

# Foreign Taxpayers

Public Act 115 of 1999 made significant changes to the way foreign taxpayers, non-United States firms, determined their tax base for purposes of the Michigan Single Business Tax. Prior to enactment of the amendments there had been much controversy in both the “nexus” arena and apportionment.

The Michigan Department of Treasury was planning to assert the nexus standard promulgated in Revenue Administrative Bulletin 1998-1 to all persons doing business in Michigan including foreign persons who were exempt from federal income taxation because of tax treaty agreements. The foreign firms, primarily Canadian, objected because of treaty provisions. However, their biggest concern centered in two areas. They objected to computing a tax base on elements from outside of the United States. An additional concern for Canadians was their inability to claim a credit for the Single Business Tax paid on their Canadian returns.

Beginning on January 1, 2000, the Michigan Single Business Tax will apply to “foreign persons” who are engaged in a business activity in Michigan. However, the tax will be based only on the business activity in the United States, including sales and service in the United States and compensation paid to employees, officers, and directors for services performed in the United States, whether or not the individual or business entity was subject to taxation under the federal Internal Revenue Code.

## Nexus For A Foreign Person

The determination as to whether a foreign person has nexus within Michigan is no different than the standard applied to any other person or taxpayer. The Michigan Department of Treasury will use the nexus standard promulgated in Revenue Administrative Bulletin 1998-1 to apply to foreign persons. The nexus standard is a Commerce Clause standard based on physical presence.

## Tax Base Of A Foreign Person

PA 115 of 1999 created Section 19 in the Single Business Tax Act to determine the tax base of a foreign person. In Section 19(6) a “foreign person” is defined as:

1. An individual who is not a United States resident, whether or not the individual is subject to taxation under the Internal Revenue Code.
2. A person formed under the laws of a foreign country or a political subdivision of a foreign country, whether or not the person is subject to taxation under the Internal Revenue Code.  
(MCL 208.19(6))

The statute in Section 19(1) states that the tax base of a foreign person includes the sum of business income and the adjustments under section 9 (additions and subtractions) only to the extent that they are related to a business activity in the United States. Subsection 2 requires the foreign person to calculate business income under Section 19. (MCL 208.19(1))

“Business Income” for a foreign person means gross income attributable to the taxpayer’s United States business activity and gross income derived from sources within the United States minus the deductions allowed under the Internal Revenue Code that are related to that gross income. Gross income includes the proceeds from sales shipped or delivered to any purchaser within the United States, proceeds from services performed within the United States, and a pro rata portion of the proceeds from services performed both inside and outside the United States, based on cost of performance. (MCL 208.19 (5)(a))

“Compensation” means for a foreign person the daily compensation paid to each employee, officer, and director of the foreign person multiplied by the number of days that the employee, officer, or director has physical contact with the United States in the tax year. Physical contact for part of a day with the United States equals one day. (MCL 208.19(5)(b))

Those foreign persons who are not subject to the United States federal income tax, presumably because they do not have a plant, store or warehouse in the United States, but nevertheless subject to the Michigan Single Business Tax because of RAB 98-1 would be required to keep the necessary records and prepare a pro forma US federal income tax return. The Michigan statute defines what a United States business activity is. The foreign person is required to determine federal taxable income in accordance with the provisions of the federal internal revenue code.

### **Apportionment For A Foreign Person**

A foreign person apportions the tax base computed according to the provisions of Section 19 by reference to Sections 46, 49, and 51. Special subsections were added to address the special calculations made by foreign persons. (MCL 208.19(7))

### **Property Factor For A Foreign Person**

New subsection 46(2) specifies that for a foreign person, the property factor is a fraction, the numerator of which is the average value of the taxpayer’s real and tangible personal property owned or rented in Michigan during the year by the taxpayer and the denominator of which is the average value of all the taxpayer’s real and tangible personal property owned or rented in the United States during the year. (MCL 208.46(2))

### **Payroll Factor For A Foreign Person**

New subsection 49(2) specifies that for a foreign person, the payroll factor is a fraction, the numerator of which is total wages paid for services performed in Michigan during

the tax year by the taxpayer and the denominator of which is the total wages paid for services performed in the United States during the tax year by the taxpayer.

For purposes of apportionment, “wages” means all wages, salaries, fees, bonuses, commissions, paid in the taxable year on behalf of or for the benefit of employees, officers, or directors of the taxpayer and includes, but not limited to, payments that are subject to or specifically exempt or excepted from withholding under the Internal Revenue Code. (MCL 208.49(2))

### **Sales Factor For A Foreign Person**

New subsection 51(2) specifies that for a foreign person, the sales factor is a fraction, the numerator of which is the total sales of the taxpayer in Michigan during the tax year, and the denominator of which is the total sales of the taxpayer in the United States during the tax year.  
(MCL 208.51(2))

Sales of tangible personal property are Michigan sales if the goods are delivered to a customer in Michigan. Gross receipts derived from the performance of services are Michigan sales if the services were performed entirely within Michigan. If the services were performed both within and without Michigan, Michigan sales will be a pro rata proportion of the proceeds from the services performed in Michigan to the proceeds from the services performed outside of Michigan but within the United State based on cost of performance.

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