

Resources

Michigan Notice Would Require Federally Disregarded Entities To Be Separate Taxpayers

October 6, 2010

Preliminary Notice Issued Indicating a Reversal of Position

On October 1, 2010, the Michigan Department of Treasury (the "Department") provided preliminary notice that it intends to reverse its prior position with respect to the treatment of a federally disregarded entity (a "DRE") under the Michigan Business Tax ("MBT"). Under the Department's prior administrative position, a DRE, including single-member limited liability companies and S corporation QSubs, would be disregarded as a separate entity for purposes of the MBT. However, due to the recent court decision in *Kmart Michigan Property Services, LLC v Dep't of Treasury*,¹ the Department is changing its position and now intends to require that a DRE either file a separate MBT return, or file as a separate member of an MBT unitary group (if the unitary filing requirements are satisfied).

Under the revised position, a DRE may not file as a sole proprietorship, branch or division of its owner. The MBT now is being interpreted by the Department to require a limited liability company or a QSub of an S corporation to file a separate MBT return unless the unitary filing requirements are satisfied. No exception is made for any specific type of entity that is disregarded for federal income tax purposes. Under the Department's revised administrative position, any DRE that previously had been included in MBT returns as a sole proprietor, branch or division of its owner will be considered to be a non-filer for statute of limitations purposes. The tax effect of a DRE being included in an MBT return as a branch or division of its owner may be the same as filing a unitary return; however, as stated in the notice, the normal filing procedures must be satisfied, including, for a unitary filing, listing the DRE as a separate entity in the MBT unitary return.

Tax Years to Which the Notice Applies—Retroactive Application

The Department has taken the position that the filing requirements applicable to previously disregarded entities apply to all open tax periods under the MBT. Taxpayers that are required to amend their returns to comply with the notice must do so for all open periods, even if the amended returns do not result in a change in tax liability. Taxpayers that fail to file amended returns now may be unable to amend returns in the future, and may owe tax if a DRE must file a return and pay tax separately in the future.

Proposed Deadline for Compliance

Under the notice, a taxpayer impacted by the change in position must file all required original or amended returns for open periods by no later than January 31, 2011 to avoid potential penalties. If a taxpayer must file a separate return or join a unitary group filing, all necessary returns and schedules must be completed and filed, including pro forma federal returns.

Comment Period

The Department has indicated a willingness to review comments from taxpayers on the issues raised by its changed position with respect to DREs under the MBT Act. Taxpayers that wish to comment should provide comments to the Director of Tax Policy at the Michigan Department of Treasury prior to October 15, 2010.

Taxpayers with questions about these or other Michigan tax matters may contact Wayne D. Roberts at 616-776-7514, **Steven E. Grob** at 313-568-6582, or Sherrill D. Wolford at 313-568-6849.

Michigan Notice Would Require Federally Disregarded Entities To Be Separate Taxpayers (Cont.)

¹283 Mich App 647 (2009), lv den 772 NW2d 421 (2009).

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Taxation

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