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The Michigan Business Tax Replaces the State's Much-Vilified SBT

In drafting a replacement tax, the legislature sought to create a less-complex tax scheme that was similar to tax systems of other states and less subject to litigation; whether the new MBT satisfies those other objectives seems questionable.

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The Michigan business tax climate will be radically altered with the recent enactment of the new Michigan Business Tax (MBT) Act. The MBT makes far reaching changes in the Michigan tax system. In replacing the Michigan "Single Business Tax" (SBT), the MBT, among other things, offers substantial new credits for property taxes, as well as other credits not present under the old law. The following discussion describes the details of the MBT, and contrasts the new tax with the prior system.

The current business tax system in Michigan remains in effect through the end of 2007. Its primary components include the SBT on business activity in Michigan, and property taxes on personal property located in the state. The SBT is repealed effective for business activity after 2007, and is being replaced with what has been termed the Michigan Business Tax.¹ The personal property tax was not repealed, but the MBT allows a new credit for a portion of such taxes. Also, recent amendments to the Michigan Property Tax Act grant rate relief to industrial and commercial property.

For most types of businesses, the MBT is essentially a dual tax. First, a tax is imposed on the net income of the business (referred to as the "Business Income Tax"). Second, a tax is imposed on the modified gross receipts of the business (referred to as the "Modified Gross Receipts Tax"). One reason for including a gross receipts tax is to reduce the volatility in tax revenue collections that can result from a state's reliance on only a net

income tax. Special taxes apply to taxpayers in certain industries such as financial institutions and insurance companies.

The MBT is generally levied on any person or entity conducting business activity in Michigan, regardless of the form in which the business is conducted. A significant change from the SBT is the inclusion of a unitary business concept, whereby affiliated taxpayers with certain business relationships must file a combined return. A very broad nexus standard for the Modified Gross Receipts Tax coupled with sales-factor-only apportionment for most taxpayers will result in increased tax liabilities for many non-Michigan-based businesses selling into the Michigan market (an intention of the drafters of the MBT). Many of the tax credits provided in the MBT Act will be available for investments or activities in Michigan only (another intention of the drafters).

As with any dramatic change in a tax system, the MBT has winners and losers. Overall, the new tax was intended to be revenue neutral in terms of the dollars of tax revenue it raised, compared to the revenue raised under the prior tax system. Significant shifts of the tax liability, however, will occur among various industries and types of taxpayers.

The Business Income Tax

As noted above, the first of the two primary components of the MBT is the Business Income Tax, or "BIT."² The BIT is generally imposed on every taxpayer (other than financial institutions and insurance companies) that has business activity in Michigan, unless prohibited by P.L. 86-272 (the federal "Interstate Commerce Tax Act," discussed further below). The BIT is imposed at 4.95% of the business income tax base, after allocation and apportionment. The tax base computation starts with "business income," which is that part of federal taxable income (FTI) "derived from business activity."³ This may leave open the possibility of *nonbusiness* income being tax-exempt, although the MBT Act contains no specific definition of nonbusiness income or any casual transaction that may be excluded from the BIT base. Business income is then subject to several additions and subtractions, including the following:

- Add federally tax-exempt interest and dividends from non-Michigan municipal securities, net of related expenses not deducted for federal tax purposes.
- Add back taxes imposed on or measured by net income, to the extent deducted in computing FTI.
- Add back any net operating losses deducted in computing FTI.
- To the extent included in FTI, subtract dividends and royalties received from persons other than U.S. persons and foreign operating entities.⁴
- To the extent included in FTI, add back the loss (or subtract the income) attributable to another entity whose business activities are subject to the BIT, or would be subject to the BIT if the business activities were in Michigan.
- To the extent deducted in arriving at FTI, add back any royalty, interest, or other expense paid to a related person for the use of an intangible asset if that person is not included in the taxpayer's unitary business group. This addback does not apply if the taxpayer can demonstrate that the transaction: (1) has a nontax business purpose other than the avoidance of tax, (2) is conducted with arm's-length pricing and terms, and (3) satisfies one of the following: (a) it is a pass-through of another transaction between the related person and a third party on comparable terms, (b) the addition results in double taxation (e.g., the transaction is subject to tax in another jurisdiction), or (c) the addition is unreasonable as determined by the Michigan Department of Treasury, and the taxpayer agrees that the addition would be unreasonable.
- To the extent included in FTI, deduct interest income from U.S. obligations.

- To the extent included in FTI, deduct any net earnings from self-employment of the taxpayer or of a partner or member of a taxpayer that is a partnership or limited liability company (LLC), except to the extent that those net earnings represent a reasonable return on capital. (This provision places sole proprietors and entities taxed as partnerships on an equal footing with corporations, which can deduct all compensation, whether paid to the owners or others.)
- After allocating or apportioning the adjusted business income, deduct any available business loss incurred after 2007. A "business loss" is negative taxable business income after allocation or apportionment. Business losses may be carried forward for up to ten years.⁵

For a unitary business group, business income is the sum of the business income of each person included in the group (other than a foreign operating entity or a person taxed as an insurance company or financial institution), less any income or deductions from transactions between persons included in the group.⁶

The Modified Gross Receipts Tax

The second main component of the MBT is the Modified Gross Receipts Tax, or "MGRT."⁷ The MGRT is imposed on every taxpayer (other than financial institutions and insurance companies) with "substantial nexus" in Michigan. Substantial nexus exists if the taxpayer either (1) has a physical presence in Michigan for more than one day during the tax year, or (2) "actively solicits" sales in Michigan and has Michigan gross receipts of at least \$350,000. The statute empowers the Michigan Department of Treasury to define "actively solicits" through written guidance that will apply prospectively.⁸ The statute contains no specific requirement that such guidance be promulgated under the Michigan Administrative Procedures Act. "Physical presence" is any activity conducted by a taxpayer directly or on behalf of the taxpayer through its employee, agent, or independent contractor, but it does not include activities of professionals or other service providers if the activity is not significantly associated with the taxpayer's ability to establish and maintain a market in Michigan.⁹

The nexus rules are different for the BIT as compared to the MGRT. An out-of-state taxpayer whose only activity in Michigan is solicitation of sales appears to be exempt from the BIT under P.L. 86-272.¹⁰ This is one reason why a pure business income tax may not have been sufficient to adequately tax out-of-state companies selling into Michigan. In contrast, mere solicitation of sales in Michigan may be sufficient to create nexus for the MGRT. Thus, the MGRT nexus standard is similar to the nexus standard applicable under the SBT, which was set forth in Michigan Revenue Administration Bulletin (RAB) 1998-1.¹¹

The MGRT is imposed on the MGRT base, after allocation or apportionment to Michigan, at the rate of 0.8%. The law states that the MGRT is imposed on "the privilege of doing business and not upon income or property."¹² The MGRT base is a taxpayer's "gross receipts less *purchases from other firms* before apportionment."¹³ "Purchases from other firms" is a critical component of the tax calculation, and one that may generate significant controversy; such purchases include the following:

- Inventory (including shipping, delivery, or engineering charges included in the contract price) acquired during the tax year.
- Assets (including the costs of fabrication and installation) acquired during the tax year that are, or will become, eligible for depreciation, amortization, or accelerated cost recovery for federal income tax purposes.

- To the extent not included in inventory or depreciable property, materials and supplies, including repair parts and fuel.
- For a staffing company, compensation of personnel supplied to customers of staffing companies.
- For a person included in major groups 15 (general building contractors), 16 (heavy construction contractors), and 17 (special trade contractors) under the U.S. Department of Labor's "standard industrial classification" (SIC) codes, that does not qualify for a credit under MBT Act §417 (discussed below), payments to subcontractors for a construction project under a contract specific to that project. (This provision eliminates potential pyramiding of gross receipts tax for certain contractors and their subcontractors).¹⁴

For a unitary business group, the tax base is the sum of the modified gross receipts of each person (other than a foreign operating entity or a person taxed as an insurance company or a financial institution) included in the group, less any modified gross receipts from transactions between persons included in the group.¹⁵

Michigan's MGRT is a unique tax that can be classified as something between a gross receipts tax and a gross margin tax. Earlier draft tax legislative proposals referenced the Texas gross margin tax as an example of this type of tax, but the enacted MGRT differs substantially from the Texas scheme.¹⁶ For example, for some taxpayers (e.g., retailers, who can deduct the cost of their inventory purchases) the tax base essentially will be their gross margin. For taxpayers who do not have items that constitute deductible "purchases from other firms," however, the tax essentially will be imposed on their gross receipts.

