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INTANGIBLES TAX: S-CORPORATIONS

House Bill 4816 (Substitute H-2)
First Analysis (9-29-88)

Sponsor: Rep. David M. Gubow
Committee: Taxation

THE APPARENT PROBLEM:

Generally speaking, S-Corporations are small business corporations (with no more than 35 shareholders) that pay no corporate taxes but instead require the stockholders to pay taxes on the corporations' income. These corporations often distribute a portion of their earnings to the stockholders so that they may pay the taxes due. Many such corporations, it is said, are family-owned and the stockholders are active in the business. Representatives of S-Corporations argue that distributions from such corporations ought to be considered exempt from the state's intangibles tax, which is imposed on income from or the value of intangible property (e.g., stocks, bonds, notes, and money) as opposed to real property. They argue that S-Corporations are more like partnerships than like other kinds of corporations in that the income is derived from active participation. The distributions of partnerships are exempt from the intangibles tax. (S-Corporations did not exist when the intangibles tax was enacted.) S-Corporation stockholders also argue that since distributions to stockholders are made for the purpose of paying other taxes it amounts to double taxation to subject the distributions to the intangible tax. The court of appeals has rejected arguments that S-Corporations are not subject to the intangibles tax, leaving it a policy question for the legislature. A compromise apparently has been reached on the matter between state tax officials and representatives of S-Corporations that would permit a partial exemption from the intangibles tax.

THE CONTENT OF THE BILL:

The bill would amend the Intangibles Tax Act to allow the shareholder of an S-Corporation to claim a deduction equal to the lesser of:

A) the amount distributed to the shareholder by the S-Corporation that is taxable as income under the intangibles tax; or

B) 10 percent of the shareholder's pro rata share of the corporation's federal taxable income for 1988; 15 percent of the shareholder's pro rata share of the corporate income for the 1989 tax year; and 20 percent of the pro rata share of the corporation's income after the 1989 tax year.

MCL 205.133a

FISCAL IMPLICATIONS:

According to information presented by the staff to the House Taxation Committee, the revenue loss to the state is estimated at $2.5 million to $3 million in 1988; $3.8 million to $4.4 million in 1989; and $5 million to $5.9 million in 1990. (9-27-88)

ARGUMENTS:

For:

The bill is a compromise between state tax officials and representatives of stockholders in S-Corporations that will allow those stockholders a partial exemption from the state's intangibles tax. That is a tax on such things as dividends from stock holdings. Stockholders in S-Corporations argue that they should be treated like partners in partnerships, who are exempt from the intangibles tax, because their relatively new kind of corporation more closely resembles a partnership than it does a traditional corporation. State tax officials opposed the original bill, which would have exempted S-Corporations from the tax completely, noting that there were still overall tax savings to this form of corporate ownership.

POSITIONS:

The Department of Treasury supports the substitute. (9-29-88)

The Michigan Committee To Encourage Small Business (a group of 80 businesses, many of which are S-Corporations) supported the original bill and does not oppose the substitute. (9-27-88)