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SBT: FARMERS' COOPERATIVES

Senate Bill 116 (Substitute H-1)
First Analysis (5-12-98)

Sponsor: Sen. Joel D. Gougeon
Senate Committee: Finance
House Committee: Tax Policy

THE APPARENT PROBLEM:

Representatives from Farmers Petroleum Cooperative, Inc., a farmers' cooperative corporation, say that auditors from the Michigan Department of Treasury instructed the corporation in connection with an audit of its single business tax liability for the periods ending August 31, 1987, 1988, 1989, and 1990, that it had overpaid its taxes by $127,612. Department officials said the cooperative had been incorrectly adding to its SBT tax base revenue and expenses attributable to business transacted with farmers and associations of farmers to whom FPC had allocated its net earnings as patronage dividends. (See <u>Background Information.</u>) In late 1996, says the cooperative, the department again conducted an audit and this time auditors decided that FPC could not exclude that revenue and interest and said the cooperative had underpaid taxes by $123,528 (plus $24,845 in penalties) for years 1991 to 1996. Reportedly, other cooperatives had also relied on the advice provided earlier and faced the prospect of costly amended SBT returns. Legislation was introduced to address this issue and a version of it was enacted as part of Public Act 124 of 1997 (House Bill 4773). Although the legislation as introduced proposed retroactive application, the legislation as enacted applied prospectively. New legislation providing retroactivity has been proposed.

THE CONTENT OF THE BILL:

The bill would amend the Single Business Tax Act to specify that, effective for tax years after <u>1990</u>, a farmers' cooperative corporation would exclude from its adjusted tax base the revenue and expenses attributable to business transacted with farmer patrons or farmer cooperative corporation patrons to whom net earnings were allocated in the form of patronage dividends as defined in the federal Internal Revenue Code. The act contains a formula for determining the tax base that involves calculating the amount of a cooperative's profits stemming from "nonpatronage sourced business." (Currently, this provision -- added by Public Act 124 of 1997 -- applies to tax years after <u>1996</u>.)

MCL 208.35

HOUSE COMMITTEE ACTION:

The provisions contained in the Senate-passed version of Senate Bill 116 were incorporated into House Bill 4773, which became Public Act 124 of 1997. However, that act's provisions regarding farmers' cooperatives apply to tax years after December 31, 1996. The House Substitute for Senate Bill 116 would change that date to 1990.

BACKGROUND INFORMATION:

The following information is from the analysis of this issue by the Senate Fiscal Agency:

The Internal Revenue Code defines farmers' cooperatives as farmers', fruit growers, or similar associations operated on a cooperative basis in order 1) to market the products of members or other producers and to return to them the sales proceeds minus expenses; or 2) to purchase supplies and equipment for the use of members or other persons and provide them at actual cost plus expenses. Under the code, a cooperative can be tax-exempt or nonexempt. Patronage dividends are payments made to members based on the quantity or value of business done with or for the patron. The federal tax code allows the cooperative to deduct from its business income all patronage dividends, and the patrons must include the dividends on their returns as income. So even nonexempt cooperatives have little or no federal taxable income. Entities exempt from the federal corporate income tax are exempt from the SBT. But nonexempt farmers' cooperatives are subject to the SBT.

FISCAL IMPLICATIONS:

The House Fiscal Agency in discussing an earlier but a similar version of the bill cited the Department of Treasury as saying that the amount of refunds due under the bill would be minimal because most farmers' cooperatives have not been paying the SBT consistent with the current law. (Fiscal Note dated 2-12-97)

ARGUMENTS:

For:

The bill would clear up the current confusion and conflict over whether certain revenue and expenses should be included in the tax base of a farmers' cooperative corporation and relieve those corporations that have not been including the revenue as part of their tax base from having to file costly amended returns. The cooperatives' dilemma stems, say their representatives, from conflicting advice from Department of Treasury auditors given just five years apart. Cooperatives began excluding revenue and expenses that had traditionally been part of their SBT base because of information from departmental auditors and later learned from subsequent audits that the department's position was the revenue and expenses should have been included in the tax base.

Against:

The bill should not apply retroactively. Those cooperatives that have mistakenly been using a diminished tax base have not been following the law and should pay the back taxes owed. The law should remain as it is now, with cooperatives not required to add certain revenues and expenses to their tax base in the future.

Response:

Because the cooperatives believed they were following information provided to them by state auditors, the fair course of action is to clarify the act by making it conform to the recent filing practices of the cooperatives.

POSITIONS:

The Michigan Farm Bureau has indicated its support for the bill. (5-6-98)

The Department of Treasury opposes the bill. (5-8-98)

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