

The New Michigan Business Tax

by Steven E. Grob and Wayne D. Roberts

Michigan's business tax structure radically changed on January 1, 2008, the day the new Michigan Business Tax (MBT) took effect. The tax, together with companion amendments to the Michigan General Property Tax Act, was enacted to replace Michigan's Single Business Tax (SBT), which was repealed effective December 31, 2007. So, what exactly is this new tax and what does it mean for you as a Michigan business taxpayer? Let's take a closer look.

In crafting the MBT, some of the objectives of the Michigan Legislature were to enact a business tax that would: 1) replace tax revenue lost by the repeal of the SBT and reduction of property taxes; 2) simplify tax compliance; and 3) be similar to taxes imposed by other states.

Upon closer inspection, you will see that the MBT actually contains four separate taxes:

[These rates are before recently enacted surcharges discussed below.]

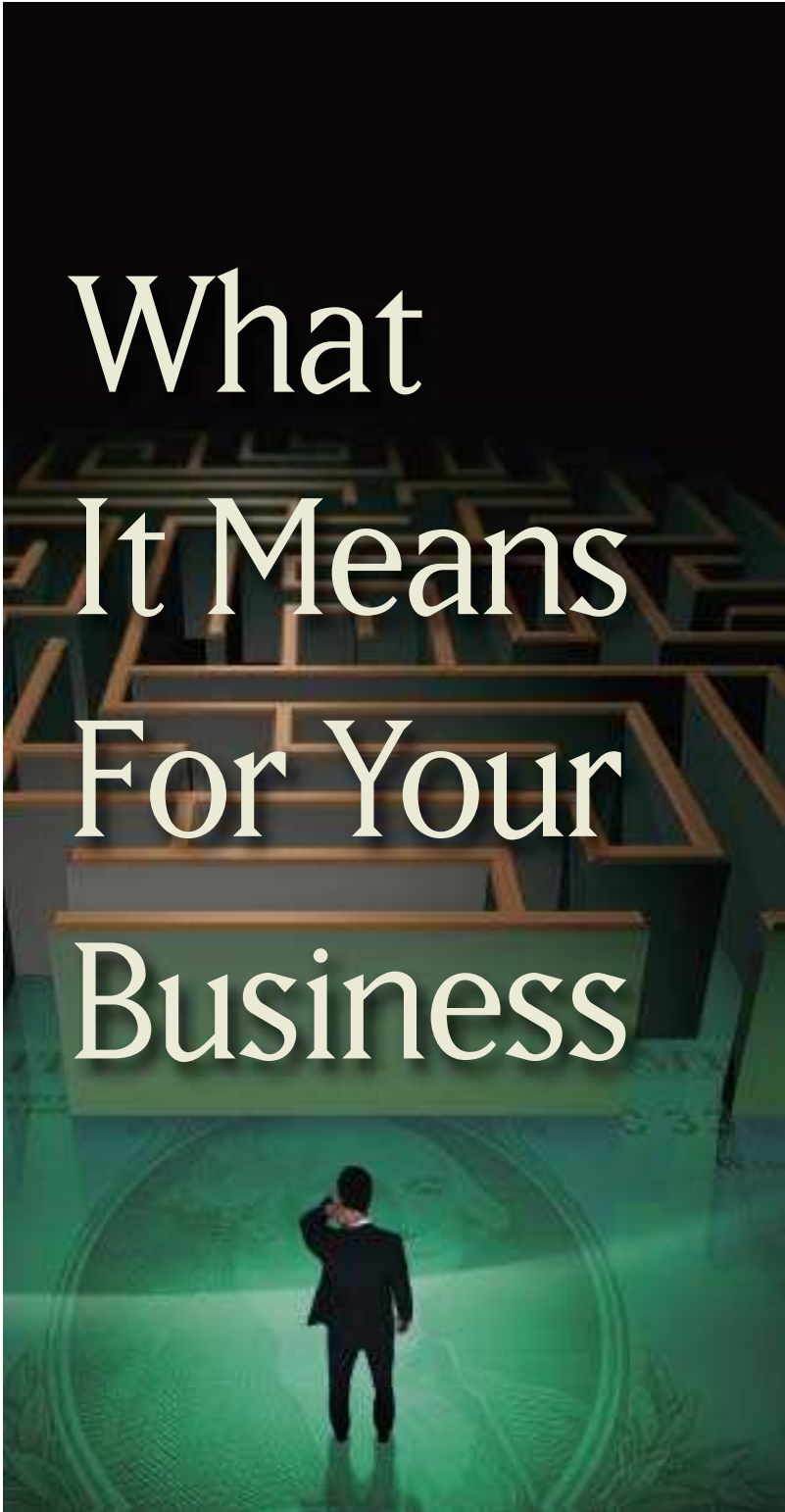
- ▶ 4.95 percent business income tax;
- ▶ 0.8 percent modified gross receipts tax;
- ▶ 0.235 percent franchise tax on financial institutions;
- ▶ 1.25 percent premiums tax on insurance companies.

