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Composite Income Tax Return Filing

RAB 2004-01. This bulletin describes the procedures for filing composite income tax returns by flow-through entities with business activity in Michigan and nonresident members in light of the enactment of recent legislation establishing composite filing provisions in the Michigan Income Tax Act.

Background

Composite income tax returns have been traditionally allowed in Michigan and many other states as a means to simplify filing requirements and reduce paperwork and processing costs for both states and affected taxpayers. The composite filing method is an alternative filing method that may be used by a flow-through entity with two or more nonresident member partners or shareholders to file one consolidated income tax return in a state taxing jurisdiction on behalf of all nonresident members who elect to participate. The composite return reports the combined distributive share income, deductions, and credits of the participating membership, and is in lieu of the individual members each filing separate nonresident returns. Historically, the Department has limited participation in composite filings to nonresident individuals, estates, or trusts that would otherwise have an income tax filing requirement with the State of Michigan based on the distributive share income from the flow-through entity, and that have no other income from Michigan sources.

Composite filing procedures generally include the execution of a filing agreement authorizing a designated corporate officer or partner to act on behalf of all electing members as a prerequisite to approval of a composite filing arrangement. As part of the agreement, the flow-through entity agrees to pay and be responsible for any collective tax liabilities incurred through the composite filing, and to provide certain documents or information relevant to tax administration when the composite return is filed. The due date of the composite income tax return followed the due date of the flow-through entity's federal income tax return (U.S. forms 1120S or 1065), which, in some cases, could be other than a calendar year.

Public Act (PA) 49 of 2003 was enacted by legislative amendment on July 11, 2003, effective October 1, 2003, authorizing the Department to allow composite income tax return filings. Prior to the enactment of this amendment, composite return filing was administratively allowed under procedures established by the Department. The Michigan tax statutes did not include language expressly allowing composite filings. Section 315 of the Michigan Income Tax Act (ITA), Michigan Compiled Laws (MCL) 206.315, as amended by 2003 PA 49, now specifically provides for composite filings, and includes provisions establishing due dates and clarifying requirements for participation and filing by members.

Issues

I. What is a composite return?

II. When is filing of a composite return authorized?

III. Who may participate in a composite filing?

IV. When is a composite return due?

V. Is a flow through entity required to execute and file a Composite Filing Agreement as a prerequisite to filing a composite return under the new law?

VI. What changes will be made to the Department's prior administrative composite filing requirements as the result of the new law?

Conclusions

I. A composite return is an income tax return filed by a flow through entity on behalf of it's electing nonresident members. The composite return replicates and combines on one return the taxable income and credits that would otherwise be reported on multiple income tax returns by the participating membership. Members who participate in a composite filing and have no other Michigan sourced income have fulfilled their annual Michigan income tax filing and payment requirements

II. A composite return is authorized by statute, MCL 206.315, effective for the calendar year 2003. Under section 315, a flow through entity as defined in MCL 206.12 may file a composite return and pay the collective tax due on behalf of all electing nonresident members. Section 12 defines a flow through entity as an S corporation, partnership, limited partnership, limited liability partnership, or limited liability company, and further defines nonresident member to mean an individual who is not domiciled in Michigan, a nonresident estate or trust, or a flow through entity with a nonresident member.

III. A composite return may be filed by a flow through entity with two or more nonresident members who elect to participate in the composite filing. A flow through entity with one electing nonresident member may file an individual or fiduciary income tax return on behalf of the member if that member has executed a Power of Attorney authorizing the flow through entity to do so. A composite return may not be filed on behalf of a single member.

IV. The due date of the composite return is now fixed by statute as on or before April 15 of the immediately succeeding tax year. For flow through entities who file fiscal year federal returns, the due date of the composite return will be April 15 of the year following the entity's fiscal year end. This provision places the due date for composite filers in conformity with the calendar year due date for members not participating in the composite filing.

V. Because the new law specifically provides for composite income tax filings, the Department will no longer require the execution and filing of a separate Composite Filing Agreement, Michigan Department of Treasury form 750, as a prerequisite to filing a composite return. Any information and documentation previously requested on the filing agreement form 750 will be incorporated into the composite return to the extent required by the Department for general tax administration purposes.

VI. The following changes to the composite filing policies and procedures used administratively by the Department in previous years will be effective for 2003 and subsequent years based on the new legislation.

- The due date for all composite filings will be April 15 of the year following the entity's tax year end. The past practice of the Department had been to establish a composite due date corresponding to the 15 day of the fourth month after the close of the entity's taxable year for fiscal year filers.

- Participation in composite filings will no longer be strictly limited to members eligible to file Michigan income tax returns (i.e. individuals, estates, and trusts). Members of a flow-through entity that are other flow-through entities with nonresident partners or shareholders may now participate in composite filings. The Department may require the composite filer to provide a schedule listing certain specified information relating to partners or shareholders of the member flow-through entity as a prerequisite to that member's participation in the composite filing.

- Members of a flow-through entity with income from other Michigan sources may now participate in a composite filing if otherwise qualified. The member would be required to file a Michigan income tax return to report the additional income and claim a credit on that return for any taxes paid on the member's behalf through the composite filing.

- 2003 PA 22 imposes a withholding tax requirement on most flow-through entities with nonresident members, including composite filers. The withholding tax requirement abolishes any quarterly estimated tax payment requirements for composite filers effective for payments due after October 1, 2003. Entities not previously registered for withholding taxes with the Department must complete and file form 518, Registration for Michigan Taxes, prior to remittance of any payments. 2003 PA 22 is effective October 1, 2003.

The Department will revise the 2003 and subsequent year Michigan Composite Income Tax Returns (form 807) and instructions to reflect all statutory changes identified in this bulletin. Since the Department will no longer require the filing of formal agreements as a prerequisite to participation in a composite filings, entities with previous agreements on record are no longer bound by the terms and conditions of those executed agreements. The revised filing procedures described in this bulletin do not apply to tax years ending before January 1, 2003.