Michigan Business Tax Frequently Asked Questions

NOTICE: The MBT was amended by 145 PA 2007 on December 1, 2007. Act 145 imposes an annual surcharge to taxpayers' MBT liability, as well as makes other changes. Some of the FAQs below have revised answers and those questions have been noted.

TIP: Type "Ctrl + F" to search the entire document.

Administrative

A1. (Answer rescinded, replacement located at A22) Will taxpayers need to calculate the business income and modified gross receipts separately and pay 85% of each to meet the estimated tax payment safe harbor provision to avoid penalty and interest?

A2. When does the MBT take effect?
The Michigan Business Tax is effective as of January 1, 2008. The MBT replaces the Single Business Tax which expires on December 31, 2007.

A3. Who must file MBT quarterly estimates?
Taxpayers expecting an annual tax liability exceeding $800 must file quarterly estimates.

A4. When are MBT quarterly estimates due?
Quarterly returns and payments for calendar year filers are due April 15, July 15, October 15, and January 15. Quarterly returns and payments for fiscal year filers are due the 15th day of the first month after each quarter.

A5. (Answer rescinded, replacement located at A23) How are quarterly estimates calculated?

A6. When are MBT Annual Returns due?
Annual Returns are due the last day of the 4th month after tax year end with payment of final liability. Taxpayers (other than Insurance Companies or Financial Organizations) are not required to file or pay if apportioned gross receipts are less than $350,000. Filing threshold is annualized for tax year less than 12 months.

A7. How can I get an extension of time to file an MBT Annual Return?
Taxpayers must file a Michigan Application for Extension of Time to File Michigan Tax Returns by the due date of the annual return with payment of estimated tax. Extensions will be granted by the Department for good cause.

If a federal extension is filed and granted, the Department will grant an automatic extension to the last day of the 8th month. Even if the IRS has approved a federal extension, a Michigan Application must also be filed.

An extension of time to file is not an extension of time to pay. Payment must be included with the Application. Extension requests received without payment will not be honored and penalty and interest will accrue on the unpaid tax from the original due date of the return. If no tax will be due on the MBT annual return, there is no need to request an extension to avoid penalty and interest.

A8. How is the tax computed if my first taxable year is less than 12 months?
Tax is computed using one of the following methods:

- Annual Method: Report full year multiplied by a ratio of the number of months in the tax year included under the MBT divided by 12.

- Actual Method: Report only those months included under the MBT.

A9. If I'm registered for the SBT what do I need to do to register for the MBT?
You are automatically registered for the MBT if you are currently registered for the SBT.

A10. When will forms be available for the Michigan Business Tax?
We are on schedule to have the 2008 Michigan Business Tax forms and instructions available on the same schedule as the quarterly and annual returns for the other Michigan taxes.

Quarterly estimated Michigan Business Tax forms will be mailed to taxpayers starting in early January 2008 for payment of their Michigan Business Tax estimates.
When the legislature adjourns for the year in December 2008 the returns will be finalized, posted on our web site and sent to the printers. We anticipate the paper forms and instructions will be available for distribution to the public in January 2009.

Fiscal year taxpayers will be granted an automatic extension for their 2008 fiscal year annual return. Returns for fiscal years ending in 2008 will be due the same date as 2008 calendar year returns, which is April 30, 2009. An extension request form need not be filed unless required to transmit payment of any tax that would be due with the annual return. The annual return tax due must be paid by the original due date, which is the last day of the fourth month after the end of the fiscal year.

In addition Taxpayers will once again starting in February 2008 be able to pay their Michigan Business Tax estimate on their Combined Return for Michigan Taxes, (Form 160).

A11. How does a Fiscal Year taxpayer file returns for their tax year ending in 2008? A taxpayer with a fiscal year beginning in 2007 and ending in 2008 must file two short period returns, one to report their final SBT liability, and the other to report their initial MBT liability.

Per Michigan Compiled Law (MCL) 208.151, the SBT is repealed on business activity in this state after December 31, 2007. A fiscal year SBT taxpayer must file a short year return for the period from the beginning of its 2007-2008 fiscal year through December 31, 2007.

A fiscal year MBT taxpayer must file a short year return for the period from January 1, 2008 to the ending of its 2007-08 fiscal year.

MCL 208.1503 provides for a computation of tax for the first tax year of less than 12 months. The SBTA does not address the computation of tax for the final tax year, however, the repeal language in MCL 208.152 requires the Department of Treasury to "prorate the liability for the tax imposed under the single business tax act as necessary to impose the equivalent of a tax at the rate of zero on business activity after December 31, 2007."

Consequently, a fiscal year taxpayer may elect to compute the tax for the final short period SBT year and the initial short period MBT year in accordance with 1 of the following methods:

1. Annual - The tax may be computed as if the Act(s) were effective throughout the taxpayer's 2007-08 federal tax period and the amount computed multiplied by a fraction, the numerator of which is the number of months of the federal period that fall in 2007 or 2008, and the denominator of which is the number of months in the full federal period (typically 12).
2. Actual - The tax may be computed based on actual business activity occurring in the final/initial short period in accordance with an accounting method satisfactory to the department that reflects the actual business activity attributable to the period. The

method of accounting used in prior fiscal years will be assumed to reflect the actual tax base attributable to the period.

The method the taxpayer employs for its final SBT return must also be used for the initial MBT return. Thus, if a taxpayer elects to use the annual method for its final SBT return it must also use the annual method for its initial MBT return.

A12. Will there be E services with MBT?
The Department is working on the implementation of electronic filing for MBT returns and plans to have this service available when the initial 2008 calendar years returns become due in April of 2009.

A13. (Answer rescinded, replacement located at A24) Will a safe harbor be allowed for 2008 estimates based on the 2007 SBT return?

A14. Will the business income tax and modified gross receipts tax be filed on a single return or on separate returns?
For taxpayers other than insurance companies and financial institutions, there will be a single MBT return that includes both the business income and modified gross receipts taxes. There may be multiple schedules.

A15. May a taxpayer make estimated MBT payments on Form 160, the Combined Return for Michigan Taxes, and if so, how will the different due dates be reconciled?
For a calendar year taxpayer, MBT quarterly returns are due the 15th day of April, July, October and January. For fiscal year filers, quarterly returns are due the 15th day of the first month after each quarter. MBT payments may be made with either of the following returns:

- Form 4548, *Michigan Business Tax Quarterly Return*, or
- Form 160, *Combined Return for Michigan Taxes*.

If filing monthly using Form 160, *Combined Return for Michigan Taxes*, and not making remittances by electronic funds transfer, monthly payments may be filed on the 20th day of the month. For example, a calendar year taxpayer may file monthly MBT estimates using Form 160 on February 20th, March 20th and on April 20th rather than April 15 for the first quarter. However, for taxpayers required to make remittances by electronic funds transfer or otherwise not using Form 160, MBT estimates remain due on the 15th day of the month following the final month of the quarter. Regardless of the method chosen, the estimated MBT for the quarter must also reasonably approximate the liability for the quarter.

A16. Will SBT overpayments be applied to MBT?
Yes. At the option of the taxpayer, any SBT overpayments from the final return may be either refunded or carried forward and applied to the initial MBT return. For fiscal years filers, the final SBT return must be made on a short year return filed for the period ending on December 31, 2007. The due date of the final SBT short year return will be April 30, 2008. If payment of the estimated tax due is made on or before this due date with an extension request, an extension of time to file the short year return will automatically be granted until the standard fiscal year due date.

A17. Will an estimated return be due for a taxpayer with a short taxable year of less than four months under the MBT?
No. An estimated return is not required for a fiscal year filer with a short taxable year of less than four calendar months under the MBT. This is similar to the treatment under IRS regulation 1.6655-5.

Payment of the annual tax liability remains due on the last day of the fourth month after the end of the fiscal year. Returns for fiscal years ending in 2008 will automatically be extended to be due the same date as 2008 calendar year returns, April 30, 2009.

For example, for a fiscal year taxpayer with a January 31, 2008 year end, an estimate would normally be due on February 15, 2008. However, this taxpayer has a short taxable year of less than four months and is not required to make an estimated return or payment. The taxpayer must pay its annual liability on May 31, 2008 but its annual return will be extended until April 30, 2009.

A18. What is the filing threshold under the Michigan Business Tax Act (MBTA)?
Section 505(1) (MCL 208.1505(1)) of the MBTA directs that a taxpayer, *other than* an insurance company or financial institution, whose apportioned or allocated gross receipts are less than $350,000.00, does not need to file a return or pay the tax imposed under the MBTA.

An insurance company, regulated by chapter 2A of the MBTA, does not have a filing threshold regarding its liability to pay the tax on gross direct premiums written on Michigan property or risk. Likewise, a financial institution, regulated by chapter 2B of the MBTA, does not have a filing threshold regarding its liability to pay the franchise tax on its net capital.

A19. When are the first and second estimated MBT payments due for a fiscal year filer with an April 30, 2008 year end?
Section 501(2) of the MBTA (MCL 208.1501(2)) instructs that, "Taxpayers not on a calendar year basis shall file quarterly returns and make estimated payments on the appropriate due date which in the taxpayer's fiscal year corresponds to the calendar year."

The taxpayer in this question has a fiscal year that runs from May 1, 2007 through April 30, 2008. The Single Business Tax Act (SBTA) would apply to the taxpayer's business activity from May 1, 2007 through December 31, 2007. Under the SBTA, the taxpayer's quarterly estimated payments are due on August 31 and November 30. Based upon the prior fiscal year end, the taxpayer's first quarterly estimated payment of MBT is due on February 15, 2008, and the second on May 15, 2008.

A20. Can a fiscal year filer request an extension for the first MBT return?
Fiscal year taxpayers will be granted an automatic extension for their 2008 fiscal year annual return. Returns for fiscal years ending in 2008 will be due the same date as 2008 calendar year returns, which is April 30, 2009. However, an extension of time to file is not an extension of time to pay. An extension request form need not be filed unless required to transmit payment of any tax that would be due with the annual return. The annual return tax due must be paid by the original due date, which is the last day of the fourth month after the end of the fiscal year.

A fiscal year taxpayer may request an additional extension on Form 4, *Application for Extension of Time to File Michigan Tax Returns*, if the extension to April 30, 2009 is not sufficient, e.g., a taxpayer with a fiscal year ending November 2008, with a federal extension granted through September 2009.

A21. (Answer rescinded, replacement located at A25) How does a taxpayer with a fiscal year end calculate tax under the MBT for estimate purposes?

A22. Will taxpayers need to calculate the business income, modified gross receipts, and surcharge separately and pay 85% of each to meet the estimated tax payment safe harbor provision in order to avoid interest?
Tax liability is comprised of the two tax bases and the surcharge. The first tax base, federal taxable income derived from business activity is defined at MCL 208.1201. Modified gross receipts, the

second tax base, is addressed at MCL 208.1203. The surcharge is calculated against the two tax bases and levied in defined percentages as described at MCL 208.1281.

These three components form the basis for tax liability. Estimated tax payments are governed by Section 501, which states that interest will not be assessed if the sum of the estimated payments equals at least 85% of the liability and the amount of each estimated payment reasonably approximates the tax liability incurred during the quarter for which each estimate is made. Therefore, while a calculation must be made for the business income tax base, the gross receipts tax base, and the surcharge calculated with reference to those tax bases in order to determine tax liability, only one estimated payment of 85% of that liability need be remitted. There is no requirement to remit an estimated payment for each separate tax liability component.

A23. How are quarterly estimates calculated?
The sum of estimated payments must equal at least 85% of estimated tax liability for the year, and the amount of each estimated payment must reasonably approximate the tax liability for that quarter. For Tax Year 2009 and after, if prior year's tax is $20,000 or less, estimated tax may be based in the prior year's amount in four equal payments, the sum of which equals the previous year's tax liability. If the year's tax liability is $800 or less, quarterly returns are not required.

Quarterly estimates must be calculated to take into account the surcharge, as explained at MCL 208.1281.

A24. Will a safe harbor be allowed for 2008 estimates based on the 2007 SBT return? No. For the 2008 tax year, estimated MBT payments must be computed on the actual business income tax base, modified gross receipts tax base and surcharge of the period combined. No interest will be charged if payments are made on time, the sum of the estimated payments equals at least 85% of annual liability, and the amount of each payment reasonably approximates the tax liability incurred during the period. Estimates cannot be based on the prior year's SBT liability and cannot be based on 1% of gross receipts.

For the 2009 and subsequent tax years, if prior year's tax is $20,000 or less, estimated tax may be based on the prior year's amount in four equal payments, the sum of which equals the previous year's tax liability.

A25. How does a taxpayer with a fiscal year end calculate tax under the MBT for estimate purposes?
If estimated tax liability for the year is over $800.00 a taxpayer must file estimated quarterly returns and payments. MCL 208.1501(1). Quarterly returns for fiscal year taxpayers are due the 15th day of the first month after each quarter. MCL 208.1501(2). Any quarter less than 3 months is due on the 15th day of the month immediately following the final month of the quarter. In the case of a short taxable year, no estimated tax payment is required if the short taxable year is a period of less than four full calendar months; or the estimated tax liability for the year is $800.00 or less. See IRS Reg. 1.6655-5(b); MCL 208.1501(1).

The estimated payment made with each quarterly return must be for the total estimated business income tax base, modified gross receipts tax base and surcharge for the quarter, or 25% of the estimated annual liability including surcharge. MCL 208.1281(5), 1501(3). To avoid interest charges, estimated payments must equal at least 85% of the liability for the tax year, and the amount of each estimated payment must reasonably approximate the tax liability for each quarter. MCL 208.1501(4)(a). If the year's tax liability is $800.00 or less, quarterly returns are not required. MCL 208.1501(1). Estimates cannot be based on the prior year's SBT liability, and can no longer be based on 1% of gross receipts.

Michigan Business Tax Frequently Asked Questions

For taxpayers whose apportioned or allocated gross receipts equal $350,000 or more, the MBTA imposes a 4.95% business income tax and a modified gross receipts tax at the rate of 0.8%. MCL 208.1201, 1203. A credit reduces the tax correspondingly if gross receipts are between $350,000 and $700,000. MCL 208.1411.

For most taxpayers, the business income tax base is essentially that part of federal taxable income derived from business activity, modified by the following to the extent included in, excluded from, or deducted in arriving at federal taxable income:

Additions:

- Interest income and dividends derived from obligations or securities of states other than Michigan,
- Taxes on or measured by net income and the tax imposed under the MBT,
- Any carryback or carryover of a net operating loss,
- Loss attributable to another taxable entity,
- Royalty, interest, or other expense paid to a person related to the taxpayer by ownership or control for the use of an intangible asset if the person is not included in the taxpayer's unitary business group.

Subtractions:

- Dividends and royalties received from persons other than United States persons and foreign operating entities,
- Income attributable to another taxable entity,
- Interest income derived from United States obligations,
- Earnings that are net earnings from self-employment as defined under section 1402 of the internal revenue code of the taxpayer or a partner or limited liability company member of the taxpayer except to the extent that those net earnings represent a reasonable return on capital.

Business Income does not include personal transactions as defined by MCL 208.1105(2).

The modified gross receipts tax base consists of gross receipts less purchases from other firms. MCL 208.1111. Gross receipts is defined as the entire amount received by a taxpayer from any activity carried on for direct or indirect gain, benefit, or advantage to the taxpayer or to others, with certain specific exceptions. MCL 208.1111. "Purchases from other firms" is generally limited to inventory acquired during the tax year, depreciable assets acquired during the tax year, and materials and supplies directly connected to inventory on depreciable assets. MCL 208.1113(4). Gross Receipts does not include personal transactions as defined by MCL 208.1111(1)(v)(*v*).

The surcharge is calculated on a taxpayer's liability after allocation or apportionment and before the calculation of credits. MCL 208.1281(1). The surcharge is imposed in the amount of 21.99% of liability and capped at $6 million for all taxpayers except financial institutions. MCL 208.1281(3) and 208.1281(1)(a).

A26. (Answer rescinded, replacement located at A30) Will a taxpayer be required to make a payment with an extension request or is the listing of estimated payments made going to be accepted as it is in the Single Business Tax?

A27. Does the $350,000 filing threshold apply to just the gross receipts tax or to both the gross receipts and business income taxes?

If a taxpayer exceeds the filing threshold provided in Section 505, and has apportioned or allocated gross receipts of $350,000.00 or more, the taxpayer is liable for both the business income tax,

under Section 201, and modified gross receipts tax, under Section 203. The taxpayer must file an MBT return.

An insurance company, regulated by chapter 2A of the MBTA, does not have a filing threshold regarding its liability to pay the tax on gross direct premiums written on Michigan property or risk. Likewise, a financial institution, regulated by chapter 2B of the MBTA, does not have a filing threshold regarding its liability to pay the franchise tax on its net capital.

A28. The SBT has a Notice of No Return, Form C-8030 to be filed by taxpayers who were not required to file. Will there be a similar MBT form?
No. The C-8030 does not constitute a return and therefore does not start the statute of limitations process. The notices cause an unnecessary burden and expense to both taxpayers and the Department. Should the Department have a question regarding a taxpayer's filing obligation, the Department will request information from the taxpayer.

