

Michigan Dept. of Treasury Issues Notice on Disregarded Entities

12/16/2010

[Paul R. Jackson](#)

The Michigan Department of Treasury has issued a Notice taking the position that entities that are disregarded for federal income tax purposes are treated as separate taxpayers under the Michigan Business Tax (MBT). Where the filing thresholds are met, disregarded entities are required to file separate returns or as a member of a unitary business group. The most common disregarded entities are single member limited liability companies and qualified S corporation subsidiaries. The Notice can be viewed [here](#).

Treasury's position applies retroactively to all tax periods under the MBT, i.e., tax periods beginning on or after January 1, 2008. In some circumstances, a disregarded entity will be required to file returns and the person previously filing returns that included the disregarded entity will be required to file revised returns. Even where a disregarded entity is properly part of a unitary group, the person previously filing the returns that included the disregarded entity will be required to refile reflecting the disregarded entity as a member of the unitary group, whether or not there is a change in tax liability.

Treasury's position is based on the 2009 Court of Appeals decision in *Kmart Michigan Property Services LLC v Department of Treasury*, which adopted the taxpayer's argument that for Michigan Single Business Tax (SBT) purposes, a single member LLC was required to be treated as a separate taxpayer. The issue under the SBT was resolved by legislation that adopted Treasury's position in the *Kmart* case. The SBT was replaced by the MBT in 2008. The legislation did not address the MBT, and the Notice reflects Treasury's concern that the reasoning of the Court of Appeals in the *Kmart* case could be applied to the MBT.

Taxpayers who must file and pay tax will owe interest from the original due date. Taxpayers who are entitled to a refund will be entitled to interest starting 45 days after a return is filed. Penalties for failure to file will be waived if returns are filed by June 30, 2011.

The Notice can produce a number of different consequences, depending on a taxpayer's circumstances. In addition to creating new MBT filing requirements for disregarded entities and their owners, Treasury's position can increase or decrease the aggregate tax liability under the MBT. Purchasers of ownership interests in disregarded entities could be particularly adversely affected.

Prior to the decision in the *Kmart* case, Treasury had taken the position that entities that were disregarded for federal income tax purposes were also disregarded for MBT purposes, the same position it had taken under the SBT prior to the *Kmart* case. Although some taxpayers will pay less tax under this interpretation, the administrative burden and likelihood

of confusion make this approach undesirable and the Michigan legislature should act to address the perceived defect as it did with the SBT.

Affected taxpayers should consider waiting to see if there is a legislative fix before taking action to meet the June 30, 2011 deadline.

If you have any questions about the Notice or any other tax-related issue, please contact Paul Jackson (pjackson@wnj.com or 231.727.2626), chair of Warner Norcross & Judd's Tax Law Group or any other member of the Tax Law Group.