

AN ALERT FROM THE BDO STATE AND LOCAL TAX PRACTICE

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► SUBJECT

“KMART FIX” LEGISLATION SIGNED INTO LAW

► SUMMARY

House Bill 5937, signed into law on March 31, 2010,¹ legislatively overrides the Michigan Department of Treasury’s (“Treasury”) guidance with respect to the *Kmart* case,² as detailed in a Notice to Taxpayers dated February 5, 2010. Treasury had required retroactive application of the Michigan Court of Appeals decision that disregarded single member limited liability companies were considered “persons” for Michigan Single Business Tax (“SBT”) purposes and therefore advised that such persons should have filed separate SBT returns.

► BACKGROUND

As detailed in a February 2010 BDO State and Local Tax Alert (see www.bdo.com/download/1270), Treasury issued a Notice indicating a retroactive application of the decision in *Kmart*. In this Notice, Treasury stated that all disregarded entities that filed on their single member/ shareholder’s SBT return would be considered nonfilers. This meant that many disregarded entities would have to file prior separate tax returns back to 1997. Additionally, all SBT filers that previously filed their tax returns by including a

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¹ Public Act 38 of 2010.

² *Kmart Michigan Property Services, LLC v. Dep’t of Treasury*, 283 Mich. App. 647, 770 N.W.2d 915 (2009), *lv. den.*, 772 N.W.2d 421 (Mich. 2009).

disregarded entity would have to file amended returns for open years. Taxpayers were given until September 30, 2010, to file all required returns and avoid penalties for failure to file timely tax returns.

▶ RETROACTIVE RELIEF

For many taxpayers, these filing requirements would have been onerous and would have resulted in double taxation, due to Treasury's definition of "open years" for the disregarded entities that had never filed separate returns. However, legislative relief was granted by House Bill 5937 in the same calendar quarter as the Notice was released, in an effort to minimize the financial statement impact for most affected taxpayers. House Bill 5937 provides that, for taxpayers that filed an SBT return by including any entity disregarded for federal income tax purposes, Treasury will not:

1. Assess the taxpayer additional tax nor reduce an overpayment of tax because the taxpayer included an entity disregarded for federal income tax purposes on the taxpayer's SBT return; nor
2. Require the entity disregarded for federal income tax purposes to file a separate SBT return.

The bill also provides that a taxpayer that included a disregarded entity is not entitled to a refund based on the disregarded entity filing as a separate taxpayer.

▶ ISSUES TO CONSIDER

There are still issues to consider with respect to the legislative "fix" for the *Kmart* case:

- What are the financial statement implications of the bill?
- What are the next steps for taxpayers that would have received refunds by separately filing the disregarded entities? The retroactive application of the legislative change denies most taxpayers the ability to claim SBT refunds, a position which is likely to be challenged. The statute construed by the Michigan Court of Appeals in *Kmart* is still in place, and under the court's holding, the statute provides that a disregarded limited liability company is a "person" for SBT purposes.
- What are the next steps for taxpayers that have already received refunds by removing a disregarded entity from its SBT returns?
- What are the implications for the Michigan Business Tax ("MBT")? The case did not deal with the MBT, but the MBT statutes also did not clearly adopt the entity classification rules. This legislative fix addresses only the SBT, so there will likely still be challenges as to the applicability of the federal entity classification election rules for MBT purposes. With combined reporting, the issue will be less significant than it was for SBT, but there are still instances where entity classification will make a difference.

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