A29. How must a fiscal year taxpayer calculate quarterly estimated payments if one quarter straddles the period in which the SBT ends and the MBT begins? Must a fiscal year taxpayer pay its final SBT quarterly estimated payment or can the taxpayer pay all remaining liability on its final SBT return?
The first MBT estimate is based on the number of months in the fiscal year quarter that fall within 2008. The quarterly estimate should be based on the actual business income tax base, modified gross receipts tax base and surcharge of the single month and should not be computed using any period from the last SBT tax year. Estimates cannot be based on the prior year's SBT tax liability.

A taxpayer must file its estimated SBT quarterly returns by the due date. If the taxpayer fails to make the estimated payment to cover the estimated SBT tax liability, the taxpayer is subject to penalty. The fact that the taxpayer's payment on the final return covers the taxpayer's liability does not negate a penalty liability for failure to make the estimated SBT quarterly payment required. The existing requirements governing payment of SBT liability continue to apply and will be enforced.

A30. Will a taxpayer be required to make a payment with an extension request or is the listing of estimated payments made going to be accepted as it is in the Single Business Tax?
If the extension request shows that estimated payments have been made that result in no unpaid estimated tax liability for the tax period covered by the extension, then no payment must accompany the extension request.

A31. When is the final short period Single Business Tax (SBT) return due for a fiscal year taxpayer? If the taxpayer chooses the annual method for calculating the final SBT liability, how does it file timely for the fiscal year that is required to close on December 31, 2007 for SBT reporting purposes?
The deadline for the filing and payment of final SBT liability for all taxpayers, both calendar year and fiscal year, is April 30, 2008.

Upon request of the taxpayer, the Department of Treasury (Department) will grant an extension to a taxpayer whose fiscal year extends beyond April 30, 2008, provided that substantially all of the tax estimated to be due is paid with the request for extension, in compliance with section 73 of the Single Business Tax Act, MCL 208.73.

Thus, if payment of the estimated tax due is made on or before April 30, 2008 with an extension request, an extension of time to file the short year return will be granted based on the taxpayer's fiscal year as reported on their federal return. The extension of 180 or 240 days will be calculated from the end of the fourth month following the federal tax year end. See instructions for the 2007 Form 4, *Application for Extension of Time to File Michigan Tax Returns*.

For a fiscal year filer with a late in the year year end, e.g., September 30, if the standard SBT extension period is not sufficient to allow a fiscal year taxpayer to gather necessary information for its final SBT return, the Department will, upon request, grant a special extension appropriate to the circumstances.

A32. Will Voluntary Disclosure continue with the Michigan Business Tax?
Yes, the Department is required to administer the Michigan Business Tax under the Revenue Act, 1941 PA 122. See MCL 208.1513(1). Voluntary Disclosure agreements are provided for under the Revenue Act at MCL 205.30c. The State Treasurer, or a representative, is authorized to enter into a voluntary disclosure agreement with non-filers that have a nexus filing responsibility and who meet certain other statutory criteria. Under a voluntary disclosure agreement, eligible persons may file returns and pay taxes and interest for a limited lookback period of four years without imposition of penalties, in exchange for future tax compliance.

While Voluntary Disclosure will continue with the Michigan Business Tax a taxpayer must still meet the statutory qualifications to enter into an agreement.

A33. Can a taxpayer who claims an error was made in the calculation of an MBT quarterly estimated payment request a refund of that payment without filing an annual MBT return?
Generally, no. Estimated payments are required for taxpayers who expect to owe an annual liability of at least $800.00. MCL 208.1501(1). The amount, manner of payment, and due dates of the quarterly estimated payments are all established in section 501, MCL 208.1501. Payments made under section 501 are a credit against the payment required with the annual return required under section 505. MCL 208.1501(7). Section 505 (MCL 208.1505) requires all taxpayers who meet the filing thresholds and nexus standards of the MBT act to file an annual or final return in the form and content prescribed by the department by the last day of the fourth month after the end of the taxpayer's tax year.

A refund claim of overpaid MBT estimates may be made pursuant to section 30(2) of the Revenue Act (MCL 205.30(2), which states:
(2) A taxpayer who paid a tax that the taxpayer claims is not due may petition the department for refund of the amount paid within the time period specified as the statute of limitations in section 27a [of the Revenue Act]. If a tax return reflects an overpayment or credits in excess of the tax, the declaration of that fact on the return constitutes a claim for refund. If the department agrees the claim is valid, the amount of overpayment, penalties, and interest shall be first applied to any known liability as provided in section 30a, and the excess, if any, shall be refunded to the taxpayer or credited, at the taxpayer's request, against any current or subsequent tax liability. (Emphasis added)

A34. The first MBT annual returns could be due before MBT forms are released to the taxpayer public. Will penalties be waived for these first MBT returns if taxpayers make a good-faith guess as to liability?
Because fiscal year taxpayers will be granted an automatic extension for their 2008 fiscal year annual return with an extended due date of April 30, 2009, MBT annual returns will not be due before forms are released later this year (2008).

In accordance with MBT Section 501, "interest provided by this act shall not be assessed …(a) If the sum of the estimated payments equals at least 85% of the liability and the amount of each estimated payment reasonably approximates the tax liability incurred during the quarter for which the estimated payment was made." MCL 208.1501(4)(a). While the Revenue Act also provides for imposition of penalties "if a taxpayer fails or refuses to file a return or pay a tax within the time specified" [MCL 205.24(2)], penalties would not be imposed if the criteria of Section 501 described above are timely met.

A35. Will there be other E services available with the MBT, in addition to electronic filing?
Yes. E-Service through the "Check My Tax Info" portion of Treasury's website will also be available in 2009, after initial returns have been received by the department. Information similar to that currently required for access to SBT tax information will be required for access to MBT account information which will include payment information, status of returns and correspondence.

A36. Will an overpayment made in connection with a taxpayer's final SBT return be applied as timely against that taxpayer's first quarter MBT estimate, even though the overpayment may have been made after the due date for the first quarter MBT estimated payment?
Yes, if a taxpayer pays the amount due with its final SBT return, and that return is timely filed (by the due date or, if an extension has been obtained, by the extended due date), any overpayment resulting from that return will be credited by the Department toward the amount owing under that taxpayer's first quarterly estimated payment under the MBT. As long as the final SBT return is timely filed, the overpayment will be credited as a timely payment against the taxpayer's first quarterly MBT estimate, even though the date of the SBT overpayment may have been later than the due date for the estimated payment.

A37. Is there a form to file to notify the Department that I will not be filing an MBT return (similar to form C-8030 for SBT)?
The Michigan Business Tax (MBT) does not have an equivalent to the form C-8030, Michigan Single Business Tax Notice of No SBT Return Required. A taxpayer with apportioned or allocated gross receipts less than $350,000 is not required to file an MBT return, and it is not necessary to file a notice to the Department that an MBT return will not be filed.

A38. Can modified gross receipts (MGR) tax separately collected from customers by new motor vehicle dealers and new or used watercraft dealers be remitted with monthly sales, use and withholding returns?
Yes. New motor vehicle dealers and new or used watercraft dealers who elect to separately collect the MGR tax, in addition to sales price, under MCL 208.1203(5) may file and remit the tax as estimated payments with their quarterly or monthly Form 160, *Combined Return for Michigan Taxes*. Generally, for a calendar year taxpayer, MBT quarterly returns are due the 15th day of April, July, October and January. For fiscal year filers, quarterly returns are due the 15th day of the first month after each quarter. MBT payments may be made with either of the following returns:

- Form 4548, *Michigan Business Tax Quarterly Return*, or
- Form 160, *Combined Return for Michigan Taxes*.

If filing monthly using Form 160, *Combined Return for Michigan Taxes*, and not making remittances by electronic funds transfer, monthly payments may be filed on the 20th day of the month. For example, a calendar year taxpayer may file monthly MBT estimates using Form 160 on February 20th, March 20th and on April 20th rather than April 15 for the first quarter. However, for taxpayers required to make remittances by electronic funds transfer or otherwise not using Form 160, MBT estimates remain due on the 15th day of the month following the final month of the quarter. Regardless of the method chosen, the estimated MBT for the quarter must also reasonably approximate the liability for the quarter.

A39. How is the book-tax deduction, provided at MCL 208.1201(2)(i), calculated? The deduction is determined by:

1) Calculate the difference between the value of all assets on the books of a taxpayer for the first fiscal period ending after July 12, 2007 and the federal tax basis for those same assets for the same period. (For a UBG, compute for each member entity individually. The group will file one combined Form 4593, entering the result for each member of the group separately).

2) Calculate the amount needed to offset the net deferred tax liability of the taxpayer which results from the imposition of the business income tax, at a rate of 4.95%, and the modified gross receipts tax, at a rate of .8%, calculated for the first fiscal period ending after July 12, 2007.

3) Take the lesser of the result of (1) or (2).

4) For the 2015 through 2019 tax years apply 4%, for the 2020 through 2024 tax years apply 6%, and for the 2025 through 2029 tax years apply 10% to the result of step (3).

5) Subtract the result of step (4) from business income in appropriate tax year.

Examples

Example 1: Company A reviews all assets on its books as of its first fiscal period which ends after July 12, 2007 and which includes the enactment date of the MBT. The book value of these assets is then compared to the federal tax basis of the same assets for the same period. The difference between the assets is calculated at $5,000. Company A calculates its net deferred liability in accordance with GAAP for this same period at $7,000. Company A reports a $5,000 book-tax difference to the Department on Form 4593 with its first MBT return. Beginning in the 2015 tax year, Company A may take 4% of the $5,000, (the lesser of the book-tax or net deferred tax liability) or $200, as a deduction to business income. Beginning in the 2020 tax year Company A may take 6%, or $300 as a deduction, and beginning in the 2025 tax year the deduction will equal 10% or $500.

Example 2: Entities A, B and C, members of a unitary business group individually calculate their book-tax difference based on their own books and records for the appropriate fiscal period. The UBG files one Form 4593 with its initial MBT return. Entity A reports a book-tax difference of $500, B reports $1,000 and C reports $2,000. The net deferred tax liability is calculated for the group in accordance with GAAP at $3,000. Beginning in the 2015 tax year the UBG will begin to take a percentage of $3,000, which is the lesser of the net deferred tax liability of the group and the combined book tax difference of the three group members.

A40. What method must a fiscal year taxpayer that will no longer be a taxpayer under the MBT or CIT after December 31, 2011, use to calculate its final MBT return?
The actual method. That is, the tax must be computed using an accounting method that reflects the actual tax basis attributable to the period.

A41. What method must a fiscal year taxpayer with an MBT election use to file returns for its tax year ending in 2012?
All MBT taxpayers must file a final MBT return for the tax year ending on December 31, 2011, including a fiscal year taxpayer with a certificated credit who elects to continue to be taxed under the Michigan Business Tax Act.

MCL 208.1117(4) directs that a taxpayer with a fiscal tax year ending after December 31, 2011 is considered to have 2 separate tax years. The first tax year is the fractional part of the fiscal tax year before January 1, 2012, and the second tax year is the fractional part of the fiscal tax year after December 31, 2011.

This means that it will be necessary for each fiscal year filer that makes the MBT election to file two short year returns.

A fiscal year taxpayer that has a certificated credit and elects to remain taxed under the MBTA must use the same method, annual or actual, to compute its MBT for each short period return for each respective portion of the same fiscal year. See MCL 208.1503(3).

Thus, if the taxpayer selects the annual method to compute its MBT for the short period from the beginning of the taxpayer's fiscal year through December 31, 2011, then the taxpayer must select the annual method to compute its MBT for the short period from January 1, 2012, to the end of the taxpayer's fiscal year.

Apportionment

Ap1. Under Chapter 3 of the MBT, if the business activities of a taxpayer are subject to tax within and without the state, each tax base must be apportioned based on the formula of sales in Michigan over sales everywhere. For purposes of apportionment, "sale" is defined in part as:

> **[t]he transfer of title to, or possession of, property that is stock in trade or other property of a kind that would properly be included in the inventory of the taxpayer if on hand at the close of the tax period or property held by the taxpayer primarily for sale to customers in the ordinary course of the taxpayer's trade or business. [MCL 208.1115(1).]**

Is the occasional sale of assets by a taxpayer a "sale" for apportionment purposes?
No, so long as the assets sold are neither stock in trade nor inventory and are not held by the taxpayer for sale to customers in the ordinary course of the taxpayer's business. This determination is made on a facts and circumstances basis. For example, the occasional and isolated sale of a desk by a law firm is not a "sale" under MCL 208.1115; the desk does not constitute stock in trade or inventory to the law firm and is not held by the taxpayer primarily for sale to customers in the ordinary course of the law firm's business. In contrast, if the law firm operates a program under which office furniture is routinely and systematically sold at auction, then such sales would be "sales" under MCL 208.1115.

If a transaction is not a "sale" under MCL 208.1115, it will be excluded from both the numerator and denominator of the sales factor.

"Sales" under MCL 208.1115 may still be included in the business income and modified gross receipts tax bases.

Ap2. How are gross receipts, rents etc. received from real property apportioned?
Receipts from real property are apportioned based on location of the real property.
Rental income received from real property is included in both the business income from business activity tax base and modified gross receipts tax base of the taxpayer. Business activity includes the rental of property. MCL 208.1105(1).

Under MCL 205.1301(1) each tax base is apportioned or allocated in accordance with the rules under Chapter 3 of the Act. Sales confined solely to Michigan are allocated to Michigan. Sales within and outside of Michigan are apportioned based on a sales factor calculated under section 303. MCL 208.1301(2).

The sales factor is a fraction, the numerator is Michigan sales and the denominator is sales everywhere. MCL 208.1303(1). Receipts from the sale, lease, rental or licensing of real property are Michigan sales if the property is located in Michigan. MCL 208.1305(1)(b).

Michigan Business Tax Frequently Asked Questions

Ap3. Does the Michigan Business Tax Act (MBTA) provide for "throw back sales"?
The MBTA does not provide for "throw back sales." A "throw back sale" describes a situation in which the income or activity from a Michigan taxpayer's sale of tangible personal property to an out-of-state purchaser is not taxable in the state of the purchaser. The sale would then be "thrown back" to Michigan by inclusion in the sales apportionment factor's numerator, and increase the portion of the tax base subject to the Michigan Business Tax.

Sales to destinations outside Michigan need not be included in the MBT sales factor numerator regardless of whether nexus exists or tax is paid in the destination jurisdiction. However, if the taxpayer does not have nexus in at least one other state, they cannot apportion their tax base, and all business income, modified gross receipts and net capital tax bases are fully allocated to Michigan. The direct premiums tax base for insurance companies is not subject to apportionment.

Ap4. What is the location of investment partnerships? Is it based on the residence of the general partner, the location of the brokerage firm, the residences of the majority of partners, or where the partnership was formed?
An investment partnership is typically organized as a limited partnership in which the investors (or limited partners) pool funds that are professionally managed by a money manager who acts as a general partner. The money manager generally has a small ownership interest in the partnership and is compensated through a set management fee and a designated percentage of the overall partnership investment profits.

For purposes of the MBT, a taxpayer is subject to tax in Michigan if the taxpayer has (1) substantial nexus in Michigan as defined in section 200 (MCL 208.1200) and (2) meets the gross receipts threshold of $350,000 under section 505 (MCL 208.1505). Substantial nexus is defined to mean either a physical presence in this state for a period of more than 1 day during the tax year or engagement in active solicitation of sales in this state with Michigan sourced gross receipts of $350,000 or more.

In the typical investment partnership described above, the location of the office from which the fund manager or general partner conducts the business activity of the partnership would constitute physical presence for purposes of the MBT nexus standards under MCL 208.1200. If this office is located in Michigan, the partnership would have physical presence in Michigan and have nexus for purposes of the MBT. If the gross receipts of this partnership were $350,000 or more, the partnership would be subject to MBT.

Ap5. (This FAQ has been amended due to 2011 PA 305.) Under MCL 208.1115, "sales" means "[f]or taxpayers not engaged in any other business activities, sales include interest, dividends, and other income from investment assets and activities and from trading assets and activities." Does this definition include the investment income of individuals?
Yes, for those taxpayers who are not engaged in any other business activity other than investing and trading, the definition of "sales" would include investment income of individuals in the apportionment factor. However as a practical matter, while investment income may constitute "sales" for apportionment purposes, an individual not engaged in a trade or business may have no tax base to apportion. This is so because investment and trading income of an individual does not constitute business income or gross receipts so long as the income or gross receipts is not derived in the regular course of the individual's trade or business.

Michigan Business Tax Frequently Asked Questions

Business Income Tax

B1. Will shareholders of S corporations and partners in partnerships be liable for Michigan individual income tax on their share of flow-through income from entities subject to MBT? Does it matter whether the shareholders or partners are residents or nonresidents? Both residents and nonresidents of Michigan are subject to Michigan income tax on their share of income from partnerships and S corporations to the extent the income is attributable to Michigan under the allocation and apportionment provisions of the Michigan Income Tax Act (MCL 206.111 - 115) and included in adjusted gross income on the partner or shareholder's federal income tax return. The imposition of the Michigan business income tax on a flow through entity under section 201 of the Michigan Business Tax Act does not affect the imposition of the Michigan income tax under section 51 of the Michigan income tax act (MCL 206.51) on the individual partners or shareholders of the flow through entity.