If a taxpayer has an unused SBT business loss carry forward that was incurred in 2006 or 2007, 65% of the loss can be deducted in the 2008 tax year only. If the taxpayer is a unitary business group, the loss carryforward can be deducted against the MGRT base of only that person included in the group, calculated as if the person were not included in the group.¹⁷

The MBT Act provides that new motor vehicle dealers and dealers in new or used personal watercraft can collect the MGRT from their customers in addition to the sales price.¹⁸

Persons Exempt From the MBT

The MBT Act states that the following persons are exempt from the Michigan Business Tax:

- (1) The U.S., any state, and their agencies and political subdivisions.
- (2) A person exempt from federal income tax, and any partnership, LLC, joint venture, unincorporated association, or other group or combination of entities acting as a unit if the entity's activities are exclusively related to the charitable, educational, or other purpose that is the basis for the exemption from federal income taxation of the partners or members, and if all of the partners or members of the entity are exempt from federal income tax, except the following:
 - (a) an organization included under IRC Section 501(c)(12) or (c)(16);
 - (b) an organization exempt under IRC Section 501(c)(4) that would be exempt under Section 501(c)(12) except that it failed to meet the latter section's requirements that 85% or more of its income consist of amounts collected from members; and
 - (c) the tax base attributable to the activities giving rise to an exempt person's unrelated business taxable income.

(3) A nonprofit cooperative housing corporation (but the exemption does not apply to business activity of such a corporation other than providing housing services to its stockholders and members).

(4) That portion of the tax base attributable to the production of agricultural goods by a person whose primary activity is the "production of agricultural goods," which means commercial farming but generally does not include the marketing at retail of agricultural goods.

(5) Certain farmers' cooperative corporations (with specified exceptions, including where the total dollar value of the cooperative corporation's incidental and emergency purchases of commodities from nonproducers to facilitate the manufacturing or marketing of commodities purchased from producers equal or exceed 5% of the corporation's total purchases).

(6) That portion of the tax base attributable to certain direct and indirect marketing activities of a qualified farmers' cooperative corporation.

(7) That portion of the tax base attributable to the services provided by an attorney-in-fact to a reciprocal insurer.

(8) That portion of the tax base attributable to a multiple employer welfare arrangement that provides only dental benefits and that has the required certificate of authority.¹⁹

Apportionment

For a taxpayer whose business activities are subject to tax both within and outside of Michigan, the Michigan tax bases will be apportioned to the state using a single sales factor. Thus, the MBT uses single-factor apportionment instead of the SBT's three-factor (property, payroll, and sales) apportionment formula that was heavily weighted towards the sales factor.²⁰ A taxpayer is subject to tax in another state if either of the following circumstances apply:

(1) The taxpayer is subject, in that other state, to a business privilege tax, a net income tax, a franchise tax measured by net income, a franchise tax for the privilege of doing business, or a corporate stock tax or a tax of the type imposed under the MBT Act.

(2) That other state has jurisdiction to subject the taxpayer to one or more of the taxes listed in (1) above, regardless of whether that state does subject the taxpayer to that tax.²¹

Generally, the sales factor is a fraction, the numerator of which is the taxpayer's total sales in Michigan during the tax year and the denominator of which is the taxpayer's total sales everywhere during the tax year. For a taxpayer that is a unitary business group, sales include sales in Michigan of every person included in the group regardless of whether the person has nexus in Michigan.²² Sales between persons included in a unitary business group must be eliminated in calculating the sales factor.

Sourcing revenue from sales involving property. Many of the sourcing rules under the MBT generally follow previously existing SBT sourcing rules. Some significant differences exist, however, especially with regard to services and income from intangibles. A taxpayer's receipts in connection with the sale or lease of tangible or intangible property are sourced as follows²³:

Selling tangible personal property. Sales of tangible personal property are in Michigan if the property is shipped or delivered (or in the case of electricity and gas, the contract requires that the property be shipped or delivered) to any purchaser within Michigan,

based on the ultimate destination at the point that the property comes to rest regardless of the "free on board" point or other conditions of the sales.

Real property. Receipts from the sale, lease, rental, or licensing of real property are in Michigan if the property is located in Michigan.

Leasing tangible personal property. Receipts from the lease or rental of tangible personal property are in Michigan to the extent that the property is used in Michigan. The extent of such use is determined based on the ratio of (1) the number of days of physical presence of the property in Michigan during the lease or rental period in the tax year, compared to (2) the number of days of physical location of the property everywhere during all lease or rental periods in the tax year. If the physical location of the property during a lease or rental period is unknown or cannot be determined, the property is deemed used in the state in which the property was located at the time the lessee obtained possession.

Leasing mobile transportation property. Receipts from the lease or rental of mobile transportation property owned by the taxpayer are in Michigan to the extent that the property is used in Michigan. The extent of an aircraft's use in Michigan is based on a ratio of (1) the number of landings of the aircraft in Michigan, compared to (2) the total number of landings of the aircraft everywhere. If the extent of the use of any transportation property in Michigan cannot be determined, the receipts are sourced to Michigan if the property has its principal base of operations in the state.

Royalties for the use of intangibles. Royalties and other income received for the use of, or the privilege of using, intangible property (which includes patents, know-how, designs, processes, copyrights, trade names, licenses, customer lists, computer software, and similar items) are attributed to the state in which the property is used by the purchaser. For property used in more than one state, the royalties or other income are apportioned to Michigan pro rata according to the portion of use in Michigan. If the portion of use cannot be determined, the royalties or other income are excluded from both the numerator and denominator of the sales factor. Intangible property is used in Michigan if the purchaser uses the property or the rights to the property in the regular course of its business operations in Michigan, regardless of the location of the purchaser's customers.

Sourcing service revenue. Under the soon-to-expire SBT, receipts from services are sourced under a cost-of-performance methodology using an all-or-none approach. In contrast, the MBT uses a type of market approach, with proportionate sourcing. Thus, for purposes of the MBT, sales from the performance of services are sourced as follows:

(1) In general, receipts from the performance of services are sourced to Michigan if the recipient of the services receives *all of the benefit* of the services in Michigan. If the recipient receives only *some of the benefit* of the services in Michigan, receipts are sourced to Michigan in proportion to the extent that the benefits are received there.

(2) Sales derived from securities brokerage services are sourced to Michigan based on the ratio of (1) sales of securities brokerage services to customers in Michigan, compared to (2) sales of securities brokerage services to all customers. If receipts from brokerage services can be associated with a particular customer but it is impractical to associate the receipts with the customer's address, that address is presumed to be the address of the branch office that generates the transactions for the customer.

