



# SALT WATCH

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## Michigan Repeals MBT; Replaces it with Corporate Income Tax

### Overview

In what has been called the biggest tax overhaul in Michigan in 17 years, Michigan Governor Rick Snyder signed House Bills 4361, 4362, and 4479 into law repealing the controversial Michigan Business Tax ("MBT") and replacing it with a more traditional Corporate Income Tax ("CIT"). The CIT, officially signed into law on May 25, 2011, will go into effect on January 1, 2012.

### Corporate Income Tax

The CIT is created by House Bill 4361 and only applies to entities that file as C Corporations for federal income tax purposes. Thus, pass-through entities such as partnerships, S corporations, and limited liability companies will not be liable for the CIT. Insurance companies and financial institutions will be subject to a separate taxing structure. Specifically, insurance companies must pay a tax of 1.25% on gross direct premiums on property located in Michigan and financial institutions are still subject to a net capital tax of 0.29%, but are no longer permitted to deduct goodwill.

### Nexus

Under the CIT, a Corporation has substantial nexus in Michigan if any of the following three items are true:

- (1) The Corporation has a physical presence in Michigan for a period of more than one day during the tax year;
- (2) The Corporation actively solicits sales in Michigan and has gross receipts of \$350,000 or more sourced to Michigan; or

- (3) The Corporation has an ownership interest or a beneficial interest in a flow-through entity, directly, or indirectly through one or more other flow-through entities, that has substantial nexus in Michigan.

*Note:* Since the CIT is a pure income tax, taxpayers who previously may have been protected under Public Law 86-272, but yet were still subject to the modified gross receipts tax under the MBT, will no longer have this filing responsibility under the CIT.

### Calculation of the CIT

The CIT will be applied to Michigan income at a rate of 6%. House Bill 4479 requires income to be apportioned using single-factor sales apportionment (Michigan sales / total company sales). Michigan income will be determined based off of federal taxable income adjusted for the effect of bonus depreciation, the domestic production activities deduction, and other modifications similar to those provided under the business income tax portion of the MBT. If a C Corporation has apportioned or allocated Michigan gross receipts of less than \$350,000 or a tax liability of less than \$100, a return is not required to be filed. The CIT will require unitary filing for corporations under common control.



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### *Credits & NOLs*

Unlike the MBT which allowed for several tax credits, the CIT will only permit three credits relating to small businesses, the film industry, and stadiums/race tracks. Losses sustained under the MBT cannot be used to offset a taxpayer's CIT liability. Losses generated after December 31, 2011 under the CIT may be carried forward, on a post-apportionment basis for ten years.

### **Michigan Business Tax ("MBT")**

House Bill 4362 repeals the MBT, effective January 1, 2012 for most taxpayers. However, taxpayers with unused certificated credits after January 1, 2012 will still be permitted to claim the credits if the taxpayer is either not subject to the CIT or elects to file under the MBT rather than the CIT.

Certificated credits, as defined in the statute, are generally economic development related credits to the MBT that were awarded to the taxpayer as a result of an agreement with the state of Michigan. A taxpayer who wishes to claim a certificated credit must pay tax on the greater of their MBT liability or a modified version of the liability had they filed under the CIT. Many of these credits are refundable.

The MBT will be declared officially repealed once it has been determined there are no outstanding certificated credits.

### **Practical Implications**

It is believed two-thirds of Michigan businesses will be exempt from the CIT.

Specifically, the Michigan Economic Development Corporation estimates 136,000 businesses currently pay the Michigan Business Tax whereas only 41,000 businesses are expected to pay the new Corporate Income Tax.

### **Nonresident Individual Taxpayers**

For personal income tax purposes, business income will now also be apportioned using a single-sales factor. While both the CIT and the personal income tax will use single-factor sales apportionment, there are substantial differences in how the sales factor is calculated under each tax. The two most important differences are (1) the personal income tax sales factor will still contain a throw-back provision; and (2) the personal income tax rules will retain the cost-of-performance methodology as it relates to the sourcing of non-tangible personal property transactions.

This change to the personal income tax apportionment method is effective after **December 31, 2010**. Thus, it is imperative nonresident owners of partnerships and other pass-through entities with operations entirely or substantially located outside of Michigan consider the impact on their **2011** non-resident Michigan individual income tax liability. Some taxpayers may not currently be in compliance with Michigan's withholding requirements as a result of this change in the law.

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### Pension Plans

In an effort to offset some of the lost revenue due to the repeal of the MBT, the legislation makes substantial changes to the taxation of pension income. Specifically both public and private pension benefits will now be taxable for people born after 1952. The legislation does provide for a limited exemption against all types of income once the taxpayer reaches age 67.

### Action Items

GBQ SALT professionals are available to assist in understanding the applicability of the current legislation and the effects it may have on your business.

For more information, please contact:

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