

Tax Law Update

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Michigan Department of Treasury Requires Single Member LLCs to File Old SBT Returns

In 2009, the Supreme Court of Michigan denied the appeal of the Michigan Court of Appeals decision in *Kmart Michigan Property Services, LLC v. Department of Treasury*, which held that a single member limited liability company was a separate taxpayer for SBT purposes, thereby striking down earlier Department of Treasury guidance in existence since 1999. On February 5, 2010, the Department of Treasury issued a notice stating that the *Kmart* decision will have retroactive effect. The implications of the retroactive application will at least require (1) amending returns for parent entities that included single member limited liability companies (SMLLC) and qualified subsidiary subsidiaries (QSubs), and (2) filing new returns for the SMLLCs and QSubs. In the worst case, for years closed by the four-year statute of limitations, the parent entity will not receive a refund for the tax on the income previously included in its SBT return but will also be liable for taxes on the SMLLCs or QSubs return that must now be retroactively filed. In other words, the income earned by SMLLCs and QSubs in closed tax years will be subject to double taxation.

For example, if a parent company paid \$40,000 of SBT in 2000 that included a SMLLC that contributed \$10,000 to the overall tax bill, the SMLLC would have to file and pay \$10,000, but the parent company's request for refund will be denied due to the running of the statute of limitations.

What the Guidance Requires

For the applicable SMLLCs and QSubs, prior year returns for all years (since inception) must be filed by September 30, 2010, along with the federal return in which the activity was included, and identifying the separate items of income, deductions, gains and losses. If amended returns are filed for the parent entity, the federal return would need to be attached, specifying the items of income, deductions, gains and losses. The amended returns are due prior to the applicable statute of limitations of four years from the date of filing.

Will the Legislature Act?

The only certain way that the Treasury's February 5 decision can be reversed is by legislative amendment, which could take several different forms. Thus, discussing what they could do is an academic discussion beyond this update. However, we will be monitoring developments in Lansing closely.

Are You Affected?

If you have filed a SBT return that included the activities of a SMLLC or QSub, then the *Kmart* decision and the Treasury notice applies to you. You may have formed SMLLCs to hold specific pieces of property, or to insulate separate divisions or branches for liability purposes from the activities of the parent entity or other divisions or branches.

An S corporation with subsidiaries that made the election to include the activities of the subsidiary with its federal return would have filed an SBT on the same basis.

What Should You Do?

The first step you should take is to gather your Federal and SBT returns from all prior years and determine which years are affected. An analysis of which returns are open under the statute of limitations should be documented, and the deadlines for amending the open years should be calendared. Any returns with a soon-to-be-expired statute that would result in a refund should be amended as soon as possible to preserve your rights to a refund, if applicable.

Note that parent entity SBT returns with profitable SMLLCs or QSubs will be due a refund by extracting the taxable base of the SMLLC or QSub. However, despite the fact that the SBT resulted in tax for many loss entities, extracting losses would increase the taxable base of the parent entity resulting in SBT due for open years under the statute of limitations.

The returns for the SMLLCs and QSubs are due September 30, 2010, so there is time to file these returns. Furthermore, we recommend waiting to determine whether the Legislature will act to remedy this aberration.

We believe that the legal reasons for establishing a SMLLC or QSub still exist so these structures should be maintained and new SMLLCs and QSubs should be considered when structuring legal entities.

Our tax group can consult with you on these matters. We will be coordinating with our lobbying affiliates in Lansing to organize a coalition of like-minded taxpayers to push corrective legislation. Please contact me to arrange for a meeting.

The Michigan Department of Treasury's Notice to Taxpayers Regarding *Kmart Michigan Property Services LLC v Dep't of Treasury*, the Single Business Tax, RAB 1999-9, and RAB 2000-5 can be viewed at http://www.michigan.gov/documents/taxes/Kmart_Notice_Retroactive_Application_Amended_Returns_1_310402_7.pdf

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