(3) Receipts derived directly or indirectly from the sale of management, distribution, administration, or securities brokerage services to, or on behalf of, a regulated investment company (RIC) or its beneficial owners (including receipts derived directly or indirectly from trustees, sponsors, or participants of employee benefit plans that have accounts in a RIC), are sourced to Michigan to the extent that the shareholders of the RIC are domiciled in Michigan. This sourcing is based on a ratio of a beginning- and end-of-year average of the number of shares owned by Michigan domiciliaries compared to the average owned by all shareholders. For this purpose, "domicile" is the shareholder's mailing address on the records of the RIC, unless the RIC or the person providing the management services has actual knowledge that the shareholder's primary residence or principal place of business is different from that mailing address. ²⁴

Loans and credit-related services. Receipts from the origination of a loan or gains from the sale of a loan secured by residential real property are sourced to Michigan only if one of the following applies:

- The real property is located in Michigan.
- The real property is located within both Michigan and one or more other states, and more than 50% of the fair market value of the property is in Michigan.
- More than 50% of the real property is not located in any one state and the borrower is located in Michigan. ²⁵

Interest from loans secured by real property are sourced under this same method. Whether the real property securing a loan is located in Michigan is determined as of the time the original agreement is made, and any and all subsequent substitutions of collateral are disregarded. ²⁶

Interest from a loan not secured by real property is sourced to Michigan if the borrower is located in Michigan. Similarly, gains from the sale of a loan not secured by real property are sourced to Michigan if the borrower is in Michigan. ²⁷

Receipts from credit card receivables (including interest, fees, and penalties from such receivables and fees charged to cardholders, such as annual fees) are sourced to Michigan if the cardholder's billing address is in Michigan. Receipts from the sale of credit card or other receivables are sourced to Michigan if the customer's billing address is in Michigan. Receipts from merchant discounts are sourced to Michigan if the merchant's commercial domicile is in Michigan. ²⁸

Loan servicing fees derived from loans of another *secured by real property* are sourced to Michigan if (1) the real property (a) is in Michigan, or (b) is located both within and outside of Michigan and more than 50% of the fair market value of the property is in Michigan; or (2) more than 50% of the fair market value of the real property is not located in any one state and the borrower is located in Michigan. Loan servicing fees derived from loans of another *not secured by real property* are sourced to Michigan if the borrower is located in Michigan. If the location of the security cannot be determined, the fees for servicing either secured or unsecured loans of another are sourced to Michigan if the lender to whom the loan servicing is provided is located in Michigan. ²⁹

Investment and trading activities. Receipts from the sale of securities and other assets from investment and trading activities (including, e.g., interest, dividends, gains) are sourced to Michigan if the customer is in Michigan. If the customer's location cannot be determined, such receipts are sourced to Michigan as follows:

- Interest, dividends, and other income from investment assets and activities and from trading assets and activities are sourced to Michigan if the average value of the assets is assigned to a regular place of business of the taxpayer within Michigan.
- The amount of receipts from trading assets and activities (including, e.g., assets and activities in the matched book, in the arbitrage book, and foreign currency transactions, but excluding amounts otherwise sourced in this section) are sourced to Michigan if the assets are assigned to a regular place of business of the taxpayer within Michigan. ³⁰

Transportation services. Receipts from transportation services rendered by a person subject to tax in another state are generally sourced to Michigan based on the ratio that "revenue miles" of the person in Michigan bear to the "revenue miles" of the person everywhere. A "revenue mile" is the transportation for a consideration of one net ton in weight or one passenger over a distance of one mile. ³¹

Receipts from maritime transportation services are sourced to Michigan if the service both originates and terminates in Michigan. If the maritime transportation services *either* originate or terminate in Michigan, but not both, 50% of those receipts are sourced to Michigan. ³² Special apportionment rules apply also to business activities that consist of (1) the transportation of both property and individuals; (2) the transportation of oil by pipeline; and (3) the transportation of gas by pipeline. ³³

Communication services. Other special apportionment rules apply with regard to receipts from the provision of communication-related services, including:

- (1) General telecommunication or mobile telecommunication services.
- (2) Telecommunication services sold on an individual call-by-call basis.
- (3) Postpaid telecommunication services.
- (4) Prepaid telecommunications services or prepaid mobile telecommunications services.
- (5) Private communication services.
- (6) Billing services and ancillary services for telecommunication service.
- (7) Access to a carrier's network or the sale of telecommunication services for resale. ³⁴

Certain terminology used in the MBT Act sections governing apportionment methods for communications services have the same meaning as those terms are defined in the state's Streamlined Sales and Use Tax Administration Act. ³⁵

Spun-off corporations. A unique apportionment rule applies to certain qualifying spun-off corporations. This rule seems to be aimed at a limited number of taxpayers. ³⁶

Alternative apportionment. If the apportionment provisions of the MBT Act do not fairly represent the extent of a taxpayer's business activity in Michigan, the taxpayer may petition for, or the Department of Treasury may require, one or more of the following with respect to all or a portion of the taxpayer's business activity, if reasonable:

- (1) Separate accounting.
- (2) The inclusion of one or more additional or alternative factors that will fairly represent the taxpayer's business activity in Michigan.
- (3) The use of any other method to effectuate an equitable allocation and apportionment of the taxpayer's tax base. ³⁷

An alternative method may be used only if it is approved by the Department. The apportionment provisions of the MBT Act are rebuttably presumed to fairly represent the business activity attributed to the taxpayer in Michigan, taken as a whole and without a separate examination of the specific elements of either tax base, unless it can be demonstrated that the business activity attributed to the taxpayer in Michigan is out of all appropriate proportion to the actual business activity transacted in Michigan and leads to a gross distorted result or would operate unconstitutionally to tax the extraterritorial activity of the taxpayer.³⁸

As a catch-all provision, all other receipts not otherwise sourced under the MBT Act are sourced based on where the benefit to the customer is received or, if where the benefit to the customer is received cannot be determined, to the customer's location.³⁹

Tax Credits

Numerous, detailed tax credit provisions are included in the MBT Act. More specifically, of the 161 pages of text that comprise the Act, approximately 93 pages are dedicated to tax credits. Some of these tax credits are continued from the SBT, while others are entirely new. Under the MBT Act, any unused SBT credits subject to carryover can be carried over and applied against a taxpayer's MBT liability for the 2008 and 2009 tax years; after 2009, except as otherwise provided in the MBT Act, any remaining unused SBT credits will be extinguished.⁴⁰

New MBT Credits. As noted above, the MBT Act has instituted several new tax credits.

Compensation credit. One frequent criticism of the much-vilified SBT was the belief that the SBT penalized Michigan-based companies by imposing a tax on a business's compensation paid to Michigan employees. The drafters of the MBT Act were conscious of this criticism and included in the MBT a specific tax credit based on that very same compensation.

The credit is 0.37% of a taxpayer's compensation paid "in this state." The compensation credit and the investment credit (discussed below) must be claimed before any other MBT credits, and the total of those two credits allowed may not exceed 65% of the total MBT liability.⁴¹

Although the MBT Act does not define compensation paid "in this state," the Department likely will provide some form of guidance relative to this issue. For now, taxpayers may find guidance by reference to the SBT, which provides that wages paid to an individual are "in this state" under any of the following circumstances:

- (1) The individual's service is performed entirely within Michigan.
- (2) The individual's service is performed both within and without Michigan, but the service performed outside the state is incidental to the individual's service within the state.
- (3) Some of the service is performed in Michigan and (a) the base of operations, or if there is no base of operations, the place from which the service is directed or controlled, is in Michigan; or (b) the base of operations or the place from which the service is directed or controlled is not in any state in which some part of the service is performed, but the individual's residence is in Michigan.⁴²

Most of Michigan's service businesses should realize significant tax benefits from the compensation credit. Nevertheless, as with any site-specific tax deduction or credit, there may be claims that the compensation credit is discriminatory in violation of the Commerce Clause. In this context, the Michigan Court of Appeals has upheld at least one site-based tax benefit provision under constitutional challenge.⁴³ Moreover, the MBT Act includes a specific severability provision that effectively severs any credit, deduction, or exemption that is held to be unconstitutional, or that is found to apply to any activity outside Michigan, by a court of competent jurisdiction for which all appeal rights have been exhausted or have expired.⁴⁴ Presumably, this severability clause is intended to accomplish two objectives: (1) to prevent the entire Act from being judicially repealed if any of its site-specific provisions are found to be unconstitutional, and (2) to limit the ability of out-of-state taxpayers to obtain refunds based on constitutional (e.g., Commerce Clause) challenges.