B2. Under MCL 208.1201, the business income tax base means the business income of the taxpayer subject to certain adjustments, including a deduction for net earnings from self-employment. Specifically, the section instructs "[t]o the extent included in federal taxable income, deduct any earnings that are net earnings from self-employment as defined under section 1402 of the [IRC] of the taxpayer or a partner or limited liability company member of the taxpayer except to the extent that those net earnings represent a reasonable return on capital." MCL 208.1201(2)(h). What impact does this deduction have on the business income tax base of professional service partnerships (for example, some consulting, law, and accounting firms)?
The impact of any deduction from business income to calculate the tax base varies by taxpayer. However, net earnings from self-employment under IRC 1402 generally means "the gross income derived by an individual from any trade or business carried on by such individual, less the deductions allowed by this subtitle which are attributable to such trade or business, plus his distributive share (whether or not distributed) of income or loss described in [IRC] 702(a)(8) from any trade or business carried on by a partnership of which he is a member," subject to certain exclusions, including rentals from real estate, dividends and interest, and certain net operating losses and personal exemptions. IRC 1402(a). Therefore, the deduction from business income for net earnings from self-employment for some professional service partnerships is likely to result in a significantly reduced business income tax base.

B3. Corporations, Limited Liability Companies (LLCs), and Partnerships will be able to fully deduct amounts paid out as compensation to employees, as well as a 100% deduction for distributions that are subject to self-employment income tax. Are S corporations treated in the same manner as partnerships and corporations in this regard? Can you clarify the treatment of S corporation distributions?
The starting point for the calculation of the income tax component of the MBT is business income, defined generally as "that part of federal taxable income derived from business activity." MCL 208.1105(2). Corporations, including S corporations, LLCs, partnerships, sole proprietorships, and any other business entity subject to MBT may deduct all compensation paid to employees to the full extent deducted in arriving at federal taxable income when computing the MBT income tax base under MCL 208.1201.

MCL 208.1201 provides for a series of specific adjustments that must be made to business income to arrive at the business income tax base. One of these adjustments is a deduction for self-employment income as defined in section 1402 of the Internal Revenue Code. MCL 208.1201(2)(h). Under section 1402, the business income of an individual or sole proprietor, and a partner's distributive share of partnership income, whether distributed or not, from any trade or business carried on by the partnership, may be considered self-employment income (with certain statutory exceptions), and subject to the federal self employment tax. Therefore, a sole

proprietorship or partnership may deduct any income subject to the federal self employment tax when computing the MBT income tax base. Corporations, including S corporations, are not subject to self employment tax, and, as a result, no deduction is allowed for earnings from self employment income for corporate entities. There is no deduction allowed for S corporation distributions that is equivalent to the self employment deduction allowed for partnerships and sole proprietorships under the MBT.

B4. Are capital gains that are included in the Modified Gross Receipts tax base also included in the Business Income tax base?

Yes, the Business Income tax base is a separate and distinct tax base from the Modified Gross Receipts tax base. A taxpayer's Business Income tax base is its business income subject to certain statutory adjustments before allocation or apportionment. MCL 208.1201(2). Business income is generally defined as "that part of federal taxable income derived from business activity." MCL 208.1105(2). "Business activity" is defined in part as "a transfer of legal or equitable title to or rental of property, whether real, personal, or mixed, tangible or intangible, . . . , made or engaged in, or caused to be made or engaged in, whether in intrastate, interstate, or foreign commerce, with the object of gain, benefit, or advantage, whether direct or indirect, to the taxpayer or to others, ..." MCL 208.1105(1).

MCL 208.1201 of the MBT makes no provision for the adjustment of capital gains that may be included in federal taxable income derived from business activity. As a result, to the extent the capital gain is derived from the business activity of the taxpayer it must also be included in the business income tax base.

B5. Is the deduction provided under MCL 208.1201(2)(i) altered by the MBT surcharge?

No. The deduction provided in section 201(2)(i) functions to offset the book-to-tax difference or deferred tax liability resulting from the change from the SBT to the MBT. The credit is taken in defined percentages beginning in tax year 2015. MCL 208.1201(2)(i).

MCL 208.1201(3) states that the deduction is only available in "the amount necessary to offset the net deferred tax liability" which would result under the business income tax under section 201 and the modified gross receipts tax under section 203. The amount of the deferred tax liability and the corresponding deduction will be calculated without reference to the surcharge**,** and the deduction will therefore remain the same as calculated prior to the enactment of 2007 PA 145.

The Department recognizes that this is a significant issue for the business community creating a need for guidance upon which it can rely. While the business community may rely on this form of guidance, the Department also intends to issue a Revenue Administrative Bulletin in the near future that further explains the position described above.

B6. Does the deduction provided under MCL 208.1201(2)(i) reduce the MBT surcharge imposed under MCL 208.1281(1)?

Yes. MCL 208.1201(3) directs that the deduction "is intended to <u>flow through</u> and reduce the surcharge imposed and levied under section 281." (Emphasis added). This same section explains that the deduction is calculated as the "the amount necessary to offset the net deferred tax liability" which would result under the business income tax under section 201 and the modified gross receipts tax under section 203. MCL 208.1201(3). The surcharge is calculated against a "taxpayer's liability under [the MBT] after allocation or apportionment to this state under this act but before calculation of the various credits." The surcharge is, thus, calculated against a taxpayer's business income and gross receipt liabilities. Therefore, the deduction, which reduces the business income tax base upon which the surcharge is calculated, will flow through and reduce the surcharge.

The Department recognizes that this is a significant issue for the business community creating a need for guidance upon which it can rely. While the business community may rely on this form of guidance, the Department also intends to issue a Revenue Administrative Bulletin in the near future that further explains the position described above.

B7. Are system software royalties, excluded from the determination of tax liability under the Single Business Tax Act ("SBTA") (see MCL 208.9(4)(g)(viii) and (7)(c)(vii)), likewise excluded from the determination of tax liability under the Michigan Business Tax Act ("MBTA")?

No. System software royalties are included in the determination of the Business Income tax base and the Modified Gross Receipts tax base under the MBTA. Unlike in the SBTA, there is no language in the MBTA which excludes such royalties from the calculation of either of these taxes.

Under the MBTA, a taxpayer (other than a financial institution or insurance company) is subject to two separate and distinct taxes, a Business Income tax and a Modified Gross Receipts tax. A taxpayer's Business Income is subject to certain statutory adjustments before allocation or apportionment. MCL 208.1201(2). Business income is generally defined as "that part of federal taxable income derived from business activity." MCL 208.1105(2). "Business activity" is defined in part as "a transfer of legal or equitable title to or rental of property, whether real, personal, or mixed, tangible or intangible, . . . , made or engaged in, or caused to be made or engaged in, whether in intrastate, interstate, or foreign commerce, with the object of gain, benefit, or advantage, whether direct or indirect, to the taxpayer or to others, ..." MCL 208.1105(1). MCL 208.1201(2)(f) states that "Except as otherwise provided under this subsection, to the extent deducted in arriving at federal taxable income, [a taxpayer must add to the Business Income tax base] any royalty, interest, or other expense paid to a person related to the taxpayer by ownership or control for the use of an intangible asset if the person is not included in the taxpayer's unitary business group." MCL 208.1201(2)(f). There is no language in the MBTA excluding system software royalties from Business Income.

Likewise, there is no language in the MBTA excluding system software royalties from the Modified Gross Receipts tax base. Generally, a taxpayer's Modified Gross Receipts tax base is "a taxpayer's gross receipts less purchases from other firms before apportionment…." MCL 208.1203(3). "Gross Receipts" is defined in part as "the entire amount received by the taxpayer from any activity whether in intrastate, interstate, or foreign commerce carried on for direct or indirect gain, benefit, or advantage to the taxpayer or to others…." MCL 208.1111(1). There is no language in the MBTA excluding system software royalties from Gross Receipts.

B8. (This FAQ has been amended due to 2011 PA 305.) Do the business income tax and modified gross receipts tax components of the MBT apply to individuals, estates, and trusts or family limited partnerships that are specifically established for estate planning purposes, on income from investments, such as capital gains, interest, dividends, or other sources of personal income?

No. The definitions of "business income" and "gross receipts" as used in the MBT Act specifically exclude this type of income received by these types of entities from the MBT tax bases and threshold amounts. Investment income, gains from the sale of personal assets or other assets not used in a trade or business, and any other income not specifically derived from a trade or business that is earned, received, or otherwise acquired by certain entities expressly enumerated by the statute are not included in gross receipts for purposes of determining the filing thresholds under sections 200, 411, or 505 (MCL 208.1200, 208.1411, or 208.1505), and are not included in the business income tax base or modified gross receipts tax base under sections 201 and 203, respectively, (MCL 208.1201 and 208.1203). This exclusion applies only to the following types of entities listed in the statute: (1) an individual; (2) an estate; (3) a

person organized for estate or gift planning purposes; (4) a person organized exclusively to conduct investment activity solely for an individual or a person related to that individual; or (5) a common trust established under the Collective Investment Funds Act, 1941 PA 174. See MCL 208.1105(2) and 208.1111(4)(w) and (x). Investment income and any other types of income earned or received by all other types of persons or entities not specifically referenced in these revised definitions must be included in the gross receipts and business income of the taxpayer.

B9. (This FAQ has been amended due to 2011 PA 305.) An individual owns 100% of an S corporation law practice with gross receipts of $500,000, net income of $100,000 after wages of $250,000, and also has the following income not related to the S corporation or any other trade or business: dividends of $100,000, interest of $250,000, capital gain of $750,000, and pension of $100,000. Is he liable for the MBT on a combined basis as an individual and owner of a S corporation?

The definitions of "business income" and "gross receipts" as used in the MBT Act expressly exclude investment income, gains from the sale of personal assets, and other income received by an individual not specifically derived from a trade or business from the definitions of business income and gross receipts, which form the basis of the MBT tax bases under MCL 208.1201 and MCL 208.1203 and the gross receipts filing thresholds under MCL 208.1505. Therefore, the taxpayer in this example would only consist of the S corporation. The MBT tax liability of the S corporation would be determined by reference to gross receipts of $500,000 and business income of $100,000. The wage, pension, interest, dividend, and capital gain income of the individual owner of the S corporation that are not related to any trade or business are not subject to MBT.

B10. If a business or unitary group taxpayer has a negative business income tax base, is the 4.95% tax rate applied to the negative business income base, with the result then netted against a positive modified gross receipts tax to determine Michigan Business Tax ("MBT") liability?

No. Other than for an insurance company under Chapter 2A and a financial institution under Chapter 2B, the Michigan Business Tax Act ("MBTA") imposes two taxes on a taxpayer: one on business income and one modified gross receipts. The Business Income tax base is a separate and distinct tax base from the Modified Gross Receipts tax base. In determining a taxpayer's total tax liability under the MBTA, one tax base is not netted, partially or wholly, against the other tax base. If the arithmetic calculation of a taxpayer's business income tax base for a tax year results in a negative value, then the business income tax base used for purposes of determining total MBT liability is zero. Thus, the 4.95% tax rate for business income applied against a zero tax base produces a business income tax liability of zero. The modified gross receipts tax, calculated by multiplying the modified gross receipts tax rate of 0.80% against the modified gross receipts tax base after apportionment and allocation, would be added to the zero value business income tax to produce the taxpayer's total MBT liability for the tax year before credits.

Even though a taxpayer may not offset a negative business income tax against a positive marginal gross receipts tax in a given tax year, the taxpayer may, under MCL 208.1201(4), carry forward the negative business loss after allocation or apportionment into the tax year immediately succeeding the loss year as an offset to the allocated or apportioned business income tax base for that succeeding tax year. Such losses may be carried forward up to 10 years following the loss year or until the loss is used up, whichever comes first. Any loss remaining after the 10 year carryforward period specified in MCL 208.1201(4) will expire unused.

B11. If a Michigan LLC has a nonresident corporate partner, does that partner file an MBT return and report and pay tax on its share of LLC income at the same 4.95% [rate]?

No. Assuming the corporation and partnership (LLC) do not constitute a unitary group, each would be a taxpayer and subject to the tax imposed under the MBT only if each had nexus in Michigan per MCL 208.1200(1). In order to meet the nexus standard, the taxpayer would need to have a physical presence in this state of more than one day or actively solicit sales and have Michigan sourced gross receipts of $350,000 or more. If the only activity the corporate partner has in Michigan is an ownership interest in a Michigan partnership, it would not have nexus in this state under either the physical presence or actively solicits standards stipulated in section 200(1) because it would have no property or employees in Michigan and does not actively solicit sales in Michigan.

B12. Under the MBT, will there be a depreciation deduction, or will Michigan conform to federal depreciation rules?

To the extent applicable, federal depreciation rules are utilized for the purpose of calculating MBT liability. Although there is no specific deduction or credit for depreciation expenses under the MBT, a taxpayer receives the benefit of any depreciation deduction taken on its federal income tax return due to the inherent structure of the business income tax base. An MBT taxpayer's business income tax base is composed of the taxpayer's "business income," with certain adjustments. MCL 208.1201(2). "Business income" is defined under the statute as "that part of *federal taxable income* derived from business activity." MCL 208.1105(2) (emphasis added). Thus, calculation of the business income tax base begins with the taxpayer's federal taxable income, a figure that already includes any deductions taken by the taxpayer on account of depreciation expenses.

Under the former SBT, any amount taken for a depreciation deduction on the taxpayer's federal tax return was required to be added back into the taxpayer's tax base for purposes of calculating SBT liability. MCL 208.9(4)(c). There is no such add-back under the MBT. See MCL 208.1201(2). Because the business income tax base is based upon federal taxable income, and depreciation expenses are not added back in to that tax base, the MBT taxpayer effectively receives the benefit of its federal depreciation deduction.

With respect to the modified gross receipts tax component of the MBT, the entire cost of a depreciable asset may be subtracted from the taxpayer's modified gross receipts tax base in the year that the asset is acquired, since such an asset meets the definition of "purchases from other firms." MCL 208.1203(3); 208.1113(6)(b).

B13. For purposes of applying section 201(2)(f)(*ii*) of the MBTA, does the phrase "subject to tax in another jurisdiction" refer only to taxation by another state, or does it also include taxation by a foreign country?

The phrase includes taxation by a foreign country. Pursuant to section 201(2)(f) of the MBTA, a taxpayer must add back to its business income tax base "any royalty, interest, or other expense paid to a person related to the taxpayer by ownership or control for the use of an intangible asset if the person is not included in the taxpayer's unitary business group." MCL 208.1201(2)(f). Such amounts need not be added back, however, if certain conditions are met:

The addition of any royalty, interest or other expense described under this subdivision is not required to be added if the taxpayer can demonstrate that the transaction has a nontax business purpose other than avoidance of this tax, is conducted with arm's-length pricing and rates and terms as applied in accordance with section 482 and 1274(d) of the internal revenue code, and …

(*ii*) Results in double taxation. For purposes of this paragraph, double taxation exists if the transaction is subject to tax in another jurisdiction.

MCL 208.1201(2)(f)(*ii*). The meaning of the phrase "subject to tax in another jurisdiction" is not specifically set forth in the statute. For purposes of applying this subsection, the Department will interpret "another jurisdiction" to mean any state other than the state of Michigan, or a foreign taxing jurisdiction.

B14. (This FAQ has been amended due to 2011 PA 305.) Is interest and dividend income included in business income under the Michigan Business Tax (MBT)?
Generally yes. Interest and dividend income that results from business activity is included in business income, unless the income is expressly excluded. For an individual, estate or other person organized for estate or gift planning purposes, the MBT excludes from business income, among other items, " [i]ncome from investment activity, including interest, dividends, royalties, and gains from an investment portfolio or retirement account, if the investment activity is not part of the person's trade or business." MCL 208.1105(2)(f)(i). In addition, for person that is organized exclusively to conduct investment activity solely for an individual or persons related to that individual, or for a common trust fund established under the Collective Investment Funds Act, 1941 PA 174, business income for that person or common trust excludes income derived from investment activity unless the activity is in the regular course of the person's or common trust's trade or business. MCL 208.1105(2).

Also excluded are dividends and interest from particular sources. For example, to the extent included in federal taxable income, dividends received from persons other than United States persons and foreign operating entities and interest income derived from United States obligations are excluded. MCL 208.1201(2)(d) and MCL 208.1201(2)(g), respectively.

B15. (This FAQ has been amended due to 2011 PA 305.) Does the sale by an individual of a direct investment in a corporation, partnership or LLC that is not traded on a public exchange constitute "personal investment activity" such that the income and proceeds from such a sale are excluded from business income and gross receipts? Similarly, is the distributive share of a partnership to a partner that is an individual business income or gross receipts to that individual?
For an individual, the sale of an ownership interest in a corporation, partnership, or limited liability company will generally not constitute business income or gross receipts to that individual so long as such investment does not constitute an integral part of the trade or business of the individual. This is true even if the shareholder, partner, or member is an active rather than passive investor. The distributive share of a partnership to a partner that is an individual does not constitute business income or gross receipts to that individual.

