



MULTISTATE TAX REPORT



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HIGHLIGHTS

RICO Requirements Not Met in New York Sales Tax Claim

A merchant that accused its competitor of gaining an unfair advantage by failing to charge cash customers New York sales tax and concealing that practice from the state did not suffer a sufficiently direct injury from the fraud to bring a claim under the Racketeer Influenced and Corrupt Organizations Act, the U.S. Supreme Court held in *Anza v. Ideal Steel Supply Corp.* The link between the failure to collect New York sales tax and the alleged competitive injury is too "attenuated," the court finds. **Page 335**

Texas Measure Replaces Franchise Tax With New Margins Tax

Texas enacts legislation replacing its current franchise tax with a margins tax by establishing a new base, the "taxable margin," to replace the existing tax base of taxable capital and taxable earned surplus. The constitutionality of the measure, however, is in question because the tax, which also applies to partnerships directly owned by natural persons, may result in a personal income tax created without voter approval. **Page 342**

New York Revises 'Convenience of Employer' Test for Home Offices

New York revises its application of the "convenience of employer test" as it applies to nonresidents whose assigned or primary office is in the state, but whose home office is outside of the state. According to the state, days spent in a home office will be treated as days worked outside the state if the taxpayer's home office qualifies as a bona fide employer office. **Page 326**

PERSPECTIVE

Michigan's SBT Under Assault: What Will Take Its Place?

Michigan appears poised to repeal its Single Business Tax, which was enacted in 1975 to replace the state's corporate income tax and currently produces approximately \$1.9 billion in annual revenues. In this article Patrick Van Tiflin, a partner with Honigman Miller Schwartz and Cohn LLP in Lansing, Michigan, explores possible alternatives to the SBT. **Page 309**

OUTLOOK

Change Required for Indian Tribes Hoping to Join SSUTA

The National Congress of American Indians and the Navajo Nation have begun talks with various players in an effort to gain tribal participation in the streamlined sales and use tax system. In this article, BNA examines the taxation of activities on Indian reservations and explores whether tribes should be treated as states, with the opportunity for full membership in the streamlining project. **Page 311**

ALSO IN THE NEWS

ALABAMA: ALJ finds Alabama apportionment includes certain compensation. **Page 316**

CALIFORNIA: California FTB proposes changes to rules on sourcing of income from intangibles. **Page 316**

KENTUCKY: Kentucky DOR releases emergency apportionment rules. **Page 321**

LOUISIANA: Louisiana revenue ruling explains NOL limitations following corporate ownership change. **Page 322**

MARYLAND: Tax court says sale of stock lacks nexus for Maryland taxation. **Page 324**

MASSACHUSETTS: Massachusetts DOR adopts regulation on add-back of interest, intangible expenses. **Page 325**

WISCONSIN: Rules gradually phase-in Wisconsin's single-factor apportionment for financial organizations. **Page 329**

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Perspective

Single Business Tax

Michigan's Single Business Tax was enacted in 1975 to replace the state's corporate income tax. Once touted as the wave of the future, the SBT has been under attack almost since it was adopted. Now the state seems poised to repeal the SBT, but what tax will take its place—and generate the same level of revenue? In this article, author Patrick Van Tiflin speculates about the possibilities.

Under Assault Since Its Inception, Michigan's SBT Is Sure to Be Repealed, But What Will Take Its Place?

BY PATRICK R. VAN TIFLIN

Mark Twain is said to have once remarked, "Rumors of my death are greatly exaggerated." The same cannot be said for the Michigan Single Business Tax. All involved in the political process in Michigan want to see the end of the SBT. The only question is: When?

Under current law, the tax is set to expire at the end of 2009, but Republicans in the Michigan House and Senate want the tax repealed beginning in 2007. A recent initiative petition drive proposes a citizen initiated law that would repeal the tax at the end of 2007. The initiative simply repeals the SBT; it does not specify a replacement. The petition signatures are being examined currently by the State Board of Canvassers.

A special six-member Senate/House Bipartisan Tax Replacement Committee has been appointed by Senate Majority Leader Kenneth R. Sikkema and House Speaker Craig M. DeRoche. The panel's mission is to explore alternatives to the SBT, which produces approximately \$1.9 billion in revenues per year. The leader of the Petition Drive to Repeal the SBT is Oakland County Executive L. Brooks Patterson, who is proposing that the replacement tax produce revenues of approximately \$1.5 billion—a tax cut of some \$400 million. Patterson views the tax cut as one which will be a stimulus to Michigan's economy, as well as a catalyst for further cost-cutting consolidation, streamlining, and privatizing of existing governmental programs.

Legislation enacted earlier this year would have repealed the SBT without identifying a replacement tax,

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but it was vetoed by Michigan Gov. Jennifer M. Granholm (D). That vetoed legislation would have ended the SBT at the end of 2007.

Even newly appointed Treasurer Robert J. Kleine has agreed that the SBT must go. The irony here is that Mr. Kleine was one of the architects of the SBT during its formulation in 1975, when he was director of the Office of Revenue and Tax Analysis of the Michigan Department of Management and Budget.

Thus, everyone seems to agree the tax must end, and at some point in the not too distant future, it will. The question to be explored by this article is what will replace it. First, some history.