Investment credit. The MBT Act, like the SBT Act, provides an investment credit, but it is calculated differently. For MBT purposes, a taxpayer is allowed a credit of 2.9% of the cost of net acquisitions of new capital assets located and used in Michigan. The calculation of the credit base is location-specific and, in addition to new fixed capital asset purchases, it applies to assets relocated into Michigan, as well as to purchases of mobile capital assets apportioned to Michigan based on the taxpayer's MBT apportionment factor. For a tax year in which credit (as calculated under the MBT Act, taking into account asset dispositions) is negative, the absolute value of that amount is added to the taxpayer's tax liability for the year.⁴⁵

Personal property tax credit. One of the more significant MBT credits is a new, *refundable* personal property tax credit.⁴⁶ The current Michigan tax on personal property has been widely criticized as a deterrent to a company's locating in Michigan, and several neighboring states have reduced or repealed their own such taxes. To address these personal property tax concerns, in addition to exemptions allowed in concurrently enacted amendments to the Michigan General Property Tax Act,⁴⁷ a credit against the MBT is allowed for: 35% of property taxes paid on industrial personal property; 23% of property taxes paid on eligible telephone personal property in 2008 and 13.5% of such taxes in subsequent years; and 10% of property taxes paid on eligible natural gas pipeline property.⁴⁸ These credits apply to personal property taxes levied after 2007. No credit is available for personal property taxes paid on "commercial property."

Research and development credit. Two separate credits are available for research and development-related activities. The first is a credit for 1.9% of a taxpayer's qualified research and development expenditures in Michigan for the tax year. The qualified expenses are determined in accordance with the definitions under IRC Section 41(b) (federal tax credit for increasing research activities).⁴⁹

The second MBT R&D credit is available for the 2008, 2009, and 2010 tax years, and is subject to approval by the Michigan Economic Growth Authority (MEGA). This refundable credit is for 30% of a qualified taxpayer's cash contributions of at least \$350,000 made for the purposes of research and development and technology innovation related to the taxpayer's business. The credit is limited to a maximum of \$300,000, and the MEGA may grant a maximum of 20 such credits annually.⁵⁰

Entrepreneurial credit. For tax years 2008 through 2010, a special tax credit (the Michigan entrepreneurial credit) may be allowed for 100% of an eligible taxpayer's MBT liability attributable to increased employment. To qualify, generally, a taxpayer must be other than a retail establishment and must, in the immediately preceding tax year, (1) have less than \$25 million in gross receipts; (2) create or transfer to Michigan at least 20 new jobs; and (3) make a capital investment in Michigan of at least \$1.25 in a new plant

or equipment. The MBT liability attributable to the increased employment is determined based on a ratio of the taxpayer's payroll for the increased jobs compared to the taxpayer's total payroll in Michigan.⁵¹

Credit for small businesses. To eliminate the "cliff" created by the MBT nexus/filing threshold of \$350,000 in gross receipts, taxpayers with gross receipts of more than \$350,000, but less than \$700,000 may claim a credit computed as follows: the taxpayer's MBT liability (generally before credits) multiplied by a fraction the numerator of which is \$700,000 less the taxpayer's apportioned gross receipts, and the denominator of which is \$350,000. This credit effectively will allow for a phased-in tax liability for taxpayers just above the \$350,000 threshold.⁵²

Other new credits. Several additional new credits are allowed for specific taxpayers or specific types of businesses. These credits include the following:

- The motor sports entertainment complex credit is a taxpayer-specific credit granted to a motor sports racing facility in Michigan that operates sanctioned motor sports racing events (e.g., NASCAR).⁵³
- A sports and entertainment facility credit is an industry-specific credit granted to certain sports and entertainment arenas.⁵⁴
- A motor vehicle dealer inventory credit, which is 2% of the expenditures by a licensed new motor vehicle dealer to acquire new motor vehicle inventory. This nonrefundable credit is limited to \$10,000 annually, and any excess may not be carried over.⁵⁵
- Two nonrefundable credits based on an eligible taxpayer's compensation in Michigan. These credits are taxpayer-specific, each intended for a particular retail enterprise. One credit is for 0.535% of the taxpayer's Michigan compensation and is limited to \$4.5 million. The eligible taxpayer has its headquarters in Michigan and has at least 17 million square feet of retail space and 2 million square feet of warehouse space in the state.⁵⁶ The other credit is for 0.125% of the taxpayer's Michigan compensation, and is limited to \$300,000. This eligible taxpayer has at least 2.5 million square feet of retail space and 1.4 million square feet of enclosed warehouse, headquarters, and transportation services in Michigan.⁵⁷
- A nonrefundable credit for 50% of the charitable contributions in excess of \$50,000 to a certain nonprofit organization for the benefit of an art, historical, or zoological institute; or an institution devoted to the procurement, care, study, and display of objects of lasting interest or value. The maximum annual credit is \$100,000.⁵⁸

MBT credits that are continued from the SBT. As noted above, the MBT Act retains certain tax credits that also were available under the SBT.

Renaissance zone credit. The credits granted to businesses that are located in a Michigan "renaissance zone" (the state's name for its enterprise zones) are retained under the MBT. In general, renaissance zone credits are granted to businesses that locate in designated areas; under certain circumstances, these credits can offset nearly all Michigan business taxes.⁵⁹

While this credit provision is essentially a direct continuation of the credit allowed under the SBT, the MBT renaissance zone provision nevertheless may impose additional credit limitations in certain instances in which a taxpayer's qualifying investment or activities in the zone decrease. Taxpayers in renaissance zones should prepare projections of business activities and related MBT calculations to more fully evaluate the renaissance zone credit provision.

Small business credit. An MBT small business credit is provided in a detailed provision that is similar to the SBT small business credit. A taxpayer's ability to benefit from this credit is based on the taxpayer's having maximum gross receipts of \$20 million (up from \$10 million under the SBT); maximum business income (as computed for purposes of this credit) of \$1.3 million (up from \$475,000 under the SBT); and maximum single officer's or shareholder's compensation or individual or pass-through entity owner's distributive income share of \$180,000 (up from \$115,000 under the SBT).⁶⁰

The small business credit can effectively reduce a taxpayer's MBT liability to 1.8% of its "adjusted business income," which is "business income" (discussed above) with the adjustments described in this credit statute.⁶¹ Given the similarities between the MBT small business credit and the SBT small business credit, existing SBT caselaw may be instructive in dealing with and planning for this new MBT credit.

Additional SBT credits continued under the MBT. The following SBT credits also are included in the MBT Act, operating generally in the same manner as they had under the SBT Act.

- A start-up business credit is available to a qualified start-up business that has no business income for two consecutive tax years. The credit equals the MBT liability "for the tax year in which the taxpayer has no business income," and, subject to limitations, may be claimed for the second of those two consecutive tax years and for each of the immediately following consecutive tax years in which the taxpayer has no business income, for up to a total of five tax years.⁶²
- A taxpayer designated as an "early stage venture" under the Michigan Early Stage Venture Investment Act of 2003, may apply to the Michigan Early Stage Venture Investment Corporation for approval of a tax voucher certificate, which may be used to pay the taxpayer's MBT liability. These tax voucher certificates are transferable.⁶³
- A taxpayer that is not subject to the Michigan income tax may claim credit against the MBT for 50% of the taxpayer's charitable contributions to specified charities, including public broadcasting stations, public libraries, and Michigan colleges and universities. The maximum annual credit is the lesser of \$5,000 or 5% of the taxpayer's tax liability.⁶⁴
- An MBT credit is available to an employer for payments made during the tax year pursuant to the Michigan Worker's Disability Compensation Act of 1969. This workers disability compensation credit is refundable and may equal as much as the total paid by the employer pursuant to §352 of the Disability Compensation Act.⁶⁵
- A nonrefundable "foundation contribution" credit for 50% of a taxpayer's contributions to an endowment fund of a community foundation or an education foundation, is available to a taxpayer that did not claim a similar credit under §261 of the Michigan Income Tax Act. The maximum annual credit is the lesser of \$5,000 or 5% of the taxpayer's tax liability.⁶⁶
- A nonrefundable "food bank and homeless shelter contribution" credit for 50% of a taxpayer's contributions to a shelter for homeless persons, a food kitchen, food bank, or other similar entity providing food or shelter to the indigent, is available to a taxpayer that does not claim a similar credit under §261 of the Michigan Income Tax Act. The maximum annual credit is the lesser of \$5,000 or 5% of the taxpayer's tax liability.⁶⁷
- A nonrefundable "next energy" credit is available to taxpayers that have been certified under the Michigan Next Energy Authority Act. This credit is based on the taxpayer's engaging in research, development, or manufacturing of various alternative energy systems.⁶⁸