B16. (This FAQ has been amended due to 2011 PA 305.) The MBT has been amended to exclude from business income and gross receipts certain personal investment activities. Which taxpayers may exclude personal investment activity from business income and gross receipts? What about family limited partnerships that demonstrate a business purpose for federal purposes yet are intended to generate valuation discounts for gift and estate tax purposes? What about an investment club organized as a partnership?
MCL 208.1105(2) and 208.1111(1)(w) and (x) exclude from business income and gross receipts income and receipts other than those received from transactions, activities, and sources in the regular course of the taxpayer's trade or business. This exclusion only applies to the following persons:

1. an individual;
2. an estate;
3. a person organized exclusively for estate or gift planning purposes;
4. a person organized exclusively to conduct investment activity solely for an individual or persons related to that individual; and

5. a common trust established under the Collective Investment Funds Act, 1941 PA 174.

Partnerships that demonstrate a business purpose may or may not be "organized for estate or gift planning purposes." To the extent that the partnership, being an investment club or otherwise, was not organized for estate or gift planning purpose or where the income and receipts of such a partnership are derived from sources, transactions or activities of the partnership's regular course of business, such amounts are not excluded from business income and gross receipts under MCL 208.1105(2) or 208.1111(1)(w) and (x).

B17. (Answer rescinded, replacement located at B55) Limited liability companies are included in the definition of "person" under the MBT. Assuming that the federal "check the box" rules are followed, does the business income adjustment set forth at section 201(2)(e), which requires a taxpayer to add the loss or subtract the income attributable to "another entity," apply to the income or loss of a disregarded limited liability company?

B18. (Answer rescinded, replacement located at B44) May taxpayers, including corporations and partnerships, take the IRC 199 deduction for MBT purposes?

B19. (Answer rescinded, replacement located at A54) What is the definition of intangible asset as used in computing the business income tax base?

B20. Our company adds a handling charge to all customer invoices. Is this handling charge taxable under the MBT?

Yes. Under the MBTA, a taxpayer (other than a financial institution or an insurance company) is subject to both a business income tax and a modified gross receipts tax, which together comprise the taxpayer's MBT liability. Handling charges added to customer invoices must be included when determining the taxpayer's business income tax base as well as its modified gross receipts tax base. There is no language in the MBTA which would exclude such handling charges from the calculation of either of these taxes.

For purposes of calculating the business income tax, "business income" is defined generally as "that part of federal taxable income derived from business activity." MCL 208.1105(2). "Business activity" means "a transfer of legal or equitable title to or rental of property, whether real, personal, or mixed, tangible or intangible, or the performance of services, or a combination thereof, made or engaged in, or caused to be made or engaged in, whether in intrastate, interstate, or foreign commerce, with the object of gain, benefit, or advantage, whether direct or indirect, to the taxpayer or to others …." MCL 208.1105(1). Selling property of any kind to and/or performing services for customers is clearly "business activity"; thus, all income received from such endeavors, to the extent that it is part of a taxpayer's federal taxable income, constitutes taxable "business income" under the MBTA. There is no language in the MBTA that would exclude handling charges added to customer invoices from business income.

Similarly, a taxpayer calculates its modified gross receipts tax base by determining its gross receipts less "purchases from other firms," as defined in MCL 208.1113(6), before apportionment. MCL 208.1203(3). "Purchases from other firms" generally includes purchases of inventory, depreciable assets, and materials and supplies used in the taxpayer's business. MCL 208.1113(6). A handling charge is a fee charged to a customer that is typically intended to cover the company's cost of packaging and mailing an order. Handling charges, even if they reflect amounts paid to a third-party that are simply passed through to customers, do not fall within the statutory definition of "purchases from other firms." Therefore, handling charges added to

customer invoices are not deducted from gross receipts when determining the modified gross receipts tax base under the MBTA.

B21. A real estate limited partnership owns an apartment project in Michigan. The partnership is in the process of selling the apartment project to avoid foreclosure. The apartment project is the partnership's only asset and the partnership will be dissolved shortly after the sale.

As a result of the sale, the partnership will have a capital gain of approximately $6.3 million, and, in addition, will have debt forgiven of approximately $2.6 million. The debt being forgiven is a seller note and accrued interest that was executed in favor of the previous owner of the project. The potential buyer has agreed to pay a portion of the seller note and interest, and the former owner has agreed to forgive the balance of the debt. For federal tax purposes, their cancellation of debt ("COD") income is a pass through item and the ultimate taxability is determined at the partner level instead of the partnership level.

The partnership will be liable for both the modified gross receipts (MGR) and business income tax portions of the MBT on the rental income of the partnership. Will the partnership COD income and capital gain that are passed through to the partners be subject to MBT?
Yes. The partnership in this example would be subject to both components of the MBT on the rental income, the capital gain, and the COD income.

A taxpayer who meets the nexus standards and gross receipts thresholds of the MBT act is subject to a business income tax imposed on the business income base of the taxpayer and a modified gross receipts tax imposed on the modified gross receipts tax base of the taxpayer. MCL 208.1201 and 1203. The business income tax base of a taxpayer means the business income of the taxpayer subject to a series of specific adjustments listed in section 201. MCL 208.1105(2) defines business income, in part, to mean "that part of federal taxable income derived from business activity. For a partnership or S corporation, business income includes payments *and items of income and expense that are attributable to the business activity of the partnership or S corporation and separately reported to the partners or shareholders*. . .". (Emphasis added).

Here, the partnership has both COD income that is attributed to the business activity of the partnership (*i.e.* forgiveness of a debt secured by a partnership asset used in the business) and capital gain attributed to the business activity of the partnership (*i.e.* sale of the same partnership asset) that are separately reported to the partners on the federal K-1 form. While both capital gain and COD income are excluded from the calculation of partnership taxable income on the federal 1065 form, they are both income of the partnership separately reported to the partners on the K-1 forms, and fall within the plain meaning of business income of a partnership as defined in MCL
208.1105(2), regardless of the ultimate taxability of the COD at the partner's level.

For the calculation of the modified gross receipts tax base under section 203 (MCL 208.1203), gross receipts is defined under section 111 (MCL 208.1111) to mean "the entire amount received from any activity whether in intrastate, interstate, or foreign commerce carried on for direct or indirect gain, benefit, or advantage to the taxpayer or to others," subject to specifically enumerated exceptions. COD income and capital gain of a partnership that are separately reported to the partners are not one of the specifically enumerated exceptions, and are therefore subject to the modified gross receipts tax imposed under section 203 of the MBT.

B22. How is a like-kind exchange treated under the MBT?

Generally, for federal income tax purposes, business or investment property exchanged solely for business or investment property of a like-kind, no gain or loss is recognized under Internal Revenue Code Section 1031. If, as part of the exchange other (not like-kind) property or money is received, gain is recognized to the extent of the other property and money received, but a loss is not recognized. Properties are of like-kind, if they are of the same nature or character, even if they differ in grade or quality.

Section 1031 does not apply to exchanges of inventory, stocks, bonds, notes, other securities or evidence of indebtedness, or certain other assets.

To the extent the like-kind exchange is or is not recognized for federal income tax purposes, the MBT Business Income tax base will recognize a similar amount. MBT Business Income means that part of federal taxable income derived from business activity. MCL 208.1105(2).

Like the SBT, the value of property received in a like-kind exchange will be excluded from gross receipts. If, as part of the exchange other (not like-kind) property or money is received and gain is recognized for federal income tax purposes, the gain will be included in gross receipts. Losses that are not recognized for federal income tax purposes similarly are not recognized for MBT and do not reduce gross receipts for the MBT.

Transfers of property in a like-kind exchange are not dispositions and do not cause the recapture of ITC. The transferor is not required to recapture ITC on the transferred property and the transferee is not entitled to ITC on the property received. However, when property that was exchanged in a like-kind exchange is disposed of, the acquisition date of the disposed property will be considered the date the original property was acquired to determine if the disposition causes recapture of ITC.

B23. (This FAQ has been amended due to 2011 PA 305.) Is an individual person who earns more than $350,000 in interest and dividends for the tax year subject to the MBT? Are the person's capital gains from sales of stock subject to the MBT?
Generally, no. Although the MBT filing threshold is $350,000 in apportioned or allocated gross receipts, MCL 208.1505(1), the definitions of "business income" and "gross receipts" as used in the MBT Act exclude investment income, gains from the sale of personal assets, and other income received by an individual that are not derived from the person's trade or business. Consequently, such amounts are not included in the determination of such person's MBT business income and gross receipts tax bases or in calculating the MBT filing threshold or the gross receipts filing threshold credit. MCL 208.1505(1); 208.1411. The interest, dividend, and capital gain income of the individual in the example, even if such income totaled more than $350,000 for a single tax year, would not be subject to the MBT, unless the trade or business of that individual includes making investments and engaging in investment activity.

B24. (Answer rescinded, replacement located at B45) Is the sale of stock by a stockholder in a closely held corporation back to the corporation or another stockholder subject to MBT?

B25. (This FAQ has been amended due to 2011 PA 305.) I am a 100% shareholder of a corporation that does business in Michigan. I am a nonresident of Michigan. The corporation is organized as a C corporation. I sell 100% of the stock of the corporation which results in a capital gain. Is the capital gain from the sale of the stock subject to the new MBT?
Generally, no. The MBT excludes from both its business income and gross receipts tax components of the MBT the income, gain and receipts derived from the sale of an interest in a business that constitutes investment activity that is not part of the regular course of the person's trade or business. See MCL 208.1105(2); and MCL 208.1111(1) (w), (x), respectively. For an

individual, the sale of an ownership interest in a corporation, partnership, or limited liability company will generally not constitute business income or gross receipts to that individual unless he or she is in the business of buying and selling ownership interests in these types of business entities. This answer does not change if the individual shareholder, partner, or member is an active rather than passive investor or is a resident rather than a nonresident of Michigan.

In this case, the C corporation is the taxpayer and would be subject to MBT if the nexus standards and gross receipts thresholds are met. A 100% individual shareholder who sells all of some of the ownership interest in the C corporation will not be subject to MBT on any gain recognized from the sale of the stock except as otherwise provided above.

B26. Does the deduction for net earnings from self employment exempt self-employed individuals from taxation under the MBT?

No. The MBT is comprised of the business income tax and the modified gross receipts tax. MCL 208.1201; MCL 208.1203. The business income tax taxes "that part of federal taxable income derived from business activity." MCL 208.1105(2). The modified gross receipts tax is levied on a taxpayer's gross receipts less purchases from other firms, a defined term. MCL 208.1203(3). The deduction for net earnings from self employment is taken from the business income tax base and does not affect the modified gross receipts tax base. Further, the deduction is not an exemption from the business income tax base. MCL 208.1201(2)(h) permits a deduction, to the extent included in federal taxable income, for net earnings from self-employment <u>as defined under section 1402 of the internal revenue code</u> of the taxpayer or a partner or limited liability company member of the taxpayer <u>except</u> to the extent that those net earnings represent a reasonable return on capital. [Emphasis added].

IRC 1402 defines net earnings from self employment to generally mean the net income and distributive share of an individual or a member of a partnership. This definition excludes several items of gross income. IRC 1402(a). For example, dividends on stock, interest on bonds, and gain on the sale of a capital asset or sale of property are all excluded from the definition of net earnings from self employment. IRC 1402(a). Each of these items, excluded by definition, will not be part of the net earnings from self employment deduction and will, thus, remain taxable in the business income tax base to the extent included in federal taxable income from business activity.

Finally, the net earnings from self employment deduction does not allow an individual, partner or limited liability company member to deduct amounts that represent a return of capital. These amounts remain taxable in the business income tax base.

B27. Under the Michigan Business Tax Act (MBTA) will a taxpayer receive a deduction for the modified gross receipts tax paid when calculating the business income tax base?

No. While any modified gross receipts tax paid pursuant to the MBTA would generally be a deduction used to arrive at federal taxable income, the starting point for the calculation of the business income tax base, section 201(2)(b) expressly provides an add back for these types of taxes to the extent deducted to arrive at federal taxable income. Specifically, MCL 208.1201(2)(b) states:

"***Add*** taxes on or measured by net income and ***the tax imposed under this act*** to the extent the taxes were deducted in arriving at federal taxable income".

Therefore, any modified gross receipts tax paid pursuant to section 203 of the MBTA may not be deducted when computing the business income tax base under section 201.

B28. Is the gain recognized on the one time sale of business assets and goodwill by an entity to another entity taxed under the Michigan Business Tax (MBT)?
Yes, the gain is taxed under the MBT. [The MBT does not provide an exception for non-corporate taxpayers for a casual transaction that was provided for under the SBTA.] To the extent the capital gain is derived from the business activity of the taxpayer and included in federal taxable income it must also be included in the business income tax base. The gain included in federal taxable income is also included in the modified gross receipts tax base. There are no statutory exceptions or exclusions that are applicable to capital gains recognized by a business from the sale of capital assets. As a result, these gains are included in gross receipts and the modified gross receipts tax base. Also see FAQs B4 and M10.

B29. We manufacture customized tooling systems, which we then sell to our customer. After the sale, although the customer owns the tooling, it physically remains at our plant, and we use the tooling to manufacture the customer's product. Are these sales of tooling taxable under the Michigan Business Tax Act (MBTA)?
Yes. Under the MBTA, a taxpayer (other than a financial institution or an insurance company) is subject to both a business income tax and a modified gross receipts tax, which together comprise the taxpayer's MBT liability. Proceeds from the sale of custom tooling must be included when determining a taxpayer's business income tax base as well as its modified gross receipts tax base. There is no language in the MBTA which would exclude such sales from the calculation of either of these taxes.

For purposes of calculating the business income tax component of the MBT, "business income" means "that part of federal taxable income derived from business activity." MCL 208.1105(2). "Business activity" is broadly defined as "a transfer of legal or equitable title to or rental of property, whether real, personal, or mixed, tangible or intangible, or the performance of services, or a combination thereof, made or engaged in, or caused to be made or engaged in, whether in intrastate, interstate, or foreign commerce, with the object of gain, benefit, or advantage, whether direct or indirect, to the taxpayer or to others …." MCL 208.1105(1). Selling property of any kind (such as the tooling) to customers and performing services (such as the design and manufacture of the tooling) for customers both clearly constitute "business activity"; thus, all income received from such endeavors, to the extent that it is part of a taxpayer's federal taxable income, constitutes taxable "business income" under the MBTA. There is no language in the MBTA that would exclude sales of custom-made tooling from business income, and the fact that the tooling remains at the manufacturer's plant does not alter that conclusion.

Similarly, a taxpayer calculates its modified gross receipts tax base by determining its gross receipts less "purchases from other firms," as defined in MCL 208.1113(6), before apportionment. MCL 208.1203(3). "Purchases from other firms" generally includes purchases of inventory, depreciable assets, and materials and supplies used in the taxpayer's business. MCL 208.1113(6). While the customized tooling might otherwise satisfy the definition of a depreciable asset or a material or supply used in the taxpayer's business, the tooling is made and sold, rather than purchased, by the taxpayer. Accordingly, the receipts from the customized tooling cannot be excluded as "purchases from other firms," and sales of such tooling are not deducted from gross receipts when determining the modified gross receipts tax base under the MBTA.

B30. How are accounts receivable factoring companies treated for purposes of the Michigan Business Tax Act (MBTA)?
Factoring is a financial transaction whereby a business sells some or all of its accounts receivable (i.e., its collectible invoices) to a factoring company at a discount. Factoring is to be distinguished from a lending transaction in that the emphasis is on the value of the receivables being sold, not the business's credit worthiness, and the receivables are actually sold to the factoring company, not simply used as collateral. The factoring company assumes all risk on the

receivables, and the amount of value assigned to each account typically depends on its age. Factoring can be a one-time transaction, or there can be an on-going relationship between the invoice seller and the factoring company.

Under the MBTA, a taxpayer (other than a financial institution or an insurance company) is subject to both a business income tax and a modified gross receipts tax, which together comprise the taxpayer's MBT liability. Proceeds collected by a factoring company from accounts receivable purchased from other businesses must be included when determining the factoring company's business income tax base and its modified gross receipts tax base. There is no language in the MBTA which would exclude such proceeds from the calculation of either of these taxes.

For purposes of calculating the business income tax component of the MBT, "business income" means "that part of federal taxable income derived from business activity." MCL 208.1105(2). "Business activity" is broadly defined as "a transfer of legal or equitable title to or rental of property, whether real, personal, or mixed, tangible or intangible, or the performance of services, or a combination thereof, made or engaged in, or caused to be made or engaged in, whether in intrastate, interstate, or foreign commerce, with the object of gain, benefit, or advantage, whether direct or indirect, to the taxpayer or to others …." MCL 208.1105(1). The services provided by a factoring company, including purchasing receivables in exchange for cash and then collecting from the underlying account debtors, clearly constitute "business activity"; thus, all income received from such endeavors, to the extent that it is part of the factoring company's federal taxable income, constitutes taxable "business income" under the MBTA. There is no language in the MBTA that would exclude from the calculation of the business income tax base the proceeds collected by a factoring company from accounts receivable purchased from other businesses.