SBT's Origins: A Rocky History

The Michigan Single Business Tax has been Michigan's principle business tax since Jan. 1, 1976. It replaced several layers of business taxes, including a corporate income tax, a franchise tax, an intangibles tax, a bank excise tax, a personal property tax on inventory, and other taxes. Over the course of time, the group of taxpayers who love to hate the SBT has greatly expanded. Various aspects of the tax have been subject to legal challenge, almost since its inception.¹

¹ *Dana Corp. v. Michigan Dept. of Treas.*, 267 Mich. App. 690; 706 N.W.2d 204 (2005) (SBT capital acquisition deduction); *Fluor Enterprises Inc. v. Michigan Dept. of Treas.*, 265 Mich. App. 711; 697 N.W.2d 539 (2005) (SBT apportionment); *Wolverine V L.P. v. Michigan Dept. of Treas.*, 265 Mich. App. 455; 695 N.W.2d 92 (2005) (SBT casual transaction); *Jefferson Smurfit Corp. v. Michigan Dept. of Treas.*, 248 Mich. App. 271; 639 N.W.2d 269 (2001) (SBT capital acquisition deduction); *Trinova v. Michigan Dept. of Treas.*, 498 U.S. 358; 111 S. Ct. 818; 112 L. Ed. 2d 884 (1991) (SBT apportionment); *Thiokol Inc. and Akzo America Inc. v. Michigan Dept. of Treas.*, 76 F.3d 751 (1996) (ERISA preemption); *Caterpillar v. Michigan Dept. of Treas.*, 440 Mich. 400; 488 N.W.2d 182 (1992) (SBT capital acquisition deduction); *Jones & Laughlin Steel Corp. v.*

The SBT has been amended so many times since its adoption in 1975 that it bears only a slight resemblance to the modified value-added tax that was touted as the wave of the future of state taxation in the nation at the time it was enacted.

At the confirmation hearing on his appointment as Treasurer, Mr. Kleine acknowledged that the current SBT is a shadow of its former self, is much too complicated, and has become a distraction. For years, taxpayers accustomed to an income-tax regime have struggled to understand why they should have substantial SBT liability at the same time they are losing money. The answer lies in the way the SBT base is calculated.

Everyone seems to agree the tax must end, and at some point in the not too distant future, it will.

Although federal taxable income is the starting point, most of the federal deductions are added back to income to arrive at the SBT base. Wages and salaries, most employee fringe benefits, depreciation, royalty expense and interest paid are among them. And in a state struggling with one of the highest unemployment rates in the nation, a tax measured by amounts paid to or for the benefit of employees is popularly viewed as counterproductive. The SBT revenue stream is more steady and predictable than the revenue generated by an income tax, but the popular perception is that the SBT is a negative influence on Michigan's attempt to participate in the good economic times being enjoyed elsewhere in the country. Rightly or wrongly, the perception has become the reality.

The SBT replaced Michigan's corporate income tax, which had been adopted in 1967. Prior to the corporate income tax, Michigan had employed a business activities tax (BAT) as its principle source of business tax revenue. The BAT presaged the SBT in that it was a tax upon a modified gross receipts base. It was in place between 1953 and 1967.

So, the \$64,000-question (or the \$400 million-question) is: "What will replace the SBT?" Here are some of the concepts being discussed:

Business License Fee

The license fee would essentially be a gross receipts tax. This plan would impose a tax on businesses based upon sales volume in Michigan. Just as with the SBT, the first \$350,000 in sales would be disregarded. Under the business license fee model, Michigan sales would be determined using the same methodology as one follows when calculating the numerator of the SBT sales factor in the three-factor tax base apportionment formula.

Combination Gross Receipts/Income Tax

A closely related proposal is a form of the former BAT. Like the SBT, it would have a deduction for capi-

tal acquisitions. This BAT simile would be coupled with an income tax based on federal taxable income. Businesses would be given the option of paying under the BAT or the income tax and might be required to stay with one or the other for a certain minimum period of years, or petition for permission to change back and forth.

Fair Tax

A third proposal being circulated is one which has been characterized in Michigan, and in other states, as the "Fair Tax Proposal." This is probably the most comprehensive of all of the proposals in that it would replace not only the SBT, but also the Michigan income tax and the personal property tax. The Fair Tax would be a very broad based sales tax, probably with a rate in the neighborhood of 9 percent. Most purchases of goods and services would be subject to the tax. In order to eliminate the regressive nature of the tax, Michigan would issue its citizens a monthly check, referred to as a "prebate," to offset what the sales tax burden would be for expenditures up to the poverty level (currently about \$25,000 per year for a family of four). The prebate would be adjusted based on family size. The tax base would include all new goods and services, would exclude all government consumption, charitable contributions, nonpublic education tuition, and intermediate sales to businesses.

Treatment of Existing Tax Incentives

Most policymakers agree that tax incentives and programs granted to Single Business taxpayers would continue to be recognized under the business license fee model and the combination gross receipts/income model. It is not clear what would happen to previously granted incentives under the Fair Tax Proposal.

Outlook for Near Term

Once the SBT repeal initiative petition signatures are reviewed, and assuming they are found to be valid, the Legislature will take up the initiative proposal. The Legislature has 40 days to enact the legislation. If the Legislature does not adopt the proposal, the initiative petition language goes before the Michigan voters in November. The initiated law that would be enacted by the Legislature or by the voters in November would not be subject to gubernatorial veto power.

The Bipartisan Tax Replacement Committee established by the Legislature is charged with responsibility to recommend a replacement tax for the SBT by Dec. 1, 2006, and a legislative vote on that replacement proposal is anticipated before the end of the year. The new tax would then go into effect at the end of 2007.

It is perhaps an understatement to say that this will be a dynamic year in Michigan politics. My advice to businesses affected by the impending repeal of the SBT is: stay tuned, stay engaged, and fasten your seatbelts. It's going to be wild ride.

Michigan Dept. of Treas., 145 Mich. App. 405; 377 N.W.2d 397 (1985) (SBT apportionment).