INTERNAL POLICY DIRECTIVE 2013-1

April 2, 2013

2011 PA 304: EXEMPTION FROM SBT FOR CERTAIN INVESTMENT ACTIVITY

POLICY ISSUES

1. Who is covered by the exemption from SBT liability provided under Public Act 304 of 2011 ("PA 304")?

2. Must a taxpayer demonstrate it is entitled to the exemption from SBT liability provided under PA 304?

3. What documentation or other evidence will the Department of Treasury ("Department") accept to determine a person's eligibility under the exemption?

4. How will the Department apply PA 304 to taxpayers in the following circumstances: (i) informal conference; (ii) refund request; (iii) final assessment that has not been paid, and; (iv) litigation?

POLICY DETERMINATION

1. PA 304 covers the following persons: an individual, an estate, a person organized for estate or gift planning purposes, a person organized exclusively to conduct investment activity for an individual or persons related to that individual, and a common trust established under the Collective Investment Funds Act. The protection under PA 304 only covers amounts received, income, or gain from those transactions, activities, or sources other than in the regular course of the person's trade or business.

2. As with any other exemption a person asserting the exemption in an original SBT return is not required to attach supporting documentation to its return; however, the person must be prepared to substantiate its exemption claim upon request or audit.

3. There may be no single document that will definitively demonstrate a person's eligibility for exemption under PA 304. Organizational documents, minutes, or memoranda created contemporaneously with the formation of the entity that describe the entity's gift or estate planning purpose are helpful. Documents created after formation or in response to the Department's request for proof, such as a sworn affidavit, are less helpful, but may be considered and evaluated in light of other evidence.

Federal income tax return documents, especially Form 1065, Form 1120-S, and schedule K-1, should be obtained and reviewed to evaluate the receipts, income, gain, distributions, the type and extent of activities in which the entity participates (whether passive investments or material participation in a trade or business), and the type and extent of any limitations on losses, deductions or credits reported. Federal gift tax or estate tax returns (e.g., Forms 709 and 706) filed by the entity may also be helpful.

Identification of the partners, shareholders, or members of the taxpayer may also evidence gift or estate planning purposes, especially when the partners, shareholders, or members are related.

4. A taxpayer at the time of filing an original SBT return is not required to submit documentation supporting the taxpayer's assertion of the exemption. However, the taxpayer must maintain documentation in its books and records and be able to provide such information to the Department upon audit or investigation. The Department may require information necessary to determine the appropriate amount of tax due, including whether the taxpayer qualifies for any claimed exemption from taxation.

   (i) If a taxpayer has requested an informal conference, the taxpayer must provide documentation to demonstrate that the taxpayer satisfies the criteria for exemption under PA 304. The Department may also request that the taxpayer provide such documentation in order to establish PA 304's application. If the taxpayer provides satisfactory documentation during the informal conference process, the Department should cancel or adjust the assessment at issue to appropriately reflect the exemption.

   (ii) If a taxpayer makes a claim for refund of SBT paid, asserting exemption under PA 304, the Department may request that the taxpayer provide supporting documentation to evaluate the taxpayer's eligibility for exemption under PA 304.

   The taxpayer must make a claim for refund for SBT paid with regards to the criteria set forth in PA 304 within the statute of limitations period prescribed under the Revenue Act. PA 304 does not toll or otherwise extend the time period within which a claim for refund may be made under the Revenue Act.

   (iii) PA 304 does not affect the rights or procedures prescribed under section 22 of the Revenue Act for pursuing an appeal of an assessment or decision of the Department. Therefore, where the Department has issued to a taxpayer a final assessment that remains unpaid, the taxpayer must pursue its appeal rights under section 22 of the Revenue Act in order to contest and obtain relief from the assessment. If the taxpayer pays the amount in a final assessment, but fails to preserve an appeal in conformance with the

Revenue Act, the assessment is considered final and the taxpayer is not entitled to a refund of any tax, interest, or penalty paid.

(iv) Where a taxpayer is currently contesting an assessment or a refund denial before the Tax Tribunal or any court with regard to whether it is eligible for PA 304 protection, the taxpayer should provide (and the Department should request) documentation, as discussed herein, which would demonstrate the taxpayer's eligibility. If the Department determines that the documentation or other information provided sufficiently demonstrates eligibility, the Department shall take action to resolve this issue and adjust any assessment or issue any refund due as a result.