Similarly, a taxpayer calculates its modified gross receipts tax base by determining its gross receipts less "purchases from other firms," as defined in MCL 208.1113(6), before apportionment. MCL 208.1203(3). Section 111(1) specifies certain items that are excluded from the definition of "gross receipts." One such exclusion is "[p]roceeds from the taxpayer's transfer of an account receivable if the sale that generated the account receivable was included in gross receipts for federal income tax purposes." The exclusion does not apply to a taxpayer that both buys and sells receivables during the tax year. MCL 208.1111(1)(f). While this exclusion will generally apply to the invoice seller (the factoring company's customer), it does not apply to the factoring company itself, since the factoring company had nothing to do with the sale that generated the transferred account receivable and it therefore will not have included that sale in gross receipts for federal income tax purposes.

"Purchases from other firms" generally includes purchases of inventory, depreciable assets, and materials and supplies used in the taxpayer's business. MCL 208.1113(6). Such "purchases from other firms" are subtracted from the taxpayer's gross receipts when determining its modified gross receipts tax base. A factoring company's purchase from another business of intangibles such as accounts receivable does not fall within the statutory definition of "purchases from other firms." Accordingly, amounts paid by a factoring company to invoice sellers for accounts receivable are not deducted from the factoring company's gross receipts when determining its modified gross receipts tax base under the MBTA.

B31. (Answer rescinded, replacement located at B46) If a C corporation owns 56% of a flow-through entity, and the two meet the MBT definition of a unitary group, how does the corporation report all of the income of the flow-through entity when all it receives from the entity is a K-1? Also, do the other owners of the flow-through entity need to reduce their federal taxable income by their share of the flow-through entity income when computing their MBT liability?

B32. Are royalties received from a foreign entity included in the tax base of the MBT?
Yes, but generally only as part of the modified gross receipts tax component of the MBT.

Royalties – including those received from foreign persons – are included in gross receipts and the gross receipts tax base for purposes of the modified gross receipts tax. MCL 208.1111(1), 208.1203.

However, for business income tax purposes, royalties received "from persons other than United States persons and foreign operating entities, including, but not limited to, amounts determined under section 78 of the [IRC] or sections 951 to 964 of the [IRC]" are subtracted from business income "to the extent included in federal taxable income." MCL 208.1201.

Foreign entities – and foreign operating entities as defined by MCL 208.1109 – cannot be included in a unitary business group. Therefore, intercompany eliminations that would otherwise remove intra-unitary business group transactions from the tax bases under are not available to royalties paid to or received by a foreign entity.

B33. (This FAQ has been amended due to 2011 PA 305.) Does business income include casual transactions or isolated sales?
Generally, yes. Business income means "that part of federal taxable income derived from business activity." MCL 208.1105. "Business activity" is broadly defined to mean:

> a transfer of legal or equitable title to or rental of property, whether real, personal, or mixed, tangible or intangible, or the performance of services, or a combination thereof, made or engaged in, or caused to be made or engaged in, whether in intrastate, interstate, or foreign commerce, with the object of gain, benefit, or advantage, whether direct or indirect, to the taxpayer or to others, but does not include the services rendered by an employee to his or her employer or services as a director of a corporation. Although 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. [MCL 208.1105(1).]

Thus, unless expressly excluded, business income will generally include income derived from any transaction included in the taxpayer's federal taxable income, including "casual transactions" or "isolated sales" that may have been excluded under the SBT.

However, the MBT does exclude certain transactions from business income.

> For an individual, estate, or person organized for estate or gift planning purposes, business income is that part of federal taxable income derived from transactions, activities, and sources in the regular course of the person's trade or business. . . ." [MCL 208.1105(2).]

In other words, for individuals, estates, and persons organized for gift and estate planning purposes, business income excludes income derived outside the regular course of the person's trade or business.

B34. How should inter-company transactions between members of a unitary business group be eliminated when the members have different year ends?
MCL 208.1511 requires the elimination of all transactions between members of the unitary business group that affect the business income tax base, modified gross receipts tax base and the apportionment formula. When members of a unitary business group have different year

ends, the combined return of the unitary business group must include each tax year of each member whose tax year ends with or within the tax year of the designated member. Each member should eliminate the inter-company items of income and expense recorded on its books for the tax period of the member that is included in the combined return of the unitary business group. In other words, inter-company eliminations are made on an entity basis in computing the members' tax bases that are summed together for the combined return.

For example, a unitary business group consists of company A, the designated member that reports on a calendar year, company B that reports on a calendar year and company C that has a fiscal year ending March 31. In 2008, companies A and B will eliminate all inter-company transactions between each other since they both report on a calendar year end. In computing their 2008 tax bases, companies A and B will also eliminate all inter-company transactions they had recorded on their books during the calendar year with company C.

Company C will report the months April 1, 2007 through December 31, 2007 on a final SBT return. Only January 1, 2008 through March 31, 2008 will be reported on the unitary group's 2008 MBT return. When computing its 2008 Business Income and Modified Gross Receipts tax bases, Company C will eliminate all inter-company transactions it has recorded on its books for the period January 1, 2008 through March 31, 2008. On the unitary group's 2009 MBT return, Company C will eliminate all inter-company transactions it has recorded on its books for the periods April 1, 2008 through March 31, 2009. Companies A and B will eliminate all intercompany transactions recorded in 2009 between each other and with company C since both A & B report on a calendar year end. While timing differences will occur due to differences in each members year end, eliminating each member's inter-company transactions that were recorded on that member's books during the periods included in the combined return will eliminate intercompany transactions from the unitary business group's tax base.

B35. A real estate limited partnership owns an apartment project in Michigan subject to mortgage debt. The partnership negotiates a reduction in the mortgage but retains ownership of the apartment project. As the result of the reduction in the mortgage, the partnership receives a 1099-C from the mortgage holder and recognizes cancellation of debt ("COD") income in the amount of the negotiated debt reduction. The COD income is reported by the partnership on schedule 1065 K and to the partners on the partnership 1065 K-1 forms in the same year the COD is reported by the mortgage holder on the 1099-C.

If any or all of the partners elect to exclude the COD from gross income on their individual federal income tax returns, must the partnership include the excluded COD in the income tax base on the MBT return filed by the partnership for that year?

Under section 108(c) of the Internal Revenue Code, a taxpayer may make an election to exclude COD from gross income if the COD qualifies as qualified real property business indebtedness. Qualified real property business indebtedness is defined in §108(c) and generally means indebtedness that is secured by real property and incurred or assumed by a taxpayer in connection with a trade or business. A taxpayer who makes this election is required to reduce the basis of the depreciable real property at the beginning of the taxable year following the taxable year in which the discharge occurs. IRC §1017(2)(2). A taxpayer who disposes of the qualified real property in the year in which the COD occurs cannot elect to exclude COD income under IRC § 108(c).

Section 703(b) of the Internal Revenue Code requires a partnership to make all elections affecting the taxable income of the partnership except in three specifically enumerated cases. One of these cases is the election to exclude COD income that qualifies as qualified real property business indebtedness. Under §703(b), the election to exclude this income must be made at the

partner's level rather than by the partnership at the partnership level. A partner choosing to make this election must first obtain the consent of the partnership and then make the election in the manner and time frames permitted in the Federal Income Tax Regulations, Reg § 1.1017-1(g). Once the election has been properly made, the partnership is required to reduce the electing partners basis of depreciable partnership property commencing in the tax year following the year the COD income is excluded. The partnership must then adjust the partner's distributive share of partnership income, deductions, gains, and losses to reflect these basis adjustments in subsequent years in the manner prescribed under section 743(b) of the Internal Revenue Code and in the Federal Income Tax Regulations, Reg §1.743-1.

In the case of partners in a real estate limited partnership who elect to exclude COD income arising from qualified real property business indebtedness, adjustments must be made by the partnership in subsequent tax years to report the additional income the partners must recognize as the result of the required basis adjustments, either through the reduced depreciation deductions or because of increased gains on the sale of the depreciable property. The additional income from these basis adjustments is reported by the partnership in subsequent tax years on the federal 1065 schedule K filed by the partnership and as a separately stated item on the K-1 forms provided to the partners. Since reporting the separately stated items from the COD in the year the COD occurs and in the year(s) the §743 income adjustments are required would result in double taxation on the MBT return, the partnership should report the COD in the year the §743 income adjustments are reported to the partners and not in the year the COD occurs. To the extent a §108(c) election has *not* been made by a partner(s), the COD attributable to that partner(s) is then reported on the MBT return in the same year the COD occurs.

Copies of all timely elections made by partners to exclude COD income should be attached to the partnership's MBT return in the year the COD occurs to allow the Department to determine the amount, if any, of COD that should be included in the partnership's MBT income tax base in that year.

B36. MCL 208.1201(2)(h) provides a deduction from the business income tax base for self employment net earnings except to the extent that the net earnings represent a reasonable return on capital. What is a "reasonable return on capital"?
The Department deems the presumptive reasonable return on capital to be the percentage of self-employment earnings reported for federal self-employment taxes as a return on capital reduction to self-employment earnings. This is a rebuttable presumption based on all the facts and circumstances.

B37. Section 201(2)(i) of the MBTA allows a series of deductions beginning in 2015, based on an amount called the "book-tax difference." A taxpayer's book-tax difference must be calculated for the first fiscal period ending after July 12, 2007. Section 201(3) states:

In order to claim this deduction, the department may require the taxpayer to report the amount of this deduction on a form as prescribed by the department that is to be filed on or after the date that the first quarterly return and estimated payment are due under this act.

Has the Department prescribed a form that taxpayers must use to report the amount of this deduction? If so, when and how will the form be filed? If the form is to be filed together with a return, will a valid extension for filing the return also extend the deadline for filing the form?
Yes, the Department will require that taxpayers file Form 4593 in order to document the future section 201(2)(i) deduction regarding the book-tax difference. Form 4593 must be filed together with the taxpayer's first annual MBT return. For a taxpayer that obtains a valid extension for filing

its annual return, the Department will treat that extension as applicable to the filing of Form 4593, as well. With respect to possible amendments of Form 4593, amendments to a taxpayer's first annual MBT return could necessitate corresponding changes to Form 4593. Accordingly, Form 4593 will be open to amendment during the same limitations period that is applicable to the first annual return, except that an amendment to Form 4593 will be permitted during the relevant period only if the taxpayer has also amended its annual return, and the changes made to the annual return have necessitated the amendment to Form 4593. A taxpayer may not amend Form 4593 on a stand-alone basis.

B38. May a taxpayer that has no MBT filing obligation for 2008 file Form 4593 (documenting the future section 201(2)(i) deduction regarding the book-tax difference) as a free-standing form, in order to preserve the possibility of taking the deduction if they later become MBT taxpayers?

No, Form 4593 may not be filed as a free-standing form. Form 4593 was designed to establish an offset for future use to a deferred liability required by GAAP for the transition from SBT to MBT. The transition period is generally in 2007 after enactment of the MBT legislation, and there is only one opportunity for MBT taxpayers to file Form 4593, documenting their book-tax difference and preserving their entitlement to claim certain future deductions based upon that calculation. Persons who are not subject to the MBT in 2008 or who were not subject to the SBT would not have established a deferred liability for the transition from SBT to MBT, and therefore will not be eligible to take the section 201(2)(i) deduction. Such persons therefore have no need to file Form 4593.

For MBT taxpayers, the Department will require that Form 4593 be filed together with the taxpayer's 2008 annual MBT return (with a valid extension extending the deadline for filing Form 4593, as well). The Department will only accept Form 4593 from MBT taxpayers in conjunction with their 2008 annual MBT return.

However, SBT taxpayers who have no 2008 MBT liability because they fail to meet the filing threshold, but who record a one-time book-tax difference under GAAP in the accounting period that includes the enactment of the MBT, may file a zero liability MBT return for 2008, along with Form 4593.

B39. MCL 208.1201(2) provides a deduction for the book-to-tax difference or deferred liability resulting from the change from the SBT to the MBT. Is the deduction available to a privately held, cash-basis partnership that is not required to (and does not) maintain its books in accordance with generally accepted accounting principles?

No. The deduction provided under MCL 208.1201(2), commonly known as the FAS 109 deduction, does not apply to a taxpayer that does not keep its books in accordance with GAAP.

The plain language of the statute makes clear that only taxpayers that use GAAP qualify for the credit. Section 201(3) states

The deduction … shall not exceed the amount necessary to offset the net deferred tax liability of the taxpayer as computed in accordance with generally accepted accounting principles.

A cash method or cash basis taxpayer may take the deduction to offset the book-to-tax difference or deferred tax liability if that taxpayer keeps its books in accordance with GAAP.

B40. At what date should the book-tax difference be calculated for the deduction provided in MCL 208.1201(2)(i)? The term "first fiscal period ending after July 12, 2007" is unclear.

The phrase "first fiscal period ending after July 12, 2007" as used in MCL 208.1201(2)(i) is the

first fiscal period of the taxpayer which ends after July 12, 2007 and which includes the July 12, 2007 enactment date of MBT.

Under FAS 109, paragraph 27, a taxpayer who maintains books and records under Generally Accepted Accounting Principles ("GAAP") must make a one-time book adjustment to reflect the change in deferred taxes that occurs as the result of a tax law change, and record that adjustment in the accounting period that includes the enactment date of the tax law change. The future deductions provided for in MCL 208.1201(2)(i) ("FAS 109 deduction") are based solely on the book-tax difference of qualifying assets for this same period, and are intended to create a one-time deferred tax asset for GAAP taxpayers to use as an offset against the one time change in the deferred tax liability that resulted from the enactment of the MBT. For SBT taxpayers, the change in deferred tax liability that results from the enactment of MBT will primarily be attributable to the difference between the net book value and tax basis of depreciable assets recorded on the books for the first fiscal period ending after July 12, 2007. Assets acquired or placed in service after the SBT was repealed on December 31, 2007 would not be included in the calculation of the one time book adjustment required under FAS 109 for the enactment of MBT.

The deferred tax asset will be recorded in the same period the taxpayer is required to record the one-time change in deferred tax liability under GAAP. As a result, the date a taxpayer must use to compute the book-tax difference for the FAS 109 deduction allowed under MCL 208.1201(2)(i) will be the same date used to compute the book-tax difference for the calculation of the one-time change in the deferred tax liability that must be reported by GAAP taxpayers under FAS 109.

Caution: If the deferred asset calculated by use of the formula specified in MCL 208.1201(2)(i) is *more* than the net deferred MBT tax liability reported under FAS 109, the deduction will be limited as provided in MCL 208.1201(3).

A taxpayer must report the amount of the FAS 109 deduction on the Michigan form 4593 with the first MBT return in order to claim the deductions allowed in the years specified in MCL 208.1201(2)(i), *i.e.* 2015 – 2029. Taxpayers must retain all records and workpapers, that are necessary to support the taxpayer's calculation of the deduction and the deferred liability recorded, for the entire period the deduction is available and for the period that the return is subject to audit by the Michigan Department of Treasury.

A taxpayer who does not maintain deferred tax liability accounts under GAAP does not need to create an offsetting deferred tax asset, and therefore is ineligible for the FAS 109 deduction allowed in MCL 208.1201(2)(i).

B41. I am a broker/dealer in securities without any W-2 payroll. My major expense is 1099 commissions paid to sales representatives. Are these commission expenses deductible on my MBT return?

Business income is generally defined as "that part of federal taxable income derived from business activity." MCL 208.1105(2). To the extent that federal taxable income derived from business activity is reduced by these expenses, a taxpayer's Business Income tax base will be reduced.

The Modified Gross Receipts tax base is a taxpayer's gross receipts less purchases from other firms before apportionment. MCL 208.1203(3). "Gross receipts" are defined as the entire amount received by the taxpayer from any activity whether in intrastate, interstate, or foreign commerce carried on for direct or indirect gain, benefit, or advantage to the taxpayer or to others with certain exceptions. MCL 208.1111(1). Section 111 provides no exception for or deduction of 1099 commission expense from gross receipts of broker/dealers. Therefore, the 1099 commission expense will not reduce the gross receipts or Modified Gross Receipts tax base.

Further, commissions paid to non-employees are not compensation as defined in MCL 208.1107(2). Only commissions, wages, salaries, fees, bonuses, and other payments made in the tax year on behalf of or for the benefit of employees, officers, or directors of the taxpayer would meet the statutory definition of compensation and qualify for the compensation credit provided under MCL 208.1403. The non-employee 1099 commissions in this example do not qualify for the compensation credit.

B42. What impact would a merger in 2008 have on the ability of the surviving entity to utilize SBT business loss carryforwards? How will losses incurred after December 31, 2007 be impacted by the merger?
The MBT provides for a limited deduction of SBT business loss carry forward in the 2008 MBT tax year in calculating the Modified Gross Receipts tax base only. MCL 208.1203(4) provides that 65% of any SBT business loss carry forward that was actually incurred in the 2006 or 2007 SBT tax years and that was not previously deducted in tax years beginning before January 1, 2008 may be deducted against the Modified Gross Receipts tax base. Any business loss carry forward incurred before January 1, 2006 is not eligible for the deduction.

In a merger two or more entities combine into one, through a purchase acquisition or a pooling of interests. A merger differs from a consolidation in that no new entity is created. The surviving entity may utilize what would have been the business loss of each of the separate entities had each entity filed a separate return. Any SBT business loss carryforward that is not deducted against the 2008 Modified Gross Receipts tax base of the surviving entity is lost.