- An authorized business or an eligible taxpayer may claim a credit for amounts certified each year by the Michigan Economic Growth Authority (MEGA). MEGA credits are available for up to 20 years. Eligibility for this credit is determined under the MEGA Act and generally involves the creation of jobs in Michigan.⁶⁹
- An historic rehabilitation credit is available to a qualified taxpayer that has a plan certified after 2007 (or certain plans certified before 2008) for the rehabilitation of an historic resource. The credit is for 25% of the taxpayer's qualified expenditures that qualify (or, in certain cases, would qualify) for the federal historic rehabilitation credit under IRC Section 47(a)(2).⁷⁰
- A brownfield credit is available to a taxpayer that makes a significant investment in the development of certain obsolete, contaminated, or blighted areas in Michigan.⁷¹
- Taxpayers may claim a "hematite ore" credit of \$1 per long ton of qualified low-grade hematite consumed in an industrial or manufacturing process (i.e., a process whereby the hematite is used as a raw material in the production of pig iron or steel) that is the business of the taxpayer. This credit is nonrefundable but may be carried forward for up to five tax years. "Qualified low-grade hematite" means pellets produced from low-grade hematitic iron ore mined in the U.S. "Low-grade hematite" is any hematitic iron formation that generally is not of sufficient quality in its original mineral state to be mined and shipped for the production of pig iron or steel without first being drilled, blasted, crushed, and ground very fine to liberate the iron minerals.⁷²

As is evident from the voluminous credit provisions included in the MBT Act, a thorough understanding of both new and existing Michigan tax credits will be a necessity for taxpayers subject to the MBT. Department of Treasury guidance, which hopefully will be forthcoming soon, should be helpful in evaluating both qualification for and calculation of these myriad credits.

Tax on Financial Institutions

Under the MBT Act, in lieu of the Business Income Tax (BIT) or the Modified Gross Receipts Tax (MGRT), a financial institution with nexus in Michigan (based on the MGRT's broad nexus standard) is subject to a franchise tax on its allocated or apportioned Michigan tax base, at a rate of 0.235%. A "financial institution" is (1) a bank holding company, national bank, state chartered bank, office of thrift supervision chartered bank or thrift institution, or a savings and loan company other than a diversified savings and loan holding company; (2) any person not subject to the insurance company tax (discussed below) who is directly or indirectly owned by an entity described in (1) and is a member of the unitary business group; (3) a unitary business group of entities described in (1) and/or (2).⁷³

The tax base of a financial institution is its "net capital," which is equity capital computed in accordance with generally accepted accounting principles, less goodwill arising from purchase accounting adjustments for transactions that occurred after 7/1/07 and the book value of U.S. obligations and Michigan obligations. Net capital also excludes up to 125% of the minimum regulatory capitalization requirements of a person subject to the MBT Act's insurance company tax. The net capital tax base is determined by averaging the net capital as of the end of the current and four preceding tax years. Special computational rules apply to financial institutions that have been in existence fewer than five years, and for financial institutions that change identity, form, or place of organization or that combine into one institution.⁷⁴

Apportionment for a financial institution. The tax base of a financial institution whose business activities are subject to tax both within and outside of Michigan is apportioned using the "gross business factor." The rules for determining whether a financial institution is deemed subject to tax in another state are similar to those under the BIT and MGRT, i.e., if either (1) the taxpayer is subject, in that other state, to a business privilege tax, a net income tax, a franchise tax measured by net income, a franchise tax for the privilege of doing business, or a corporate stock tax or a tax of the type imposed under the MBT Act; or (2) the other state has jurisdiction to subject the company to one or more of the taxes listed in (1), regardless of whether that state does subject the taxpayer to that tax. The "gross business factor" is a fraction the numerator of which is the total gross business of the financial institution in Michigan during the tax year, and the denominator of which is the total gross business of the financial institution everywhere during the tax year.⁷⁵

The items that make up a financial institution's "gross business" are sourced under special rules, which are generally similar to the apportionment sourcing rules for financial institutions that the Department had administratively prescribed under the SBT (see Michigan Revenue Administration Bulletin (RAB) 2002-14).

Under the MBT, a financial institution sources items of gross business to Michigan as follows:

- (1) *Receipts from credit card receivables*: if the card holder's billing address is located in Michigan. (Such receipts include interest and fees or penalties in the nature of interest, as well as receipts from fees charged to credit card holders such as annual fees.)
- (2) *Credit card issuer's reimbursement fees*: if the card holder's billing address is located in Michigan.
- (3) *Receipts from merchant discounts*: if the merchant's commercial domicile is in Michigan.
- (4) *Loan servicing fees for a loan secured by real property*: (a) if the real property securing the loan is in Michigan; (b) if the real property is located both within and outside Michigan, but more than 50% of the fair market value of the property is in Michigan; or (c) if more than 50% of the fair market value of the property is not located in any one state, but the borrower is located in Michigan. Loan servicing fees for a loan not secured by real property are sourced to Michigan if the borrower is located in Michigan.
- (5) *Receipts from services*: if the recipient of the services receives all of the benefit of the services in Michigan. When the recipient receives some of the benefit of the services in Michigan, the receipts are sourced to Michigan in proportion to the extent that the recipient receives such benefit in Michigan. (In contrast, for the SBT, RAB 2002-14 prescribed a costs-of-performance sourcing method).
- (6) *Receipts from investment assets and activities and trading assets and activities (including interest and dividends)*: if the financial institution's customer is in Michigan. When the location of customer cannot be determined, these receipts are in Michigan if (a) the assets or (b) the average value of the assets, depending on the specific type of investment asset and activity or trading asset and activity, is assigned to a regular place of business of the taxpayer in Michigan.
- (7) *Interest charged to customers for debit balances on margin accounts*: if the customer is located in Michigan.
- (8) *Interest on loans secured by real property*: (a) if the property is in Michigan; (b) if the property is located both within and outside Michigan, but more than 50% of the fair market value of the property is in Michigan; or (c) if more than

50% of the fair market value of the property is not located in any one state, but the borrower is located in Michigan.

(9) *Interest from loans not secured by real property*: if the borrower is located in Michigan.

(10) *Net gains from the sale of loans secured by real property or mortgage servicing rights relating to real property*: (a) if the property is in Michigan; (b) if the property is located both within and outside Michigan, but more than 50% of the fair market value of the property is in Michigan; or (c) if more than 50% of the fair market value of the property is not located in any one state, but the borrower is located in Michigan.

(11) *Net gains from the sale of (a) loans not secured by real property or (b) any other intangible assets*: if the depositor or borrower is located in Michigan.

(12) *Receipts from the lease of real property*: if the property is located in Michigan.

(13) *Receipts from the lease of tangible personal property*: if the property is located in Michigan when it is first placed in service by the lessee.

(14) *Receipts from the lease of transportation tangible personal property*: if (a) the property is used in Michigan, or (b) the extent of the use of the property within Michigan cannot be determined but the property has its principal base of operations in Michigan.⁷⁶

Tax on Insurance Companies

Under the MBT Act, in lieu of the BIT or the MGRT, an insurance company must pay a tax equal to 1.25% of gross direct premiums written on property or risk located on residing in Michigan.⁷⁷ This is an increase from the SBT, which imposed tax on adjusted gross receipts at an effective tax rate of 1.0735%.

