

## **New Michigan Department of Treasury notice creates exposure for companies with disregarded entities**

A recent tax policy adopted by the Michigan Department of Treasury (DOT) could have a very significant impact on business entities that are disregarded for federal income tax purposes. The policy will result in refunds for some companies and large tax bills for others.

### **Background**

The Michigan Court of Appeals held in *Kmart Michigan Property Services LLC v. Department of Treasury*, 283 Mich. App. 647 (2009), appeal den., 772 NW2d 421, that entities disregarded for federal tax purposes (e.g., single member limited liability companies (SMLLCs) and qualified subchapter S subsidiaries (QSSSs)) must file separate returns under the Single Business Tax (SBT). Taxpayers had previously relied on DOT RAB 1999-9 to combine disregarded entities with their parents. The court held RAB 1999-9 to be invalid. As a result of the court case, the DOT released a notice requiring disregarded entities to file a “stand alone” SBT return if they had Michigan nexus during any SBT tax year, ending December 31, 2007.

Companies with disregarded entities that have filed SBT returns must examine the effect of the Treasury announcement on the filing group. The group could face significant additional compliance costs, prior-year tax and interest, and a short timeline to obtain certain refund offsets through amended returns filed by the parent entity.

### **Required actions**

- > All disregarded entities that previously filed SBT returns with their parent entities must now file separate tax returns for each tax year going back as far as 1997.
- > Parent entities should consider amending previously filed SBT returns to remove the disregarded entities. This is only available for the 2005, 2006, and 2007 tax years.
- > Refund claims for amended returns that remove disregarded entities for the tax year ended December 31, 2005, must be filed by the later of April 30, 2009, or the actual date the return was filed (subject to the condition below).
- > All persons required to file or amend a return under the ruling and DOT Notice must do so by September 30, 2010, to avoid assessment of penalties.
- > Certain companies might be eligible to participate in the Michigan Voluntary Disclosure program. The program limits the number of prior-year SBT returns that must be filed and eliminates nonfiling penalties.

### **Taxpayer considerations**

Out-of-state companies could see a decrease in their overall SBT by excluding the disregarded entity. Unfortunately, most Michigan-based businesses will likely see an overall SBT tax increase. We can assist your business by preparing an analysis of the costs and benefits of complying with the new doctrine. Extreme caution should be exercised when making filing decisions related to the ruling. Companies that do not carefully examine the issues risk being “whipsawed” by losing available refunds and facing serious assessments for SBT, interest, and penalties.

(continued)

# Baker Tilly Tax Alert

## February 26, 2010



Candor. Insight. Results.

Other considerations:

- > The Michigan legislature could overturn the DOT's policy.
- > DOT may allow taxpayers to file returns under a Voluntary Disclosure (VDA) program, which would limit the retroactive impact of the decision to four years.
- > The DOT notice might create financial statement reporting issues related to the provision for income taxes under FIN 48 or FAS 5, relating to other non-income tax contingent liabilities.

Baker Tilly will continue to provide any pertinent developments regarding Michigan's policy. We encourage you to discuss the impact of this new policy to your circumstances with your Baker Tilly tax advisor.

---

Baker Tilly Tax Alerts provide you with timely updates about tax savings opportunities and changing regulations. Contact us at [tax@bakertilly.com](mailto:tax@bakertilly.com) with questions.

[bakertilly.com](http://bakertilly.com)

An independent member of Baker Tilly International

Baker Tilly refers to Baker Tilly Virchow Krause, LLP, an independently owned and managed member of Baker Tilly International. © 2010 Baker Tilly Virchow Krause, LLP.

Disclosure: The information provided here is of a general nature and is not intended to address the specific circumstances of any individual or entity. In specific circumstances, the services of a professional should be sought. Pursuant to the rules of professional conduct set forth in Circular 230, as promulgated by the United States Department of the Treasury, nothing contained in this communication was intended or written to be used by any taxpayer for the purpose of avoiding penalties that may be imposed on the taxpayer by the Internal Revenue Service, and it cannot be used by any taxpayer for such purpose. No one, without our express prior written permission, may use or refer to any tax advice in this communication in promoting, marketing, or recommending a partnership or other entity, investment plan, or arrangement to any other party.