A taxpayer's Business Income tax base is its business income subject to certain statutory adjustments before allocation or apportionment. MCL 208.1201(2). Business income is generally defined as "that part of federal taxable income derived from business activity." MCL 208.1105(2). To this extent, the calculation of the MBT business income tax base of the surviving entity will follow federal regulations.

The MBT provides for the deduction of a business loss incurred after December 31, 2007. This deduction may only be taken against the Business Income tax base of an entity. Losses incurred after December 31, 2007 may not be deducted against the Modified Gross Receipts tax base. "Business loss" is defined as a negative business income taxable amount after allocation or apportionment. Any unused business loss may be carried forward to the year following the loss year and the next 9 successive tax years or until the loss is used up, whichever occurs first, but for not more than 10 taxable years after the loss year. MCL 208.1201(5). The surviving entity of a merger that files a 2008 MBT return will be able to begin deducting any resulting 2008 business loss against its 2009 Business Income tax base as permitted by statute.

B43. (Answer rescinded, replacement located at B47) Can a taxpayer net the cost of purchased securities with the proceeds from those securities? For purposes of taxing the gain, is the cost the actual cost of the securities or the fair market value on January 1, 2008?

B44. May taxpayers take the IRC 199 deduction for MBT purposes?
No. For federal tax purposes, the domestic production activities deduction under IRC 199 provides a tax benefit for certain domestic production activities. In particular, IRC 199 allows a deduction equal to a specified percentage of the taxpayer's qualified production activities income for the tax year.

This federal deduction, however, does not flow through to the MBT. The MBT defines "federal taxable income" to mean "taxable income as defined in section 63 of the internal revenue code,

except that federal taxable income shall be calculated as if . . . section 199 of the [IRC was] not in effect." MCL 208.1109 (emphasis added). Thus, to the extent that the IRC 199 deduction is included in federal taxable income for federal tax purposes, that deduction must be added back in calculating federal taxable income for MBT purposes.

B45. (This FAQ has been amended due to 2011 PA 305.) Is the sale of stock by a stockholder in a closely held corporation back to the corporation or to another stockholder subject to MBT?

For an individual, the sale of stock in a corporation will generally not constitute business income or gross receipts to that individual so long as the investment does not constitute nor is part of the individual's trade or business. The sale of stock would generally be included in a taxpayer's business income and modified gross receipts tax bases; however, there are specific exceptions. MCL 208.1105(2)(f)(i) provides that for an individual, an estate, or a person organized for estate or gift planning purposes, income from investment activity is not included in business income if the investment activity is not part of the person's trade or business. Therefore, to the extent that the stockholder is an individual and the sale of the stock is investment activity that does not constitute part of the individual's trade or business, the sale of the stock is not included as business income subject to MBT. Similar treatment is accorded with regard to modified gross receipts.

B46. If a C corporation owns 56% of a flow-through entity, and the two meet the MBT definition of a unitary group, how does the corporation report all of the income of the flow-through entity when all it receives from the entity is a K-1? Also, do the other owners of the flow-through entity need to reduce their federal taxable income by their share of the flow-through entity income when computing their MBT liability?

Assuming the C corporation and the flow-through entity constitute a unitary group as defined under MCL 208.1117(6), they are required to file one combined return pursuant to MCL 208.1511. The business income tax base of the unitary group is determined by adding the business income tax bases of the C corporation and the flow through entity as computed under MCL 208.1201 and then eliminating any inter-group transactions. The modified gross receipts ("MGR") tax base is determined in a similar manner by computing the MGR tax base of each member under MCL 208.1203 and then eliminating inter-group transactions. If either or both members of the unitary group have nexus in states other than Michigan, the apportionment percentage is determined on a combined basis and then applied to the total business income tax and MGR tax bases of the unitary group. How or in what manner the members of a unitary group share information necessary to prepare a combined return is not determined by the Department.

Owners of the flow-through entity that are not included in the unitary group must adjust their MBT income tax and modified gross receipts bases to remove their share of income or losses from the flow through entity pursuant to MCL 208.1202(2)(e) and 208.1111(1)(bb), respectively.

B47. (This FAQ has been amended due to 2011 PA 305.) Can a taxpayer net the cost of purchased securities with the proceeds from those securities? For purposes of taxing the gain, is the cost the actual cost of the securities or the fair market value?

Generally, securities, such as stocks, bonds and similar intangibles, will be capital assets under section 1221 of the IRC unless the securities are inventory to the taxpayer. Receipts from the sale of capital assets could be taxable in both the business income and modified gross receipts tax bases of the MBT.

Business income is generally defined as "that part of federal taxable income derived from business activity." MCL 208.1105(2). To the extent the capital gain from the sale of the securities is derived from the business activity of the taxpayer, the gain must be included in the business

income tax base of the MBT. For this purpose, the capital gain will be computed the same as it is federally, which is amount realized minus basis. The result will flow to the MBT return if the gain is derived from the business activity of the taxpayer. The "cost" or basis is the acquisition cost of the asset just as it is for federal purposes and is not the fair market value as of January 1, 2008, the date that the MBT went into effect.

For purposes of the modified gross receipts tax base, if the securities are sold at a gain then the proceeds of the sale of the securities minus any gain from the sale, to the extent that the gain was included in federal taxable income, will be excluded from the tax base. MCL 208.1111(1)(p).

If the securities were held for investment purposes by an individual, estate or person organized for gift or estate planning purposes and the investment activity is not part of the individual's, estate's or person's trade or business, the gain is not included in the business income tax base. MCL 208.1105(2)(f). There is a similar exclusion under the gross receipts tax base. MCL 208.1111(1)(w). Additionally, the receipts may also be excluded from both the business income tax base and the modified gross receipts tax base if the securities were held for investment purposes and sold by a person organized exclusively to conduct such investment activity who does not conduct investment activity for any person other than an individual and/or persons related to that individual. MCL 208.1105(2) and 208.1111(1)(x).

B48. An individual shareholder of an S corporation receives income from the S corporation that is reported on a federal 1099-MISC form. Would the income reported on the 1099-MISC constitute business income subject to MBT, or personal compensation exempt from MBT?
Generally, the Michigan tax treatment of income reported on the 1099-MISC form will depend on the nature of the income. The 1099-MISC form is a federal reporting vehicle used for various types of income, including prizes and awards, rents, royalties, and nonemployee compensation.

The MBT is imposed on the business income and modified gross receipts tax bases of taxpayers with business activity in Michigan, subject to statutory threshold amounts. Income reported to an individual on a 1099-MISC form will be considered business income and/or gross receipts under the definitions of those terms in MCL 208.1105 and 208.1111 and subject to MBT if the income is properly reported by the taxpayer (a) as business income on federal schedule C (Profit or Loss from Business – Sole Proprietorship) or on any similar federal schedule or form, or (b) as rental or royalty income reported on federal schedule E (Supplemental Income or Loss from rental real estate, royalties, etc.) or elsewhere on the federal return. Payments for services rendered as an employee/shareholder of the S corporation or for director fees would not be considered gross receipts or business income and would not be subject to MBT.

If the shareholder owns more than 50% of the S corporation either directly or indirectly and receives 1099-MISC income from the S corporation that is considered either business income or rental or royalty income for federal income tax purposes, the shareholder and the S corporation would generally be deemed part of a unitary business group (UBG) for MBT purposes. The UBG would be required to file an MBT return if the combined gross receipts of all members exceed the statutory thresholds.

B49. How is the book-tax deduction to the business income tax base affected if the various members of a unitary business group each have and report a book-tax difference on Form 4593 with the initial required MBT return and the unitary business group's (UBG) membership later changes?
MCL 208.1201(2)(i) provides a future deduction to a taxpayer's business income tax base, calculated as the lesser of the taxpayer's book-tax difference for the first fiscal period ending after July 12, 2007 or the taxpayer's net deferred tax liability as computed in accordance with generally

accepted accounting principles. MCL 208.1201(2)(i)-(3). The deduction will be claimed by deducting a percentage of this figure beginning in the 2015 tax year. MCL 208.1201(2)(i).

The deduction (phased in over 15 years) equals the lesser of either the taxpayer's book-tax difference for the stated fiscal period *or* the taxpayer's net deferred tax liability, as computed in accordance with GAAP. Therefore, both the book-tax calculation and the net deferred tax liability are necessary to compute the deduction to business income. Thus, when UBG members depart or arrive they must consider both the book-tax difference and the net deferred tax liability.

In the instance of a member leaving the group, the departing member will leave the group with its individually calculated book-tax number as reported on Form 4593 with the UBG's initial MBT return. Likewise, the departing member leaves the group with its share of the net deferred tax liability. If the group members calculated this amount individually then the departing member would simply leave the group with its individual amount. If the group calculated the net deferred tax liability only at the group level then the departing member must figure its pro rata share of the amount, computed as if the member had been a single entity filing a stand alone return when the liability was booked.

A new member which calculated and timely reported its own book-tax difference as well as calculated its own net deferred tax liability is later added to a UBG that has calculated its own book-tax difference and net deferred liability for the group. The added member contributes its book-tax difference and its net deferred liability to those of the group. The group may use, in addition to the group's existing numbers, the book-tax difference and net deferred liability of the added member which would have resulted had the member remained a single entity

B50. (This FAQ has been amended due to 2011 PA 305.) An investment partnership has sales of capital asset securities consisting of both gains and losses that result in an overall gain. In determining the business income and modified gross receipts tax bases, is only the net gain included in the tax bases?

Generally, for federal reporting, gains and losses are classified as either ordinary or capital. Capital gains or losses are either short term or long term and netted on federal Schedule D. Investment property such as stocks and bonds are capital assets and the gain or loss generated is a capital gain or loss. Federally, for a partnership or an S corporation, these gains and losses are separately reported to the partners or shareholders.

The MBT imposes tax on the business income tax base of every taxpayer with business activity within this state. The business income tax base means a taxpayer's business income subject to certain adjustments. "Business income" means that part of federal taxable income derived from business activity. For a partnership or an S corporation, business income includes payments and items of income and expense that are attributable to business activity of the partnership or S corporation and separately reported to the partners or shareholders. MCL 208.1105. There are no statutory adjustments to the business income tax base for the disposition of capital assets. MCL 208.1201. Therefore, any net capital gain attributable to business activity of the investment partnership that is separately reported to the partners is also included in the MBT business income tax base of the partnership.

The MBT also imposes tax on the modified gross receipts tax base of each taxpayer with nexus. MCL 208.1203. "Gross receipts" means the entire amount received by the taxpayer as determined by using the taxpayer's method of accounting used for federal income tax purposes, from any activity whether in intrastate, interstate, or foreign commerce carried on for direct or indirect gain, benefit, or advantage to the taxpayer or to others with certain exceptions.

Subsection (p) provides an exception for each capital asset sold. MCL 208.1111(1)(p). When a capital asset is sold or disposed of at a gain, only the gain is effectively included in gross receipts. This exception does not make a similar provision for capital assets sold at a loss. In such cases, the exception only excludes the proceeds from gross receipts. There is no adjustment or deduction of losses from the gross receipts. Therefore, a taxpayer may not net capital gains and losses when calculating the modified gross receipts tax base.

Finally, there is an exception to the inclusion of gains into the business income tax base or the modified gross receipts tax base of an investment partnership if the investment partnership was organized for gift or estate planning purposes or was organized exclusively to conduct investment activity and does not conduct investment activity for any person other than an individual or persons related to that individual, and the gains were derived from activities that were not in regular course of the investment partnership's trade or business. MCL 208.1105(2). Unless the facts and circumstances surrounding the investment partnership meet this exemption, gains from the sale of capital assets must be included in business income and gross receipts as described above.

B51. In January 2008, the State of Michigan decoupled from federal bonus depreciation. Consequently, we have to add-back to business income bonus depreciation that was taken on the federal return.

Since bonus depreciation is not allowed for Michigan Business Tax returns, when increasing the business income for the amount of bonus depreciation taken, is it allowable to compute and subtract from business income regular MACRS depreciation or section 179 expense on those assets for which bonus depreciation was claimed for federal purposes?

The amount of IRC §179 expense deduction taken on a taxpayer's federal tax return will be allowed in computing MBT business income. This amount will not vary in computing business income for federal and Michigan tax purposes. A taxpayer that did not elect and take a federal §179 expense deduction on its federal tax return may not claim the federal deduction in its computation of business income under the MBT.

Any IRC §168(k) bonus depreciation claimed on a taxpayer's federal return will not be allowed for MBT purposes. Taxpayers should re-compute MBT depreciation using a federally accepted depreciation method that computes a depreciation amount as if IRC §168(k) was not in effect. This depreciation method must be used consistently over the life of the asset until retired or disposed of when computing MBT business income. The federal depreciation expense that is calculated as if §168(k) was not in effect is the deduction used in calculating MBT business income. A taxpayer must keep sufficient records to track the basis of the asset and depreciation deduction claimed for purposes of the MBT.

B52. How is the book-tax deduction, provided at MCL 208.1201(2)(i), calculated?

The deduction is determined by:

1) Calculate the difference between the value of all assets on the books of a taxpayer for the first fiscal period ending after July 12, 2007 and the federal tax basis for those same assets for the same period. (For a UBG, compute for each member entity individually. The group will file one combined Form 4593, entering the result for each member of the group separately).

2) Calculate the amount needed to offset the net deferred tax liability of the taxpayer which results from the imposition of the business income tax, at a rate of 4.95%, and the modified gross receipts tax, at a rate of .8%, calculated for the first fiscal period ending after July 12, 2007.

3) Take the lesser of the result of (1) or (2).

4) For the 2015 through 2019 tax years apply 4%, for the 2020 through 2024 tax years apply 6%, and for the 2025 through 2029 tax years apply 10% to the result of step (3).

5) Subtract the result of step (4) from business income in appropriate tax year.

Examples

Example 1: Company A reviews all assets on its books as of its first fiscal period which ends after July 12, 2007 and which includes the enactment date of the MBT. The book value of these assets is then compared to the federal tax basis of the same assets for the same period. The difference between the assets is calculated at $5,000. Company A calculates its net deferred liability in accordance with GAAP for this same period at $7,000. Company A reports a $5,000 book-tax difference to the Department on Form 4593 with its first MBT return. Beginning in the 2015 tax year, Company A may take 4% of the $5,000, (the lesser of the book-tax or net deferred tax liability) or $200, as a deduction to business income. Beginning in the 2020 tax year Company A may take 6%, or $300 as a deduction, and beginning in the 2025 tax year the deduction will equal 10% or $500.

Example 2: Entities A, B and C, members of a unitary business group individually calculate their book-tax difference based on their own books and records for the appropriate fiscal period. The UBG files one Form 4593 with its initial MBT return. Entity A reports a book-tax difference of $500, B reports $1,000 and C reports $2,000. The net deferred tax liability is calculated for the group in accordance with GAAP at $3,000. Beginning in the 2015 tax year the UBG will begin to take a percentage of $3,000, which is the lesser of the net deferred tax liability of the group and the combined book tax difference of the three group members.

B53. Are the qualified affordable housing deductions from business income and gross receipts under MCL 208.1201(7) and 208.1203(6) limited to qualified affordable housing projects ("QuAHPs") that purchase residential rental units after the effective date of 168 PA 2008?

No. Under the MBT, QuAHPs are permitted a deduction from business income and gross receipts for income and receipts generally attributable to rent-restricted residential rental units in this state owned by the QuAHP. More specifically, the deduction from business income states:

[F]or a person that is a qualified affordable housing project, deduct an amount equal to the product of that person's taxable income that is attributable to residential rental units in this state owned by the qualified affordable housing project multiplied by a fraction, the numerator of which is the number of rent restricted units in this state owned by that qualified affordable housing project and the denominator of which is the number of all residential rental units in this state owned by the qualified affordable housing project. [MCL 208.1201(7).]

Similarly, the deduction from gross receipts states:

[F]or a person that is a qualified affordable housing project, deduct an amount equal to that person's total gross receipts attributable to residential rental units in this state owned by the qualified affordable housing project multiplied by a fraction, the numerator of which is the number of rent restricted units in this state owned by the qualified affordable housing project and the denominator of which is the number of all rental units in this state owned by the qualified affordable housing project. [MCL 208.1203(6).]

There is no requirement under MCL 208.1201(7) and 208.1203(6) that the deductions are limited to QuAHPs that purchase rental units after the effective date of 168 PA 2008 or rental units purchased after that date. That is, the deductions under MCL 208.1201(7) and 208.1203(6) are available to QuAHPs for all rental units that meet the requirements set forth under MCL 208.1201 and 208.1203, subject only to extinguishment under the following provision:

If a qualified affordable housing project no longer meets the requirements of subsection (9)(b) or fails to operate those residential rental units as rent restricted units in accordance with the operation agreement and the requirements of subsection (9)(c), the taxpayer is entitled to the deductions under subsections (6) and (7) as long as the qualified affordable housing project continues to offer some of the residential rental units purchased as rent restricted units in accordance with the operation agreement. [MCL 208.1201(8). The disqualification provision for gross receipts purposes is substantially the same and found at MCL 208.1203(7).]