DISCUSSION

PA 304 amends section 27a of the Revenue Act[1] to prohibit the Department from assessing a tax or reducing an overpayment, and to require the Department to approve a claim for refund for any tax paid, under the SBT, for "an individual, estate or person organized for estate or gift planning purposes" or for a person that is organized exclusively to conduct investment activity for an individual or persons related to that individual, or by a common trust established under the collective investment funds act for receipts, income, or gain other than those from transactions, activities, and sources in the regular course of the person's trade or business.[2] The term "person related to that individual" means a spouse, sibling (by blood or adoption), ancestor, lineal descendant of the individual or related person, or trust benefiting the individual or persons related to that individual.[3] A "common trust" established under the Collective Investment Funds Act means a trust participating in a common trust fund, which is "a fund maintained by a financial institution or 1 or more affiliated financial institutions exclusively for the collective investment and reinvestment of money contributed to the fund by the financial institution or the affiliated financial institutions in its capacity as a fiduciary or cofiduciary."[4]

PA 304 applies retroactively. It precludes the Department from assessing non-filers who demonstrate eligibility for the exemption back to January 1, 1976, the effective date of the SBT. For persons who filed SBT returns or are making claims for refunds, the statute of limitations provision under section 27a(2) of the Revenue Act[5] applies.

There are two criteria that must be met in order for a person to be exempt under PA 304:

(1) the person must be one of the named entities to which the exemption applies (i.e, an individual, an estate, a person organized for estate or gift planning purposes, a common trust established under the

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[1] 1941 PA 122, as amended MCL 205.27a.
[2] MCL 205.27a(10) and (11).
[3] MCL 205.27a(11).
[4] MCL 555.101(2)(b).
[5] MCL 205.27a(2).

Collective Investment Funds Act,[6] or a person organized exclusively to conduct investment activity for an individual or a person related to that individual), and;

(2) the receipts, income, or gain must be derived from activities, including investment activity, other than from transactions, activities, and sources in the regular course of the person's trade or business.

Like any exemption from tax, the taxpayer must be able to demonstrate it is entitled to the exemption from SBT under PA 304. A person claiming protection under PA 304 must be in the exempt class of persons enumerated in the statute. An estate may establish this by providing documents demonstrating the creation of the estate or trust, including revocable or irrevocable trust instruments and forms filed with, or orders issued by, probate courts that establish the creation and/or the operation of the estate. An entity that is "organized for gift or estate planning purposes" or organized exclusively to conduct investment activity for an individual or a person related to that individual may provide the following:

(1) incorporation or other formation documents (such as original or restated articles of incorporation or organization, charters, or trust instruments);

(2) operating or governance documents (such as partnership agreements, limited liability company operating agreements, distribution or member contribution agreements, or trust administration and distribution instruments);

(3) complete lists of partners, members, shareholders, trustees, or beneficiaries (as the case may be), and;

(4) descriptions and other information as to whether and how such partners, members, shareholders, trustees, and/or beneficiaries relate to each other so as to support an estate or gift planning purpose.

A trust established under the Collective Investment Funds Act participating in a common trust fund may provide the trust formation documents and a copy of the written plan for the common trust fund approved by the board of directors of the financial institution administering the common trust fund.

Documentation created contemporaneously with the formation of the entity that describes the entity's gift or estate planning purpose is the best, most objective information an entity can provide to demonstrate that it is in the statutorily-enumerated class of persons eligible for exemption. Documentation developed after formation or in response to the Department's request for proof, such as a sworn statement or an affidavit, is less helpful,

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[6] MCL 555.101 et seq.

but may be considered and evaluated in light of other evidence regarding the purpose of the entity or the nature of the transactions, activities or sources from which receipts, income, or gain are derived.

To establish eligibility for exemption under PA 304, a person must also demonstrate that the receipts, income, or gain are from transactions, activities, or sources other than in the regular course of the person's trade or business. Copies of federal income tax return documents, especially Form 1065, Form 1120-S, and schedule K-1s, and any federal estate or gift tax returns, such as Forms 706 and 709, should be obtained from any entity claiming the exemption in order to evaluate the nature and sources of the receipts, income, and gain derived (e.g., interest, dividends, annuities, royalties, gains or losses from investment portfolios, rental or non-rental real estate income), the type and extent of activities in which the entity participates (whether passive investments or material participation in a trade or business) and the type and extent of any limitations on losses, deductions, or credits the entity reported. Attention should be paid to the principal business activity identified in Box A of any Form 1065 provided and to activities identified on attachments to any schedules K and K-1 provided. If federal income tax return documents reveal any business deductions taken or material participation in a trade or business, this would suggest that the entity is engaged in a trade or business and that the eligibility criteria for exemption under PA 304 are not met. Alternatively, if return documents, particularly schedule K-1s, suggest passive investment activity, this might suggest that the receipts, income, or gain are derived from activities other than in a regular course of trade or business.

PA 304 amends the Revenue Act and has retroactive application. It does not limit, modify or otherwise affect the rights or procedural requirements prescribed in the Revenue Act for contesting assessments or for claiming refunds. The procedures of administration, audit, assessment, interest, penalty and appeal provided in sections 21 through 30 of the Revenue Act are unchanged.