House
Legislative
Analysis
Section

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SBT: DEF'N OF GROSS RECEIPTS

Senate Bill 1300 (Substitute H-1)
First Analysis (11-29-00)

Sponsor: Sen. Joanne G. Emmons
House Committee: Tax Policy
Senate Committee: Finance

THE APPARENT PROBLEM:

Legislation has been introduced as a result of a dispute between advertising agencies and state tax officials over how to treat certain monies under the Single Business Tax Act. Generally speaking, the dispute concerns money paid by a client to an agency to obtain time on television or radio, or space in a periodical, etc. The question is whether such payments should be considered as gross receipts by the agency when calculating the tax base on which the SBT is levied. The agencies say that the amount paid to them should not be considered in their gross receipts because they simply pass the money on (minus a commission, which should be included in gross receipts) to another entity to purchase time, space, production capabilities, or talent on behalf of their clients. The Department of Treasury has taken the view that the payments by clients to advertising agencies should be counted as gross receipts as the SBT act is currently written. Reportedly, this dispute is in litigation. At the same time, representatives of the treasury department and the business sector have been working for several months to provide a clearer, less circular definition of the term"gross receipts" in the SBT act and to alter the act to make it conform to a recent Michigan Court of Appeals decision, *PM One, Limited v Department of Treasury*. The decision dealt with how to treat amounts paid to a real estate management company that are used to make purchases from third-party vendors on behalf of and for the benefit of the clients of the management company. The court excluded the payments from the management company's gross receipts.

THE CONTENT OF THE BILL:

The bill would amend the Single Business Tax Act to provide revised definitions of "gross receipts" and "sale" (or "sales"). It also would provide a statement that a provision to exclude certain amounts received by advertising agencies from gross receipts was to be considered curative, applied retroactively, and "intended to correct any misinterpretation by the Department of Treasury of legislative intent."

The term "gross receipts" would be defined in the bill to mean the entire amount received by the taxpayer from any activity whether in intrastate, interstate, or foreign commerce carried on for direct or indirect gain, benefit, or advantage to the taxpayer or to others, with certain specified exceptions. The exceptions would include:

• Proceeds from sales by a principal that the taxpayer collected in an agency capacity solely on behalf of the principal and delivered to the principal.

• Amounts received by the taxpayer as an agent solely on behalf of the principal that were expended by the taxpayer for any of the following six purposes: 1) the performance of a service by a third party for the benefit of the principal that was required by law to be performed by a licensed person; 2) the performance of a service by a third party for the benefit of the principal that the taxpayer had not undertaken a contractual duty to perform; 3) principal and interest under a mortgage loan or land contract, lease or rental payments, or taxes, utilities, or insurance premiums relating to real or personal property owned or leased by the principal; 4) a capital asset of a type that was, or under the federal Internal Revenue Code, will become eligible for depreciation, amortization, or accelerated cost recovery by the principal for federal income tax purposes, or for real property owned or leased by the principal; 5) property not described in the clause above purchased by the taxpayer on behalf of the principal and that the taxpayer did not take title to or use in the course of performing its contractual business activities; and 6) fees, taxes, assessments, levies, fines, penalties, or other payments established by law that were paid to a governmental entity and that were the legal obligation of the principal.

• Amounts that were excluded from gross income of a foreign corporation engaged in the international

operation of aircraft under the federal Internal Revenue Code.

• Amounts received by an advertising agency used to acquire advertising media time, space, production, or talent on behalf of another person.

The term "sale" (or "sales") would be modified to remove references to gross receipts and replace it with a reference to "amounts received by the taxpayer as consideration" from certain specified activities or transactions. Also, the bill would add to the definition amounts received from the rental, lease, licensing, or use of tangible or intangible property that constituted business activity and would exclude from the definition dividends, interest, and royalties received by the taxpayer to the extent deducted from the taxpayer's tax base under other provisions in the SBT act.

The bill contains a special enacting section that applies to the exclusion from gross receipts of amounts received by an advertising agency used to acquire advertising media time, space, production, or talent on behalf of another person. It says that this provision "is retroactive and applies to all disputes pending in any court on or commenced after the effective date" of the bill. It also says, as mentioned earlier, that the provision "is curative and intended to correct any misinterpretation by the Department of Treasury of legislative intent that an advertising agency's collection and remittance of amounts for advertising media time, space, production, and talent on behalf on another person are not a sale and should not be included in gross receipts under . . . the Single Business Tax Act."