B54. What is the definition of intangible asset as used in computing the business income tax base?

Intangible assets are defined as those assets that cannot be seen, touched or physically measured and which are created through time and/or effort. Intangible assets may include but are not limited to patents, franchises, trademarks and goodwill. Intellectual property is an intangible asset and includes copyrights, trademarks, patents, and trade secrets. Intangible assets may be wasting and have a finite life such as a patent or they may have an infinite life such as goodwill.

Under the MBT, a person must add back, in computing its business income tax base, certain payments made for the use of intangible assets that were deducted in arriving at federal taxable income. The payments must have been to a person related through ownership or control that is not a member of a unitary group with the taxpayer. Add back of the deducted payments is required unless the taxpayer can prove to the satisfaction of the Department that the payments were at arms-length, have a business purpose other than the avoidance of tax and meet one of three other requirements. MCL 208.1201(2) (f) sets forth these requirements:

> Except as otherwise provided under this subdivision, to the extent deducted in arriving at federal taxable income, add any royalty, interest, or other expense paid to a person related to the taxpayer by ownership or control for the use of an intangible asset if the person is not included in the taxpayer's unitary business group. The addition of any royalty, interest, or other expense described under this subdivision is not required to be added if the taxpayer can demonstrate that the transaction has a nontax business purpose other than avoidance of this tax, is conducted with arm's-length pricing and rates and terms as applied in accordance with sections 482 and 1274(d) of the internal revenue code, and satisfies 1 of the following:
>
> (i) Is a pass through of another transaction between a third party and the related person with comparable rates and terms.
>
> (ii) Results in double taxation. For purposes of this subparagraph, double taxation exists if the transaction is subject to tax in another jurisdiction.
>
> (iii) Is unreasonable as determined by the treasurer, and the taxpayer agrees that the addition would be unreasonable based on the taxpayer's facts and circumstances.

B55. Limited liability companies are included in the definition of "person" under the MBT. Assuming that the federal "check the box" rules are followed, does the business income adjustment set forth at section 201(2)(e), which requires a taxpayer to add the loss or

subtract the income attributable to "another entity," apply to the income or loss of a disregarded limited liability company?
Generally, no. Although a limited liability company (LLC) is defined as a "person" under the MBTA, MCL 208.1113(3), if it is a single member LLC disregarded for federal tax purposes, it is similarly classified as a disregarded entity under the MBTA. MCL 208.1512(1). The owner of the LLC is the MBT taxpayer, and the disregarded entity is treated as a sole proprietorship, branch or division of its owner. Section 201(2)(e) requires the taxpayer to add back a loss or subtract income attributable to "another entity whose business activities are taxable under this section." MCL 208.1201(2)(e). A disregarded LLC's business activities would not be separately taxable under section 201; therefore, the section 201(2)(e) adjustment does not apply to an LLC that is a disregarded entity for federal tax purposes.

There are certain exceptions to the general default rule under MCL 208.1512(1) that a federally disregarded entity is similarly classified as a disregarded entity under the MBT. See *Notice to Taxpayers Regarding Federally Disregarded Entities and the Michigan Business Tax*, issued January 26, 2012, for details.

Credits

C1. Does the Michigan Business Tax Act contain a Renaissance Zone Credit?
The Michigan Business Tax Act (MBTA), at section 208.1433, provides a Renaissance Zone Credit that is equivalent to the Renaissance Zone Credit found in the Single Business Tax Act (SBTA) at section 208.39b. A taxpayer that is a business located and conducting business activity within a Renaissance Zone may claim the credit against the Michigan Business Tax (MBT) for the tax year. The credit allowed continues through the tax year in which the Renaissance Zone designation expires and is not refundable.

To obtain the credit an otherwise qualified taxpayer must file an MBT annual return. The credit is equal to the lesser of the following:

a. The tax liability attributable to business activity conducted within a Renaissance Zone in the tax year.
b. Ten percent (10%) of adjusted services performed in a designated Renaissance Zone.
c. For a taxpayer located and conducting business activity in a Renaissance Zone before December 31, 2002, the product of the following:
    i. The Single Business Tax (SBT) Renaissance Zone Credit claimed for the tax year ending in 2007.
    ii. The ratio of the taxpayer's payroll in this state in the tax year divided by the taxpayer's payroll in this state in its SBT tax year ending in 2007.
    iii. The ratio of the taxpayer's Renaissance Zone Business Activity Factor for the tax year divided by the taxpayer's Renaissance Zone Business Activity Factor for its SBT tax year ending in 2007.

The MBTA definitions of terms such as "adjusted services performed in a designated Renaissance Zone" and "Renaissance Zone Business Activity Factor" are repeated from the SBTA.

C2. How does a Professional Employer Organization, as defined by MCL 208.1113(4), determine compensation for the small business credit disqualifier in accordance with MCL 208.1417(8)?
Under MCL 208.1417 an entity is disqualified from taking the small business credit if more than $180,000 is paid to an officer, director, shareholder or other defined person. A PEO is disqualified

based on amounts paid to its own officers and employees. Individuals leased to a PEO's client are not considered for calculating the PEO's disqualifiers.

C3. How are the adjusted business income and compensation disqualifiers of the small business credit, found in MCL 208.1417, computed for PEOs and their clients?
MCL 208.1417(8) requires a client of a PEO to include compensation paid to the client's officers and employees leased to the client.

For the adjusted business income disqualifier, this means that the client adds compensation and director's fees paid for active shareholders and officers to business income as outlined in MCL 208.1417(9). If the client's adjusted business income exceeds $1.3 million, the client is disqualified from taking the small business credit under MCL 208.1417(1).

Likewise, for the compensation disqualifier, the client will consider all compensation, director's fees and distributive shares paid to its officers, owners and shareholders, even though leased from a PEO. Under MCL 208.1417(1)(a) and (b), the client will be disqualified from taking the small business credit if more than $180,000 in compensation is allocated or paid to these individuals.

While MCL 208.1417(8) directs clients of PEOs to consider all compensation of officers and employees; officers/shareholders/owners compensation and distributive shares are included for purposes of the disqualifiers.

Active Shareholder is defined in MCL 208.1417(9)(a) as receiving at least $10,000 in compensation, director's fees or dividends and owning at least 5% of outstanding stock or other ownership interest.

C4. Is a Professional Employer Organization, as defined by MCL 208.1113(4), entitled to the Compensation Credit of MCL 208.1403?
Yes, a PEO can take the credit for compensation that was paid to its own officers and employees, that is those individuals that actually operate the PEO entity.

However, MCL 208.1403(2) states that a PEO "shall not include payments by the professional employer organization to the officers and employees of a client ..." This means that a PEO cannot take the credit for compensation paid to officers of the operating entity nor for compensation paid to the employees leased by the PEO to the operating entity/client.

Thus, both a PEO and the operating entity it manages will take the credit to the extent permitted.

C5. (Answer rescinded, replacement located at C41) How is the alternate credit under MCL 208.1417 used by a unitary business group? How do the disqualifiers and percentage reducers work?

C6. (Answer rescinded, replacement located at C21) What is the compensation credit?

C7. Do Historic Rehabilitation and Brownfield credits, approved under the Single Business Tax Act, carryover and can they be used against Michigan Business Tax liability?
Yes. MCL 208.1435(8) and MCL 208.1437(18) provide that Historic Rehabilitation and Brownfield credits, respectively, issued under the SBTA and unused at the end of the last tax year under the SBTA "may be claimed against the tax imposed under [the MBTA] for the years the carryforward would have been available under [the SBTA]."

The SBTA provided a carryforward period of 10 years for each of these credits. Thus, a taxpayer or assignee with unused Historic Rehabilitation or Brownfield credit carryforwards at the close of the SBT may use and carryforward any unused portion of these credits for an uninterrupted period of 10 years.

The MBT also provides a 10 year carryforward period for Historic Rehabilitation and Brownfield credits approved in MBT years.

C8. Will Single Business Tax (SBT) credit carry forwards carry over to the Michigan Business Tax (MBT)?

Yes, with the exception of the Historical Preservation Credit and the Brownfield Credit, any unused SBT credit carry forward can be applied to MBT tax years 2008 and 2009. Any unused SBT carry forward remaining after 2009 is lost. MCL 208.1401. This carry forward provision applies to any unused SBT credit even if the SBT credit was not retained under the MBT and is subject to credit ordering.

The Historic Preservation Credit and Brownfield Credit carry forwards from the SBT may be claimed against the MBT for the remaining years the carry forward would have been available under the SBTA. MCL 208.1435(8) and 208.1437(18).

C9. How are existing SBT credits, or those awarded but not yet certified, handled under the MBT?

An unused carryforward from an SBT credit may be applied against the MBT liability for the 2008 and 2009 tax years only, unless specified separately. For the Michigan Historic Preservation and Brownfield Credits, an unused carryforward can be claimed against the tax imposed under the MBT for the same years the carryforward would have been available under the SBT.

For Brownfield credit purposes, the MBT allows a taxpayer that received a preapproval letter prior to January 1, 2008 under the SBTA to receive a certificate of completion and claim a credit against the tax imposed by the MBTA, provided that all other requirements are met. See MCL 208.1437. A similar provision for the Historic Preservation Credit allows a qualified taxpayer that has a rehabilitation plan certified before January 1, 2008 under the SBTA for the rehabilitation of an historic resource for which a certification of completed rehabilitation has been issued after 2007 to claim a credit against the tax imposed by the MBT. See MCL 208.1435.

Because the MBT provides for historic and brownfield credits for projects initiated prior to January 1, 2008, Public Act 240 of 2006 does not apply. PA 240 provided that a brownfield or historic rehabilitation project approved before 2007 and completed after that year could be claimed as a credit on an amended 2007 SBT return unless the credits may be claimed “for a tax year that begins after December 31, 2007 under any other tax act .”

C10. Who is considered an officer for purposes of the Small Business Alternative Credit under MCL 208.1417?

The Small Business Alternative Credit (similar to the SBT credit commonly known as the small business credit) is generally available to taxpayers with gross receipts that do not exceed $20,000,000.00 and an adjusted business income minus loss adjustment that does not exceed $1,300,000.00 – adjusted annually for inflation – subject to certain additional disqualifiers. MCL 208.1417(1).

One such disqualifier states that "a corporation other than a subchapter S corporation is disqualified if . . . compensation and directors' fees of a shareholder or officer exceed $180,000.00." MCL 208.1417(1)(b). If the compensation and directors' fees of an officer of a

corporation exceed $160,000 but are less than or equal to $180,000, then the taxpayer is not disqualified but must reduce the credit by a specified percentage.

Under the MBT, "officer" means "an officer of a corporation other than a subchapter S corporation, including all of the following: (a) [t]he chairperson of the board[;] (b) [t]he president, vice president, secretary, or treasurer of the corporation or board[;] or (c) [p]ersons performing similar duties to persons described in subdivisions (a) and (b)." MCL 208.1111(5). "Corporation" means "a taxpayer that is required or has elected to file as a corporation under the internal revenue code." MCL 208.1107(3).

In other words, corporations and entities – such as limited liability companies – that elect to be taxed as corporations for federal tax purposes have officers under the MBT. "Officers" include the chairperson of the board; the president, vice president, secretary, and treasurer of the corporation or board; and any employee, member, manager, partner, or other person performing duties similar to those of chairpersons, presidents, vice presidents, secretaries, and treasurers.

C11. (Answer rescinded, replacement located at C22) Is the farmland preservation credit available under the Michigan Business Tax?

C12. (Answer rescinded, replacement located at C27) Will the recapture limiting language of MCL 208.1403(3)(d)-(f) apply to both the Michigan Business Tax Investment Tax Credit (ITC) and ITC taken under the former Single Business Tax?

C13. MCL 208.38g(34) and 208.39c(16) of the SBT permit taxpayers with pre-approval letters issued – or rehabilitation plans certified – prior to 2007 for projects completed after the taxpayer's last tax year under the SBT but prior to 2010 to claim a certain portion of the credit amount that would have been available in 2008 and 2009 had the SBT not been repealed on the taxpayer's amended 2007 SBT return. Are these provisions superseded by the MBT?

Yes. MCL 208.38g(34) and 208.39c(16) of the SBT also state that the provisions allowing 2008 and 2009 credits to be claimed on the taxpayer's amended 2007 SBT return *do not apply* if credits for tax years beginning after December 31, 2007, for the same project are provided for under a new tax act. MCL 208.38g(34)(f) and 208.39c(16)(e). Under the MBT, a taxpayer with a certified rehabilitation plan or pre-approval letter is expressly authorized to claim a credit for the corresponding brownfield project or rehabilitation plan for tax years beginning after December 31, 2007. MCL 208.1435 and 208.1437. Thus, the MBT supersedes MCL 208.38g(34) and 208.39c(16).

C14. Under the MBTA, is the section 281 surcharge imposed before or after available credits are applied? Does the surcharge apply to both the modified gross receipts tax and the business income tax? Can the alternative small business credit eliminate liability for the surcharge?

Section 281(1) of the MBTA provides as follows:

(1) In addition to the taxes imposed and levied under the act …, to meet deficiencies in state funds an annual surcharge is imposed and levied on each taxpayer equal to the following percentage of the taxpayer's tax liability under this act after allocation or apportionment to this state under this act but before calculation of the various credits available under this act:

(a) For each taxpayer other than a person subject to the tax imposed and levied under chapter 2B, 21.99%.

MCL § 208.1281(1). Thus, the surcharge is imposed on each taxpayer subject to the MBT *after* allocation or apportionment under section 301, but *prior to* the calculation and application of any available credits, including SBT credits carried forward by the taxpayer. Section 281(5) provides that the surcharge "shall constitute a part of the tax imposed under this act and shall be administered, collected, and enforced as provided under this act." MCL § 208.1281(5).

Under the statutory language quoted above, the surcharge is imposed upon "the taxpayer's tax liability under this act." MCL § 208.1281(1). Subject to filing thresholds, nexus standards, and exemptions, both the modified gross receipts tax and the business income tax are components of a taxpayer's MBT liability. Accordingly, the surcharge applies to both the modified gross receipts tax and the business income tax.

The various credits available under the MBT can be utilized to mitigate a taxpayer's tax liability only to the extent specified in the statute. With respect to the small business alternative credit, section 417(1) provides that this credit is to be taken *after* the credits provided for in sections 403 and 405. MCL § 208.1417(1). The combined compensation and investment tax credits allowed under section 403 may not exceed 50% of the taxpayer's total MBT liability in tax year 2008 and 52% of the taxpayer's total MBT liability in tax years 2009 and beyond, while the research and development credit allowed under section 405, combined with the taxpayer's total section 403 credits, cannot exceed 65% of the taxpayer's total tax liability under the MBT. MCL §§ 208.1403(1); 208.1405.

If the taxpayer is then eligible for and calculates the section 417 small business alternative credit, the amount of the credit "shall not exceed 100% of the tax liability imposed under this act." MCL § 208.1417(5). Since the surcharge (which constitutes a part of the taxpayer's tax liability imposed under the act) is imposed *prior to* the calculation of any credits, including the section 417 small business alternative credit, it is possible that the application of that credit could totally eliminate the taxpayer's tax liability for that tax year, including the amount of that liability that is attributable to the surcharge.

C15. Is the Arts and Culture credit available for donations made to science museums?
MCL 208.1422 provides a credit for a taxpayer that makes charitable contributions of at least $50,000 during the tax year to either

(a) A municipality or a nonprofit corporation affiliated with a municipality and an art, historical, or zoological institute for the purpose of benefiting the art, historical, or zoological institute

Or

(b) An institution devoted to the procurement, care, study, and display of objects of lasting interest or value.

The first of these two categories delineates art, historical or zoological institutes as acceptable donees. This narrow list does not include science museums. The language of the second category creates a facts and circumstances test for other types of Michigan museums.

Science museums generally focus on discovery and interactive activities. However, if under the facts and circumstances, it is demonstrated that a science museum is "devoted to the procurement, care, study, and display of objects of lasting interest or value" the museum will qualify for the credit.

C16. (This FAQ has been amended due to 2011 PA 305.) What types of expenses qualify for the MBT's "research and development" credit?

MCL 208.1405 provides a credit against the MBT equal to 1.90% of a taxpayers "research and development expenses" for the 2009 tax year and each tax year after 2009. The credit is for 1.52% of research and development expenses for the 2008 tax year. The credit combined with credits under section 403 (Compensation Credit and Investment Tax Credit) cannot exceed 65% of a taxpayer's tax liability before the surcharge under section 281. Research and development expenses are "qualified research expenses" as that term is defined in Internal Revenue Code Section 41(b). "Qualified research expenses" is defined in IRC 41(b) as "the sum of … in-house research expenses and contract research expenses." In house research expenses are defined, in pertinent part, as: i) any wages paid or incurred to an employee for qualified services performed by such employee; ii) any amount paid or incurred for supplies used in the conduct of qualified research; and iii) under regulations prescribed by the Secretary, any amount paid or incurred to another person for the right to use computers in the conduct of qualified research. IRC 41(b)(2)(A).

Contract research expenses are "65 percent of any amount paid or incurred by the taxpayer to any person (other than an employee of the taxpayer) for qualified research." IRC 41(b)(3)(A).

