actual filing requirements?

The Notice addresses specific filing requirements under the heading "Completing and Filing Required Return" starting at the bottom of page 2. The filing requirements include certain disclosure requirements as well as attachments that must accompany the return. One significant required attachment is a pro-forma federal return to accompany each previously disregarded entity. As mentioned earlier, the compliance requirements associated with this issue could be substantial.

Does this decision impact a group of taxpayers that were granted permission by Treasury to file the Michigan SBT return on a Consolidated or Combined basis?

The SBT treated each entity (person) as a separate taxpayer. In some instances, a group of "affiliated" entities that met certain requirements could request permission to file a Consolidated or Combined SBT return on Form C-8007. The request had to be submitted prior to the date set for filing or the extended due date of the annual return of the parent corporation of the proposed group for the taxable year the taxpayer was requesting consolidated filing. Treasury had the sole discretion to grant or deny this request. At the time of the request **all members of the affiliated group that qualified** for consolidated or combined SBT filing had to be included in the request. Because the disregarded entities would not have been listed on the original Form C-8007, it is likely that Treasury will not treat those entities as part of the original request to file Consolidated or Combined SBT returns. Unless Treasury provides guidance to the contrary, each disregarded entity would be treated as if it were not part of the Consolidated or Combined SBT return and would need to follow the guidance set out in the Notice as previously discussed.

Does this decision apply to entities that file as part of a unitary group under the Michigan Business Tax?

In many instances, the decision in Kmart will have little impact on a unitary group of entities. However, the facts surrounding each disregarded entity will need to be reviewed to determine whether they are unitary with the other entities in the group. This is a complicated area of the MBT and should be considered as part of any unitary analysis.

So what do you recommend that taxpayers do at this time to address this issue?

As mentioned earlier, each taxpayer's situation will be unique. Lacking a fix by the legislature on this issue that eliminates any compliance, Treasury's position will stand. At a minimum;

Each SBT filer should identify any disregarded entity whose operating results were included in a previously filed SBT return for all open years.

For SBT tax return years where the statute of limitations for refunds is about to expire, consider filing an amended return to protect the refund because it is uncertain at this time whether the Legislature can come up with a timely resolution to this issue.

If there is no immediate expiration to the statute of limitations on any return years, consider waiting 30 days before beginning the process of preparing separate returns and amended returns to allow the Legislature time to address the issue.

For disregarded entities that could be impacted by this decision, begin the process of identifying the location of the records needed to support the process.

If you have questions or would like additional information, please contact us.

[David Barrons](#), Partner-in-Charge, Multi-State Tax Group

[Mike Lewakowski](#), Senior Manager, Multi-State Tax Group

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