Most Michigan business taxpayers will be subject to both the business income tax and the modified gross receipts tax. For such taxpayers, the sum of these two taxes will equal their total MBT liability before credits (and before the new MBT surcharge, which is discussed below).

The MBT is imposed on all types of taxpayers, whether entities or individuals, that have the requisite business activity in Michigan. Financial institutions and insurance companies are exempt from the business income tax and the modified gross receipts tax. Instead, a franchise tax is imposed on financial institutions at a rate of 0.235 percent of the financial institution's net capital, and a premiums tax is imposed on insurance companies at a rate of 1.25 percent of gross direct premiums written on property or risk located in Michigan.

BUSINESS INCOME TAX — The MBT's business income tax is imposed at 4.95 percent (6.0385 percent after the surcharge) of a taxpayer's "business income." Business income will equal the taxpayer's federal taxable income (under the Internal Revenue Code) from business activities, with certain adjustments, including a deduction for net earnings from self-employment. There are potential complexities associated with some of these adjustments, and further complexities arise if a taxpayer is a member of a unitary group that must file a combined return. Unitary filing is discussed below.

Michigan-based businesses are subject to the business income tax if they have at least \$350,000 of Michigan gross receipts. In general, non-Michigan businesses are subject to the business income tax if, in addition to having at least \$350,000 of Michigan gross receipts, (i) they have a physical presence in Michigan (through employees, independent contractors, agents,



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deduction for "purchases from other firms." In general, "purchases from other firms" is defined to include purchases of inventory, purchases of assets that are subject to depreciation or amortization for federal income tax purposes, and purchases of materials and supplies. Special deductions are allowed for compensation paid by a "staffing company" and subcontractor costs for certain building contractors.

For businesses that do not have significant "purchases from other firms," the MGRT will closely resemble a pure gross receipts tax. For businesses with large inventory purchases, the MGRT may more closely resemble a margins tax.

Michigan businesses are subject to the modified gross receipts tax if they have at least \$350,000 in Michigan gross receipts. In contrast to the business income tax (discussed above), non-Michigan businesses may be subject to the modified gross receipts tax if they have either (1) physical presence in Michigan for more than one day, or (2) economic presence in Michigan (which may be established, based on a facts and circumstances test, by such businesses having at least \$350,000 of Michigan gross receipts and "actively soliciting sales" in Michigan).

APPORTIONMENT — Very generally, "apportionment" is the manner in which a taxpayer's tax base is divided among the states in which it does business.

or other representatives) for more than one day, and (2) the activities of representatives in Michigan exceed the mere solicitation of sales of tangible personal property.