Direct premiums *do not* include:

- Premiums on policies not taken.
- Returned premiums on cancelled policies.
- Receipts from the sale of annuities.
- Receipts on reinsurance premiums if the tax has been paid on the original premiums.
- For each insurance company subject to tax, the first \$190 million of disability insurance premiums written in Michigan, other than credit insurance and disability income insurance premiums. This exemption is reduced by \$2 for each \$1 by which the insurance company's gross direct premiums from insurance carrier services in Michigan and outside Michigan exceed \$280 million.⁷⁸

This gross direct premiums tax on insurance companies is in lieu of all other privilege or franchise fees or taxes imposed by the MBT Act or by any other Michigan law, except taxes on real and personal property and general sales and use taxes, and except as otherwise provided in the Michigan Insurance Code of 1956.⁷⁹ In that regard, an insurance company is subject to the greater of (1) the tax imposed by the MBT, or, if applicable, (2) the tax imposed by §476a of the Michigan Insurance Code (retaliatory tax on foreign insurers). Also, insurance companies must use a calendar tax year, with annual returns due by the following March 1.⁸⁰

Insurance company tax credits. An insurance company can claim credits against the current year's premiums tax for various fees and assessments from the immediately preceding tax year paid to special insurance industry funds as follows:

- (1) Payments to the Michigan Worker's Compensation Placement Facility.
- (2) Payments to the Michigan Basic Property Insurance Association.
- (3) Payments to the Michigan Automobile Insurance Placement Facility.
- (4) Payments to the Michigan Property and Casualty Guaranty Association.
- (5) Payments to the Michigan Life and Health Guaranty Association.⁸¹

An insurance company is also allowed a credit against the premiums tax for 50% of the examination fees paid by the insurance company during the tax year pursuant to §224 of the Michigan Insurance Code of 1956. In addition, an insurance company that does not make any of the payments listed under items (1) - (4), above, may claim the new MBT compensation credit (discussed above), limited to 65% of the insurance company's tax liability for the tax year after claiming the other credits allowed under the insurance company gross direct premiums tax.⁸²

An insurance company subject to the Michigan Worker's Disability Compensation (WDC) Act of 1969 may claim a credit against the premiums tax for payments it made during the tax year pursuant to WDC Act §352 (regarding certain weekly supplemental payments). The insurance company may claim the §352 payments made during a calendar quarter as a credit against the estimated tax payments made under the MBT Act. Any credit in excess of an estimated payment will be refunded to the insurance company on a quarterly basis within 60 calendar days after receipt of a properly completed estimated tax return. Any subsequent increase or decrease in the amount claimed for payments made by the insurance company will be reflected in the amount of the credit taken for the calendar quarter in which the adjustment is finalized. This credit is an addition to any other credits for which the insurance company is eligible under the MBT Act. Any excess of this credit over the insurance company's tax liability for the tax year will be refunded, without interest, within 60 calendar days of receipt of a properly completed annual return as required by the MBT Act.⁸³

Miscellaneous Administrative Provisions

The MBT Act contains various administrative provisions dealing with, among other things, estimated taxes, return filings, and a possible rebate of the tax in certain situations.

Estimated tax payments. A taxpayer that reasonably expects its MBT liability for the tax year to exceed \$800 must file an estimated return and pay an estimated tax quarterly. For calendar year taxpayers, the quarterly returns and payments are due by April 15, July 15, October 15, and January 15. Fiscal year taxpayers must file and make estimated payments by the appropriate due dates that, in the taxpayer's fiscal year, correspond to these calendar year dates.⁸⁴

The quarterly estimated payments should be computed based on either (1) the estimated BIT base and MGRT base for the quarter, or (2) 25% of the estimated annual liability. The second, third, and fourth estimated payments in each tax year must include adjustments, if necessary, to correct under- or overpayments from previous quarters in the tax year to a revised estimate of the annual tax liability. In the case an underpayment of tax, no interest will be assessed if the sum of the estimated payments equals at least 85% of the liability, and each estimated payment reasonably approximates the tax liability incurred during the quarter for which the estimated payment was made. Also, a limited safe harbor applies for estimated payments based on the prior year's tax liability. For 2009 and each subsequent tax year, if the prior year's MBT liability was \$20,000 or less, a taxpayer can avoid underpayment interest by making four equal estimated payments the sum of which at least equals that prior year's liability.⁸⁵

Short first period. Special tax computation rules apply for a taxpayer whose tax year ends before 12/31/08, or whose first tax year is less than 12 months. Such taxpayer may elect to compute the MBT for that 2008 portion of the year, or for that first year, under one of two methods:

- (1) Compute the tax as if the MBT Act were effective on the first day of the taxpayer's annual accounting period, and then multiply that result by a fraction, the numerator of which is the number of months in the taxpayer's first tax year and the denominator of which is 12.
- (2) Compute the tax by determining the BIT base and the MGRT base in the first tax year using an accounting method satisfactory to the Department that reflects the actual BIT base and the actual MGRT base attributable to the period. ⁸⁶

Filing returns. An annual or final return must be filed by the last day of the fourth month after the end of the taxpayer's tax year (e.g., by April 30 for a calendar-year taxpayer). Any final liability must be remitted with this return. (Unlike the SBT, where the first estimated payment date coincided with the prior year tax return's due date, under the MBT the first estimated payment is due 15 days before the annual return filing date (e.g., April 15 and April 30 for a calendar-year taxpayer).) As noted above, a taxpayer (other than an insurance company or financial institution) whose apportioned or allocated gross receipts are less than \$350,000 need not file a return or pay any MBT. ⁸⁷

Extensions. A taxpayer, upon showing good cause, may apply for, and the Department may grant, an extension of the date for filing the annual return. Interest will apply, however, on any tax unpaid for the extension period. ⁸⁸

A taxpayer that is granted an extension of time to file its federal income tax return can receive an automatic extension to file its annual or final MBT return until the last day of the eighth month following the original due date of the return. To receive the automatic extension, the taxpayer must file with the Department a copy of the federal extension request, together with a tentative MBT return and payment of an estimated tax, by the original due date of the MBT return. Again, interest will apply to any unpaid taxes for the period of the extension. ⁸⁹

Federal tax information. A taxpayer may be required to furnish a copy of all or any portion of any tax returns filed pursuant to the Internal Revenue Code. A taxpayer whose federal income tax return is adjusted so that it affects the taxpayer's BIT tax base or MGRT tax base, must file an amended MBT return within 120 days after the final determination by the IRS. ⁹⁰

Unitary filers. A unitary business group must file a combined return that includes each U.S. person, other than a foreign operating entity, that is included in the group. Each U.S. person included in a unitary business group or in a combined return will be treated as a single person, and all transactions between those persons included in the group will be eliminated from the BIT base, the MGRT base, and the apportionment formula under the MBT Act. If a U.S. person included in a unitary business group or in a combined return is subject to tax as an insurance company or financial institution, any business income, modified gross receipts, and sales attributable to that person will be eliminated from, respectively, the BIT base, the MGRT base, and the apportionment formula. ⁹¹

Administration; coordination with other acts. The tax imposed by MBT Act will be administered by the Michigan Department of Treasury pursuant to the Revenue Act and the MBT Act. If a conflict exists between those Acts, the provisions of

the MBT Act will control. The Department has been legislatively instructed to promulgate rules to implement the MBT Act pursuant to the Administrative Procedures Act of 1969. (The Department was issued similar instructions under the SBT Act, but no rules were ever promulgated pursuant to that Act.)⁹²

Severability provision. As mentioned above, the MBT Act contains a severability provision in the event that some portion of the Act is declared unconstitutional. Under that provision, if a court of competent jurisdiction issues a final order, for which all rights of appeal have been exhausted or have expired, which determines that any provision of the MBT Act that provides a deduction, credit, or exemption with respect to employment, persons, services, investment, or any other activity that is limited to only Michigan is either (1) unconstitutional or (2) applies to employment, persons, services, investment, or any other activity outside of Michigan, that deduction, credit, or exemption will be severed from the Act and will not be in effect for any other tax year to which the final order applies, and the remaining provisions of the MBT Act will remain in effect.⁹³