MCL 208.7

HOUSE COMMITTEE ACTION:

The House Tax Policy Committee adopted a substitute that incorporates three amendments. Two of the amendments added the word "production" to the list of things acquired by an advertising agency (media time, space, production, or talent). A third amended the special enacting section which said, as passed by the Senate, that the advertising provision was retroactive and "applies to all disputes pending in any court on the effective date" of the bill. The amendment made the provision read, "applied to all disputes pending in any court on or commenced after the effective date" of the bill. (Emphasis added)

BACKGROUND INFORMATION

The current definition of "gross receipts" in the Single Business Tax Act is as follows: the sum of sales (as that term is defined in the act) and rental and lease receipts, with certain exceptions. The term does not include the amounts received in an agency or other representative capacity, solely on behalf of another or others. But it does include amounts received by persons having the power or authority to expend or otherwise appropriate such amounts in payment for or in consideration of sales or services made or rendered by themselves or by others acting under their direction and control or by such fiduciaries as guardians, executors, administrators, receivers, conservators, or trustees other than trustees of taxes received or collected from others under direction of the laws of the federal government or of any state or local governments.

FISCAL IMPLICATIONS:

Both the House Fiscal Agency and Senate Fiscal Agency say the bill would reduce General Fund revenues from the SBT by an unknown amount. The SFA says revenues would be affected primarily through the exclusion from gross receipts of 1) amounts relating to duties in an agency capacity; and 2) amounts used by advertising agencies to acquire media services on behalf of another person. (The third exclusion is for the income of a foreign corporation engaged in the international operation of aircraft.) The SFA offers no estimate of losses from the first exclusion (which is based on the Michigan Court of Appeals decision in *PM One, Limited v Department of Treasury*), but says it "could affect revenues substantially if large taxpayers, or large numbers of taxpayers, were to restructure their operations to take advantage of the exclusions".

The SFA estimates that the second exclusion would cost $6.3 million in fiscal year 2000-01. Of that, about $5.1 million would be refunded to taxpayers due to the retroactive effect of the bill, and $1.2 million would be due to reduced tax liabilities based on business activity. In subsequent years, says the SFA, the second exclusion would reduce revenue by about $1 million per year. The SFA says, "The estimate is preliminary and will be revised when more information is received from the Department of Treasury." (HFA fiscal note dated 11-27-00 and SFA floor analysis dated 10-2-00)

ARGUMENTS:

For:

The bill would provide greater clarity and transparency, and less circularity, to the definition of "gross receipts" in the Single Business Tax Act. The new definition is the result of efforts by state tax officials and business representatives. It also reflects a recent Michigan Court of Appeals decision interpreting the SBT's treatment of certain amounts paid to businesses when acting in an agency capacity.

For:

Representatives of advertising agencies say that the bill would prevent double taxation of certain revenues that occurs now due to state tax interpretations. The bill would specifically say that payments received by an advertising agency used to acquire advertising media time, space, production, or talent on behalf of another person would not be considered in the advertising agency's gross receipts for SBT purposes. That issue has been in dispute. Moreover, the bill makes this provision retroactive in recognition that refunds are due those agencies whose SBT liability has included those gross receipts in their tax base. These revenues are simply passed through by the advertising agency and paid to a third party on behalf of clients. The payments should not be included in the gross receipts of both the agency and the third party as that constitutes double taxation and violates the value added concept.

Against:

State tax officials oppose the retroactive feature of the bill. They say the interpretation of the current statute regarding the treatment of advertising agencies is before the courts. A trial has been completed and the parties are awaiting a decision. It is not fair for the legislature to intervene at this point in the trial by changing the rules. The Department of Treasury does not believe it has been misinterpreting the intent of the legislature (as this bill would have it) regarding the treatment of money received by an agency and then expended on a client's behalf. While it is acceptable to change the treatment of certain advertising agency revenues prospectively, making the provision retroactive is not warranted.

POSITIONS:

A representative of Bozell Worldwide testified in support of the bill. (11-28-00)

The Department of Treasury is opposed to the bill in its current form. (11-28-00)

Analyst: C. Couch

#This analysis was prepared by nonpartisan House staff for use by House members in their deliberations, and does not constitute an official statement of legislative intent.