MODIFIED GROSS RECEIPTS TAX

— The MBT's modified gross receipts tax is a tax equal to 0.8 percent (0.976 percent after the surcharge) of a taxpayer's "modified gross receipts." Computation of the tax base begins with gross receipts, which generally is equal to total sales. This amount is then reduced by a

The MBT apportions the tax base of a taxpayer based solely on a sales factor, i.e., Michigan sales divided by sales everywhere. This apportionment method was adopted, in part, to avoid penalizing taxpayers that locate property in Michigan and employ Michigan workers by excluding property and payroll from the apportionment formula. In connection with sales factor apportionment, the MBT also adopts a

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"market-based" apportionment approach for sourcing income from services and from intangible assets such as trademarks, copyrights and other intellectual property. In general, income from services and intangible assets is sourced to the state in which the customer receives the benefit of the services or use of the property.

UNITARY COMBINED FILING REQUIRED

— Groups of persons and entities that are under common ownership, including individuals, corporations, partnerships, LLCs and trusts, are required to file combined returns if there is a flow of value among the members of the group, or the members have business activities that are integrated with, are dependent upon, or contribute to, each other. This unitary combined filing requirement is a significant departure from the SBT, which generally was imposed on each taxpayer separately (unless taxpayers were granted permission to file combined). Unitary combined filing generally will limit certain types of tax planning, including the ability of taxpayers to use the \$350,000 gross receipts threshold and separate entities to plan around the MBT.

For many Michigan taxpayers, the unitary filing requirement will complicate tax return filings due to business structures that include employee leasing companies, equipment leasing companies, or affiliated retailers, wholesalers or manufacturers. There are also potential complexities associated with family members

involved in related businesses. Taxpayers should carefully review unitary filing matters with experienced tax counsel.

TAX CREDITS AND PERSONAL PROPERTY TAX RELIEF

— Major goals of the MBT were to provide targeted tax credits and relief from personal property taxes. Personal property tax relief is afforded through two principal avenues: personal property tax credits within the MBT and personal property tax exemptions set forth in MBT companion amendments to the Michigan General Property Tax Act. In addition, more than one-half of the total text of the MBT Act is dedicated to targeted tax credit provisions.

PERSONAL PROPERTY TAX CREDITS

— Personal property tax credits are available for the following taxes levied and paid after December 31, 2007:

Type of Personal Property Tax Paid	Credit Percentage
Industrial Personal Property Tax	35 percent (this credit effectively replaced the 15 percent SBT credit for industrial personal property taxes)
Telephone Utility Personal Property Tax	23 percent for 2008; 13.5 percent for 2009 and later years
Natural Gas Pipeline Personal Property Tax	10 percent



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PERSONAL PROPERTY TAX

EXEMPTIONS — Personal property tax exemptions are available for the following:

Type of Personal Property	Exemption
Industrial Personal Property	Exempt from 24 Mills of personal property tax
Commercial Personal Property	Exempt from 12 Mills of personal property tax

Importantly, the determination of whether personal property is industrial, commercial, or another classification is made under section 27a of the Michigan General Property Tax Act. Such classification must be reflected accurately in the local assessor's records. This reliance on property tax classification for the availability of credits and exemptions increases the importance of classification by the local assessor and may result in an increase of classification appeals.

MBT TAX CREDITS — In addition to personal property tax credits, there are many other tax credits allowed under the MBT. Some MBT tax credits are carried over from the SBT, and some are entirely new. The more widely applicable MBT credits available are shown in the chart to the right.

There are also credits for a wide variety of activities, including start-up businesses, early stage ventures, charitable contributions to specified charities, public broadcasting stations, public libraries, and Michigan colleges and universities, payments to workers compensation funds, education foundations, contributions to food banks and homeless shelters, and "next energy" activities. Each taxpayer should carefully evaluate the numerous MBT credit provisions to ensure utilization of all available credits.

Certain combinations of credits are limited. For taxpayers other than insurance companies, for 2008, the combination of compensation and R&D credits cannot exceed 50 percent of MBT liability before the surcharge. This percentage increases to 52 percent for 2009 and later years. Also, the combination of compensation, investment and R&D credits cannot exceed 65 percent of MBT liability before surcharge.