Possible tax rebate. The MBT Act contains a rebate feature that applies to the state's 2008, 2009, and 2010 fiscal years ending September 30, if the tax revenue generated is more than a specified level. For FY 2008, if the combined revenue from both the MBT and the SBT, less revenue from the MBT's tax on insurance companies, exceeds \$2.398 billion, half of the excess will be deposited in the Michigan Budget Stabilization Fund and the other half will be refunded to taxpayers. For FY 2009, the revenue limit (excluding revenue from the tax on insurance companies) would be \$2.398 billion increased by (1) 1% and (2) the percentage change in Michigan personal income from FY 2008 to FY 2009. For FY 2010, the revenue limit (excluding the tax on insurance companies) would be \$2.398 billion increased by (1) 2.01% and (2) the percentage change in personal income from FY 2009 to FY 2010. If the excess revenue is less than \$5 million, all of the excess would be credited to the Budget Stabilization Fund. Any refunds will be applied pro rata to taxpayers based on a ratio of the positive net payments made by the taxpayer during the fiscal year, compared to the total positive net cash payments made by all taxpayers during the fiscal year.⁹⁴

Conclusion

As designed, the new MBT generally will shift a significant portion of the state's business tax burden from businesses based in Michigan to businesses based out-of-state. In drafting a replacement to the SBT, some of the legislature's other objectives were to create a less-complex tax scheme that was similar to tax systems of other states and less subject to litigation. Whether the new MBT satisfies those other objectives seems questionable. Administrative guidance from the Department is expected, and the legislature may propose a technical corrections bill to clarify or amplify some of the provisions of the Act. []

Sidebar

Practice Note: **Caveat Vendor (Let the Seller Beware)**

For most types of businesses, the Michigan Business Tax (MBT) is essentially a dual tax, i.e., taxes are imposed on both the net income of the business (the "Business Income Tax" or BIT) and the business's modified gross receipts (the "Modified Gross Receipts

Tax" or MGRT). The MGRT is imposed on every taxpayer (other than financial institutions and insurance companies) with "substantial nexus" in Michigan. Substantial nexus exists if the taxpayer either (1) has a physical presence in Michigan for more than one day during the tax year, or (2) "actively solicits" sales in Michigan and has Michigan gross receipts of at least \$350,000. The Michigan Department of Treasury has yet to define "actively solicits." "Physical presence" is any activity conducted by a taxpayer directly or on its behalf through its employee, agent, or independent contractor, but it does not include activities of professionals or other service providers if the activity is not significantly associated with the taxpayer's ability to establish and maintain a market in Michigan.

An out-of-state taxpayer whose only activity in Michigan is the solicitation of sales appears to be exempt from the BIT under P.L. 86-272. In contrast, mere solicitation of sales in Michigan may be sufficient to create nexus for the MGRT. Thus, the MGRT nexus standard is similar to the nexus standard applicable under the SBT, which was set forth in Michigan Revenue Administration Bulletin (RAB) 1998-1.

NOTES

¹ Mich. Comp. Laws §§208.151 and 208.152 (SBT repeal). The MBT Act passed the legislature on 6/28/07 (S.B. 94) and was signed by Governor Granholm (D) on 7/12/07. As discussed below, this bill was enacted as part of a package of legislation that included House Bills Nos. 4369, 4370, 4371, and 4372, which generally involve property taxes. For more background on the SBT, see Grob, "The Michigan SBT Is History...Almost, but First Some Significant Changes," 9 J. Multistate Tax'n 6 (September 1999).

² MBT Act §201.

³ MBT Act §105(2). Under §105(1), "business activity" generally is (1) any transfer of title to or rental of property, whether real, personal, or mixed, tangible or intangible, or (2) the performance of services, or (3) a combination thereof, whether carried on in intrastate, interstate, or foreign commerce, with the object of gain, benefit, or advantage, whether direct or indirect, to the taxpayer or to others. Business activity does not include services rendered by an employee to his or her employer, or services as a director of a corporation. Further, "[a]lthough an activity of a taxpayer may be incidental to another or to other of his or her business activities, each activity shall be considered to be business engaged in within the meaning of this act."

⁴ Under MBT Act §109(5), a "foreign operating entity" is a U.S. person: (1) that would otherwise be a part of a unitary group that has at least one member taxable in Michigan; (2) that has substantial operations outside the U.S., the District of Columbia, Puerto Rico, any U.S. territory or possession, or a political subdivision of any of the foregoing; and (3)

at least 80% of whose income is active foreign business income as defined in IRC §861(c)(1)(B).

⁵ MBT Act §§201(2) and (4).

⁶ MBT Act §201(3). Under §117(6), a "unitary business group" is a group of U.S. persons, other than a foreign operating entity, one of which owns or controls, directly or indirectly, more than 50% of the ownership interest, with voting rights or ownership interests that confer comparable rights to voting rights of the other U.S. persons, and that has business activities or operations that (1) result in a flow of value between or among persons included in the unitary business group, or (2) are integrated with, are dependent upon, or contribute to each other. Flow of value is determined by reviewing the totality of facts and circumstances of business activities and operations.

⁷ MBT Act §203.

⁸ MBT Act §§200(1) and (2).

⁹ MBT Act §200(3).

¹⁰ P.L. 86-272 (the "Interstate Commerce Tax Act," 15 USC §§381-384) limits a state's ability to assert income tax jurisdiction over a business whose only activity in the state is the solicitation of orders for sales of tangible personal property, provided the orders are sent out of the state for approval and are filled by shipment from outside the state. P.L. 86-272 does not protect other types of activities in a state and does not apply to non-income taxes (e.g., sales or use taxes) or to the sale of intangibles. See Wisconsin Dept. of Revenue v. William Wrigley, Jr., Co., 505 US 214, 120 L Ed 2d 174 (1992), which was analyzed in Marcus and Lieberman, "Does *Wrigley* Clarify 'Solicitation' for Purposes of Taxing Interstate Commerce?," 2 J. Multistate Tax'n 148 (Sep/Oct 1992). See also Lieberman, "MTC Guidelines on P.L. 86-272 Implement the U.S. Supreme Court's Decision in *Wrigley*," 5 J. Multistate Tax'n 52 (May/Jun 1995).

¹¹ RAB 1998-1 was discussed in Grob, "New Nexus Standard Seeks to Broaden Michigan's Perception of Tax Jurisdiction," 9 J. Multistate Tax'n 14 (Mar/Apr 1999).

¹² MBT Act §§203(1) and (2).

¹³ MBT Act §203(3). Emphasis added.

¹⁴ MBT Act §113(6).

¹⁵ MBT Act §203(3).

¹⁶ The Texas margin tax was analyzed in Jackson and Wellington, "Major Tax Reform in Texas: An Overview of the State's New Margin Tax," 16 J. Multistate Tax'n 8 (October 2006).

¹⁷ MBT Act §203(4).

¹⁸ MBT Act §203(5).

¹⁹ MBT Act §207.

²⁰ MBT Act §§301(1) and (2). Apportionment under the SBT initially used an equally weighted three-factor formula. Mich. Comp. Laws §208.45(1). Over the years, the weighting of the SBT sales factor gradually increased from its initial 1/3 to 92.5% for tax years beginning after 2005. *Id.*, §§208.45 and 208.45a. (Absent the repeal of the SBT, the sales factor would have increased to 95% for tax years beginning after 2007. *Id.*, §208.45a(3).)

²¹ MBT Act §301(3). This "subject to tax" definition is similar to the one contained in the SBT Act.

