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Madam Chair, Vice Chair Calley, members of the Committee - thank you for the opportunity to provide testimony regarding this important legislation.

Last fall, The Michigan Court of Appeals, in *Kmart Michigan Property Services LLC* determined that a single member limited liability company disregarded for federal tax purposes was permitted to file a separate Michigan Single Business Tax return from its owner, Kmart Corporation.

The federal law had created the concept of a "disregarded entity" to simplify the tax treatment of new forms of legal entities that were evolving at the time.

It allowed taxpayers to elect how they would be treated, that is, taxpayers have the option of having them disregarded and included in the return of their owner, or by making the so-called "check the box" election, to have them taxed separately.

Kmart involved an entity that did not check the box and therefore was disregarded for federal purposes.

Basically the court found that the SBT did not incorporate the federal concept of who a taxpayer is, since it taxed entities like partnerships without regard to their federal tax treatment, and that a disregarded entity was not bound by the election made for federal tax purposes and was entitled to be treated as a separate taxpayer under the SBT.

This decision was contrary to administrative guidance previously issued by the Department of Treasury in Revenue Bulletins 1999-9 and 2000-5, guidance that followed the federal treatment and was relied upon by Michigan businesses for business planning purposes for several years.

In a statement issued by the Department in early February, Treasury announced its intent to give full retroactive effect to the decision in *Kmart* to not only permit but also require taxpayers to follow the decision for all open tax years.

Under the notice, all taxpayers that are disregarded entities for federal tax purposes that filed as a division of their owner under the SBT must now file a separate SBT return with no statute of limitations.

Treasury views these entities as non-filers even though they were included in the returns of their owners. The owners are instructed to amend their returns to exclude those same entities, but only to the extent that the 4 year statute of limitations remains open.

The requirement to file separate returns for prior years may increase the overall tax liability or reduce it, depending on the specific facts, and frankly in most instances that I've examined with my clients the net tax change is not substantial.

There certainly are exceptions to this, since there are thousands of disregarded entities in existence. These entities very are popular with small closely held businesses, but also utilized regularly by large companies.

Another troubling aspect of the notice is the potential **whipsaw** from being limited to a four year period to claim refunds for the tax paid by the owners of these entities while being subject to unlimited assessment of tax for prior years.

The notice creates some winners and some losers from a tax standpoint, but there's a huge number of companies for which the most substantial impact is the **enormous compliance burden** in filing prior year returns for all prior years for these previously disregarded entities.

Therefore it is not merely the risk of the assessment of tax liability and interest which is troubling to the MACPA, its nearly 18,000 members, and their clients and employers. It is the extremely burdensome filing requirements which we are here today to ask that you address.

Literally **thousands** of Michigan business would be required to file years of amended returns for a tax that has been, as you very-well know, eliminated.

While many CPAs make a living filing tax returns for their clients, we and our members are focused on the greater good to our businesses and business climate in Michigan from this legislation.

It undoes the effects of this decision and preserves the original expectations of taxpayers who followed Treasury's prior guidance regarding how their businesses would be taxed.

The legislation before you is a sound, simple and balanced solution to the unfortunate consequences of the *Kmart* decision.

It does three things.

First it eliminates the return filing requirements described in Treasury's notice,

second it bars the department's ability to assess tax, interest or penalty as a result of the *Kmart* decision,

and **third**, it overrides the ability to claim a refund as a result of the decision.

In short, this legislation restores the **pre-Kmart status quo**.

I thank you for your time and ask for your support for this bill. I'll gladly answer any questions you may have.