Credit Description	Credit Details
SBT Credit Carryforwards	SBT credit carryforwards apply to MBT tax liabilities for tax years 2008 and 2009 only
Compensation Credit	.296 percent of Michigan compensation for 2008; .37 percent of Michigan compensation for 2009 and later years
Investment Credit	2.32 percent of net investment in Michigan tangible, depreciable/amortizable assets for 2008; 2.9 percent credit for 2009 and later years
Research & Development Credit	1.52 percent of Michigan R&D expenses in 2008; 1.9 percent credit for 2009 and later years
Alternate Tax Credit	Allowed to small business with less than \$20M in gross receipts and less than \$180,000 in shareholder/officer compensation – results in MBT liability equal to (MBT rate of 1.8 percent multiplied by taxpayer's adjusted business income)
MBT Phase-In Credit	Eliminates cliff experienced when gross receipts reach \$350,000 – credit equal to tax liability x (apportioned gross receipts – \$350,000/\$350,000)
Entrepreneurial Credit	Based on adding at least 20 jobs in Michigan for 2008 – 2010
Municipal and Arts Contribution	50 percent of contribution in excess of \$50,000 to municipalities and art, historical, or zoological institute (maximum credit \$10,000)
Renaissance Zone Credit	This credit carried over from the SBT; available for certain renaissance zone activities and expenditures

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EXPANSION AND REPEAL OF THE MICHIGAN USE TAX ON SERVICES

— The MBT was enacted on July 12, 2007. Soon thereafter, the Michigan Legislature reported a budget deficit of approximately \$700 million. To offset this deficit and to avoid a complete government shut-down, the Legislature passed Public Act 93 of 2007 to expand Michigan’s six percent use tax to apply to 23 specifically designated services that were not previously taxable in Michigan.

When the services tax was enacted, Michigan businesses and individuals from across the state expressed immediate and vigorous opposition to it. In response, on December 1, 2007, Governor Granholm signed into law Public Act 145 of 2007 to:

- ▶ repeal the services tax on the same day that it became effective; and
- ▶ increase tax revenue from the MBT to replace revenue projected to be lost due to the repeal of the services tax by reducing certain credits and imposing certain surcharges.

MBT SURCHARGE: INCREASED MBT LIABILITIES

— To replace the revenue projected to be lost by the repeal of the services tax, PA 145 imposed surcharges on the MBT liability of most Michigan taxpayers. The applicability of the surcharges can be summarized as follows:

Business/Industry	Surcharge Percentage
Taxpayers other than financial institutions or insurance companies	21.99 percent surcharge on MBT liability after allocation and apportionment to Michigan, but before credits
Financial Institutions	27.7 percent surcharge for tax years ending after 2007 and before 2009; 23.4 percent surcharge for tax years ending after 2008
Insurance Companies	No surcharge

The maximum amount of the surcharge on any non-financial institution in any tax year is \$6,000,000 per taxpayer. The MBT surcharge has been reported as a “temporary” tax because PA 145 provides that this surcharge will not apply after 2016 if Michigan personal

income growth exceeds zero percent in 2014, 2015 or 2016. PA 145 also reduced the availability of certain MBT credits (such reductions are reflected in the above summary of credits). The tax surcharge cannot be offset by the compensation, investment and R&D credits.

Whether the MBT is an improvement over the SBT remains to be seen and likely will be the subject of continuing debate among taxpayers.

CONCLUSION — The MBT and its companion property tax legislation radically changed the Michigan business tax structure. With unitary combined filing, economic nexus, and a multitude of complex tax credits and exemptions, the MBT incorporates state tax concepts that are entirely new to Michigan. Taxpayers should carefully evaluate their Michigan tax positions. In this evaluation, businesses and individuals should note that there are many complex issues in the MBT that are far beyond the scope of this article. The Michigan Department of Treasury has been working hard and has issued a significant amount of guidance with respect to some of these complex issues, but much more guidance is needed. There have been several technical correction bills passed since the enactment of the MBT, and more are expected. Whether the MBT is an improvement over the SBT remains to be seen and likely will be the subject of continuing debate among taxpayers.

Additional information on the MBT is available online at www.mibusinesstax.com. ●



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