²² MBT Act §303. Michigan's unitary rule is similar to what is known as the "Finnigan" rule, which generally stands for the proposition that if any member of a unitary group has nexus in a taxing state, a sale into that state by any other member of the group is also included in that state's sales factor numerator, even if the selling entity does not have nexus in the taxing state. This rule comes from the holding in a California case, Appeal of Finnigan Corp., Cal. SBE, No. 88-SBE-022-A, 1/24/90. In Finnigan, the State Board of Equalization had rejected its earlier holding in Appeal of Joyce, Inc., Cal. SBE, No. 66-SBE-070, 11/23/66 (the "Joyce" rule), which required the sourcing of a group member's sales to the destination state only if the selling member was taxable in that state, regardless of whether any other member had nexus there. Subsequently, in Appeal of

Huffy Corp., Cal. SBE, No. 99-SBE-005, 4/22/99, *amended on denial of reh'g* Cal. SBE, No. 99-SBE-005-A, 9/1/99, the SBE rejected the Finnigan rule in favor of its old taxing rule established in Joyce, but Huffy was applied prospectively only. For more on California's actions in this area, see Shop Talk, "California SBE Reverses *Finnigan*, Returns to *Joyce* Apportionment Rule," 9 J. Multistate Tax'n 40 (July 1999). For more on this subject generally, see Houghton, Dennen, and Borucki, "Apportionment Opportunities and Problems Involving the Sales Factor," 12 J. Multistate Tax'n 10 (May 2002).

²³ MBT Act §305(1).

²⁴ MBT Act §305(2).

²⁵ MBT Act §305(3). For purposes of §305, a borrower is considered located in Michigan if the borrower's billing address is in Michigan. *Id.*, §305(21).

²⁶ MBT Act §305(4).

²⁷ MBT Act §§305(5) and (6). This gain-sourcing rule applies also to income recorded under the coupon-stripping rules of IRC §1286 (tax treatment of stripped bonds). *Id.*, §305(6).

²⁸ MBT Act §§305(7) and (8). Merchant discounts are computed net of any cardholder chargebacks, but are not reduced by any interchange transaction fees or by any issuer's reimbursement fees paid to another for charges made by its cardholders. *Id.*, §305(8).

²⁹ MBT Act §305(9).

³⁰ MBT Act §305(10).

³¹ MBT Act §§113(7), 305(11)(a). For purposes of subsection (11), if a taxpayer can show that revenue mile information is not available or cannot be obtained without unreasonable expense to the taxpayer, receipts from transportation services everywhere are sourced to Michigan based on the ratio that the miles of transportation services performed in Michigan bears to the miles of transportation services performed everywhere. If the Michigan Department of Treasury determines that the information required for the calculations under subsection (11) is not available or cannot be obtained

without unreasonable expense to the taxpayer, the Department may use other available information that, in its opinion, will result in an equitable allocation of the taxpayer's receipts to Michigan. *Id.*, §305(12).

³² MBT Act §305(11)(b).

³³ MBT Act §§305(11)(c), (d), and (e).

³⁴ MBT Act §§305(13) through (19).

³⁵ MBT Act §305(20), referencing 2004 P.A. 174, Mich. Comp. Laws §§205.801 to 205.833. Effective 9/1/04, Michigan amended various provisions of its sales and use tax laws to generally conform to the Streamlined Sales and Use Tax Agreement (SSUTA), which became effective on 10/1/05. For more on the SSUTA, see Friedman, Kearns, and Houghton, "Streamlined Sales Tax Update: The Long Journey Towards a Simplified Sales Tax System," 16 J. Multistate Tax'n 6 (Mar/Apr 2006).

³⁶ MBT Act §307.

³⁷ MBT Act §309(1).

³⁸ MBT Act §§309(2) and (3). These alternative apportionment provisions are similar to §69 of the SBT Act.

³⁹ MBT Act §311.

⁴⁰ MBT Act §401.

⁴¹ MBT Act §§403(1) and (2).

⁴² Mich. Comp. Laws §208.50 (SBT apportionment sourcing provision for payroll).

⁴³ *Jefferson Smurfit Corp. v. Dept. of Treasury*, 248 Mich. App. 271, 639 NW2d 269 (2001), *app. den.* 467 Mich. 920, 656 NW2d 519 (2002), *cert. den.* U.S.S.Ct., 5/19/03

(Michigan SBT's site-based capital acquisition deduction (CAD) upheld as having no discriminatory impact on interstate commerce). This case was analyzed in Shop Talk, "Final Resolution of Michigan Single Business Tax CAD Dispute," 13 J. Multistate Tax'n 38 (August 2003). See also Grob, "Michigan: Capital Acquisition Deduction Again Survives Constitutional Challenge," 16 J. Multistate Tax'n 48 (Mar/Apr 2006), which discussed *Dana Corp. v. Dept. of Treasury*, 267 Mich. App. 690, 706 NW2d 204 (2005), where the court again upheld the validity of the SBT Act's CAD provisions, finding that, in making its Commerce Clause constitutional analysis, the "fair apportionment" test was part of the "nondiscrimination" test. For more background on the CAD, see Grob, *supra* note 1.

⁴⁴ MBT Act §519.

⁴⁵ MBT Act §§403(3) and(4).

⁴⁶ MBT Act §413.

⁴⁷ As noted above, the MBT Act (S.B. 94), *supra* note 1, was enacted as part of a package of legislation that included the following House Bills also signed into law on 7/12/07: H.B. 4369, (exempts industrial personal property from the 18-mill local school property tax, and exempts commercial personal property from 12 mills of the 18-mill tax); H.B. 4370 (exempts industrial personal property from the 6-mill state education tax); H.B. 4371 (exempts certain personal property from both the 6-mill state education tax and the 18-mill local school property tax); and H.B. 4372 (amends the General Property Tax Act consistent with the exemption of commercial and industrial personal property from local school property tax and the state education tax).

⁴⁸ MBT Act §§413(1)(a), (b), and (c).

⁴⁹ MBT Act §405. This R&D credit, together with the compensation and investment credits, may not exceed 75% of a taxpayer's total MBT liability.

⁵⁰ MBT Act §407.

⁵¹ MBT Act §441.

⁵² MBT Act §411.

[53](#) MBT Act §409.

[54](#) MBT Act §410.

[55](#) MBT Act §445.

[56](#) MBT Act §447.

[57](#) MBT Act §449.

[58](#) MBT Act §422.

[59](#) MBT Act §433.

[60](#) MBT Act §417.

[61](#) MBT Act §§417(4) and (9)(b).

[62](#) MBT Act §415.

[63](#) MBT Act §419.

[64](#) MBT Act §421.

[65](#) MBT Act §423.

[66](#) MBT Act §425.

[67](#) MBT Act §427.

[68](#) MBT Act §429.

[69](#) MBT Act §431.

[70](#) MBT Act §435.

[71](#) MBT Act §437.

[72](#) MBT Act §439.

[73](#) MBT Act §§263, 261(f).

[74](#) MBT Act §265.

[75](#) MBT Act §267.

[76](#) MBT Act §269. For receipts from loans and credit-related services and investment and trading activities, the financial institution sourcing rules are similar to the general MBT sourcing rules. See text accompanying notes 25-30, *supra*.

[77](#) MBT Act §235.

[78](#) MBT Act §235(2).

[79](#) MBT Act §235(3).

[80](#) MBT Act §243. Also see Mich. Comp. Laws §500.476a (retaliatory tax on foreign insurers). The automatic extension (discussed in the text, below) for filing MBT returns is not available for insurance companies. MBT Act §243(3).

[81](#) MBT Act §237(1).

[82](#) MBT Act §239.

[83](#) MBT Act §241.

[84](#) MBT Act §§501(1) and (2).

[85](#) MBT Act §§501(3) and (4).

[86](#) MBT Act §503.

[87](#) MBT Act §505.

[88](#) MBT Act §505(3).

[89](#) MBT Act §505(4).

[90](#) MBT Act §507.

[91](#) MBT Act §511.

[92](#) MBT Act §513, referencing the Revenue Act (1941 P.A. No. 122), Mich. Comp. Laws §§205.1 to 205.31, and the Administrative Procedures Act (1969 P.A. No. 306), Mich. Comp. Laws §24.201 *et seq.*

[93](#) MBT Act §519.

[94](#) MBT Act §601.