The MBT credit is available for a percentage of the sum of these expenses.

C17. Is there a filing threshold phase-in for the Michigan Business Tax?
Yes. MCL 208.1411 provides that a taxpayer with allocated or apportioned gross receipts to Michigan of more than $350,000 but less than $700,000 may claim a credit against the taxpayer's liability after application of the alternate credit found at MCL 208.1417. The phase-in credit is a fraction "the numerator of which is the difference between the person's allocated or apportioned gross receipts and $700,000.00 and the denominator of which is $350,000.00."

For example, if a taxpayer has allocated gross receipts of $500,000 and a liability (after application of Sec 417) of $10,000, the taxpayer would multiply $10,000 by the fraction $200,000/$350,000 (or 57%) and receive a credit of $5,700, reducing the taxpayer's liability to $4,300.

The phase-in credit declines linearly as gross receipts increase, thereby avoiding an all-or nothing "cliff effect."

C18. Does Schedule C (sole proprietor) income of over $180,000.00 preclude the taxpayer from using the Small Business Alternative Credit?
Yes. Section 417 of the Michigan Business Tax Act (MBTA) provides the alternate credit. MCL 208.1417. Section 417 instructs that the Small Business Alternate Credit is available to any taxpayer with gross receipts that do not exceed $20 million and with adjusted business income minus the loss adjustment that does not exceed $1.3 million (adjusted annually for inflation).

Regarding disqualifiers, section 417 expressly directs that, "An individual . . . is disqualified [credit] if the individual . . . receives more than $180,000.00 as a distributive share of the adjusted business income minus the loss adjustment of the individual . . . ."

Note: the distributive share disqualifier has been raised from $115,000.00 in the SBT's comparable Small Business Credit to $180,000.00 in the MBT's Small Business Alternative Credit.

C19. How will unused carryforward credits under the Single Business Tax Act (SBTA), the application of which is limited to tax years 2008 and 2009 under the Michigan Business Tax Act (MBTA), be treated for fiscal year taxpayers?

Section 401 of the MBTA provides that except as specifically provided for in the MBTA, any unused carryforward of any credit under the SBTA may be applied against MBT tax liability only for the tax years 2008 and 2009, and any unused carryforward after 2009 is extinguished. MCL 208.1401. The MBTA defines "tax year", in pertinent part, as the calendar year, or the fiscal year ending during the calendar year, upon the basis of which the tax base of a taxpayer is computed under this act. If a return is made for a fractional part of a year, tax year means the period for which the return is made. Except for the first return required by this act, a taxpayer's tax year is for the same period as is covered by its federal income tax return. MCL 208.1117(4).

Thus, for a fiscal year taxpayer, the MBT 2008 tax year runs from January 1, 2008 to the end of the month in calendar year 2008 that constitutes the end of the taxpayer's fiscal year. The taxpayer's 2009 tax year is the taxpayer's 12-month fiscal year ending during calendar year 2009.

Therefore, for a taxpayer who files pursuant to a fiscal year, the unused carryforward of any SBT credit applies against the taxpayer's MBT tax liability for the tax year running from January 1, 2008 to the end of the month in calendar year 2008 that ends the taxpayer's fiscal year. Any remaining unused SBT carryforward credit would be applied to the taxpayer's MBT tax liability for the taxpayer's 12-month fiscal year ending during calendar year 2009. Any still remaining unused SBT carryforward credit beyond the end of the taxpayer's 12-month fiscal year ending during calendar year 2009 would be extinguished.

Example: A taxpayer has a 12-month fiscal year that begins October 1st and ends September 30th. The taxpayer files a short period SBT final return for the period from October 1, 2007 through December 31, 2007, with the taxpayer retaining an unused SBT carryforward credit in the amount of $1,000.00, after determining the final SBT tax liability. The taxpayer's 2008 tax year, its first under the MBTA, runs from January 1, 2008 through September 30, 2008. The taxpayer has an MBT tax liability of $500.00 before application of the unused SBT carryforward credit. Applying the $1,000.00 unused SBT carryforward credit against the $500.00 MBT tax liability results in a remaining unused SBT carryforward credit of $500.00.

For the 2009 tax year, which runs from October 1, 2008 through September 30, 2009, the taxpayer has an MBT tax liability of $400.00, before application of the unused SBT credit carried forward from the 2008 MBT year. Applying the $500.00 remaining unused SBT carryforward credit against the taxpayer's $400.00 MBT tax liability results in a residual unused SBT carryforward credit of $100.00. Under MCL 208.1401, the remaining $100.00 of unused SBT carryforward credit would be extinguished.

C20. How is stock ownership determined with respect to Small Business Alternate Credit disqualifiers? Will the attribution rules used for the SBT and found in IRC section 318 apply when computing the active shareholder rules under the MBT?

The Small Business Alternate Credit operates similarly to the Small Business Credit that was provided for under the Single Business Tax Act. The Small Business Alternate Credit is available to entities that meet certain statutory criteria.

One of these criteria is that the entity must include in adjusted business income the compensation, dividends and director fees of "active shareholders." An "active shareholder" is a shareholder who receives, in any combination, at least $10,000 in compensation, directors' fees, or dividends from the business, and who owns at least 5% of the outstanding stock or other ownership interest. MCL 208.1417(9)(a). A "shareholder" is a person who owns outstanding stock in a business or is a member of a business entity that files as a corporation for federal income tax purposes. An individual is considered as the owner of the stock owned, directly or

indirectly, by or for family members as defined by section 318(a)(1) of the Internal Revenue Code. MCL 208.1115(2).

The MBT definitions of “active shareholder” and “shareholder” are essentially similar to the definitions under the SBTA. Therefore, the attribution rules for stock ownership and for determining “active shareholders” will be applied to the Small Business Alternative Credit in a similar manner as they were under the SBTA.

C21. What is the compensation credit?
MCL 208.1403 provides a credit at the rate of .296% of a taxpayer’s compensation in Michigan for the 2008 tax year. For the 2009 tax year and beyond, the rate is increased to .370% of Michigan compensation. The compensation credit cannot exceed 50% of the taxpayer’s liability imposed under the MBT for the 2008 tax year. For the 2009 tax year and beyond, the credit cannot exceed 52% of liability.

C22. Is the farmland preservation credit available under the Michigan Business Tax?
Yes. 2007 PA 174 amends MCL 324.36109(2) to allow the Farmland Preservation credit against the MBT. Under Section 36109, qualifying taxpayers may claim a credit for the amount by which the property taxes on qualifying farmland exceed 3.5% of the business income tax base of the MBT, plus compensation to shareholders not included in the business income tax base, excluding certain listed deductions.

C23. How were the rates of the Compensation Credit, the Investment Tax Credit, and the Research and Development Credit impacted by the passage of PA 145, which added the surcharge to the MBT?
Although the primary purpose of PA 145, which became effective on December 1, 2007, was to institute a surcharge to replace the revenue from the repealed service tax, PA 145 made a number of additional changes to the MBT, including changes to the Compensation Credit, the Investment Tax Credit, and the Research and Development Credit.

The rate of the Compensation Credit was reduced from 0.370% to 0.296% for the 2008 tax year. The rate will return to 0.370% for the 2009 tax year and beyond. MCL 208.1403(2). The rate of the Investment Tax Credit was reduced from 2.90% to 2.32% for the 2008 tax year. The rate will return to 2.90% for the 2009 tax year and beyond. MCL 208.1403(3). Finally, PA 145 reduced the rate of the Research and Development Credit from 1.90% to 1.52% for the 2008 tax year. The rate will return to 1.90% for the 2009 tax year and beyond. MCL 208.1405.

PA 145 also reduced the cap on the combined Compensation Credit and Investment Tax Credit for taxpayers other than insurance companies from 65% of the taxpayer's MBT liability to 50% of the taxpayer's MBT liability before the imposition of the surcharge for the 2008 tax year, and to 52% for the 2009 tax year and beyond. MCL 208.1403(1). For insurance companies, the Compensation Credit remains capped at 65% of the taxpayer's liability for all tax years. MCL 208.1239(2).

Finally, the cap on the combined Compensation Credit, Investment Tax Credit, and Research and Development Credit was reduced from 75% of the taxpayer's MBT liability to 65% of the taxpayer's MBT liability before the imposition of the surcharge. MCL 208.1405.

C24. Can a pre-2008 Brownfield credit or Historic Preservation credit of a unitary business group member be used in 2008 and thereafter against the tax liability of the entire unitary business group?
Yes. To the extent that a qualified taxpayer under the Brownfield credit or Historic Preservation credit provisions is included within a unitary business group taxpayer for relevant tax years, the

qualified taxpayer's unused pre-2008 Brownfield credit and/or Historic Preservation credit (i.e. such credits earned under the SBT) may be applied against the tax liability imposed on the entire unitary business group taxpayer (of which the qualified taxpayer is a member) for the tax years the carryforward would have been available under the SBT. See MCL 208.1435(8) and 208.1437(18).

C25. Regarding the industrial personal property tax credit under the MBT, will the Department continue to look to the parcel classification assigned by the local property tax assessor for qualification for the credit, as it has done under the SBT?
Yes**.** The Department in administering the industrial personal property tax credit will continue to recognize that the General Property Tax Act places sole authority to ascertain and classify taxable property in an assessing district in the hands of the local assessor. MCL 211.19 and 211.34c(1).

C26. The MBT Act provides the following credits will be taken sequentially before any other credits: compensation and investment credits (MCL §208.1403), research and development credit (MCL §208.1405), alternate/small business credit (MCL §208.1417), tax phase-in credit (MCL §208.1411). In what order are the other MBT credits claimed? For taxpayers other than Insurance Companies, the MBT credits must be claimed in the following order:

Nonrefundable Credits

Sec. 401 – *Unused Carry forwards from SBT*
Sec. 403(2) - *Compensation Credit*
Sec. 403(3) - *Investment Tax Credit*
Sec. 405 - *Research and Development Credit*
Sec. 417 – *Small Business Alternate Tax Credit*
Sec. 411 – *Gross Receipts Filing Threshold Credit*
Sec. 425 - *Community or Education Foundation Credit*
Sec. 427 - *Homeless Shelter/Food Bank Credit*
Sec. 409(1) - *NASCAR Speedway Credit*
Sec. 410 - *Stadium Credit*
Sec. 415 - *Start-Up Business Credit*
Sec. 421 - *Public Contribution Credit*
Sec. 422 - *Arts and Culture Credit*
Sec. 429 - *Next Energy Business Activity Credits*
Sec. 433 – *Renaissance Zone Credit*
Sec. 435 –*Historic Preservation Credit*
Sec. 439 – *Low Grade Hematite Credit*
Sec. 441 –*Entrepreneurial Credit*
Sec. 445 - *New Dealer Motor Vehicle Inventory Credit*
Sec. 447 - *Large Food Retailer Credit*
Sec. 449 – *Mid Size Food Retailer Credit*
Sec. 451 – *Bottle Deposit Administration Credit*
Sec. 437 – *Brownfield Rehabilitation Credit*
Sec. 453 – *Private Equity Fund Credit*

Refundable Credits

Sec. 407 - *MEGA Research and Development Credit* Sec. 413 - *Personal Property Tax Credits*
Sec. 423 - *Worker's Disability Supplemental Benefit Credit*

Sec. 429 - *Next Energy Payroll Credit*
Sec. 431 – *MEGA Employment Tax Credit*
Sec. 409(2) – *NASCAR Safety Credit*
Sec. 450 – *Hybrid Technology Research and Development Credit*

The placement of any future credits enacted will be based on the ordering prescribed by statute. Absent specific language, or in the case of conflicting language, the date of enactment will determine when a credit is taken, nonrefundable credits first and refundable credits next, and the language contained within the most recently enacted section will control.

Credits available for Insurance Companies and the order they are claimed:

Nonrefundable Credits

Sec. 237 – *Insurance Company Premiums Tax Credits*
(a) Amounts paid to the Michigan worker's compensation placement facility
(b) Amounts paid to the Michigan basic property insurance association
(c) Amounts paid to the Michigan automobile insurance placement facility
(d) Amounts paid to the property and casualty guaranty association
(e) Amounts paid to the Michigan life and health guaranty association
Sec. 239 – *Insurance Company Premiums Tax Credits 50% examination fees*
Sec. 401 – *Unused Carry forwards from SBT*
Sec. 239/403(2) – *Insurance Company Compensation Credit*
Sec. 433 – *Renaissance Zone Credit* Sec. 435 – *Historic Preservation Credit*
Sec. 437 – *Brownfield Rehabilitation Credit*

Refundable Credits

Sec. 241 – *Worker's Disability Supplemental Benefit Credit*
Sec. 431 – *MEGA Employment Tax Credit*

Credits available for Financial Organizations and the order they are claimed:

Nonrefundable Credits

Sec. 401 – *Unused Carry forwards from SBT*
Sec. 403(2) –*Compensation Credit*
Sec. 433 – *Renaissance Zone Credit* Sec. 435 –*Historic Preservation Credit*
Sec. 437 – *Brownfield Rehabilitation Credit*

Refundable Credits

Sec. 431 – *MEGA Employment Tax Credit*

C27. MCL §208.1403(3)(d)-(f) provides for investment credit recapture. The recapture language includes the limiters "to the extent used and at the rate used." Does this limiting language only apply to assets acquired during SBT tax years? Also, does the Department

deem the investment credit for assets acquired in the same year to be claimed on a FIFO, pro-rata, or other method?

The Department interprets the limiting phrase “to the extent the credit is used and at the rate at which the credit was used” to apply only to disposal of assets that were acquired under the SBTA, former 1975 PA 228. Available SBT ITC is “used” and is used “at the rate” that was in effect under the SBTA on a FIFO basis. For recapture purposes, SBT ITC carry-forwards are deemed to have been “used” first, before MBT ITC, when computing the “amount used.” The Department anticipates developing guidance to assist in the computation of ITC recapture of assets that were acquired under the SBTA.

ITC recapture of MBT assets acquired after December 31, 2007 is not limited by the language “to the extent the credit is used and at the rate at which the credit was used.” Therefore, the recapture of ITC upon disposal of assets acquired under the MBT is not dependant on whether the compensation or investment credit is capped. This MBT interpretation for assets acquired under the MBT reverses an interpretation previously given in FAQ #C12.

C28. (Answer rescinded, replaced by C57) Under MCL 208.1403(2), a taxpayer may claim a credit against the MBT equal to a specified percentage of the taxpayer's "compensation in this state." What is the definition of "compensation in this state"?

C29. How is the Small Business Alternative Credit under MCL 208.1417 calculated by a taxpayer that is a unitary business group? How do the disqualifiers and percentage reducers work?

The Small Business Alternative Credit "is available to any *taxpayer* with gross receipts that do not exceed $20,000,000.00 and with adjusted business income minus the loss adjustment that does not exceed $1,300,000.00 as adjusted annually for inflation using the Detroit consumer price index" and subject to certain additional disqualifiers. MCL 208.1417(1) (emphasis added). Specifically, if gross receipts exceed $19,000,000, the credit is reduced

"Taxpayer" is defined as "a person or a unitary business group." MCL 208.1117(5). The gross receipts and adjusted business income thresholds under MCL 207.1417(1) apply to taxpayers. Thus, for a taxpayer that is a unitary business group, the gross receipts and adjusted business income thresholds are those of the unitary business group.

The disqualifiers under MCL 208.1417(1)(a) and (b) apply to a taxpayer that is a unitary business group if such disqualifiers apply to any member of that unitary business group. For example, a taxpayer that is a unitary business group is disqualified from taking the Credit under MCL 208.1417 if that unitary business group includes a member that is a partnership and any one partner of that partnership receives more than $180,000.00 as a distributive share of the adjusted business income minus loss adjustment of the partnership.

Similarly, the reduction percentages under MCL 208.1417(1)(c) apply to a taxpayer that is a unitary business group if such reduction percentages apply to any member of that unitary business group. For example, the Small Business Alternative Credit of a taxpayer is reduced by 20% if the taxpayer is a unitary business group that includes a member that is a corporation and the compensation and directors' fees of an officer of that member corporation exceed $160,000.00 but are less than $165,000.00.

C30. How do foreign persons with no U.S. federal taxable income calculate adjusted business income for purposes of the Small Business Alternative Credit under MCL 208.1417?

When calculating adjusted business income for purposes of the Small Business Alternative Credit, a foreign person with no U.S. federal taxable income includes only compensation and directors' fees under MCL 208.1417(9)(b).

C31. My company intends to purchase a significant piece of business equipment in the near future. This equipment is the type of property that is or will become eligible for depreciation for federal tax purposes. Under the MBT, can my company deduct the cost of this equipment in the year of purchase when calculating its modified gross receipts tax base, and also qualify for the investment tax credit, which is applied against final MBT liability?

Yes. In calculating its modified gross receipts tax base, a taxpayer determines the amount of its gross receipts for the tax year and then subtracts any "purchases from other firms" before apportioning the result. MCL 208.1203(3). Pursuant to MCL 208.1113(6), "purchases from other firms" includes "[a]ssets, including the cost of fabrication and installation, acquired during the tax year of a type that are, or under the internal revenue code will become, eligible for depreciation, amortization, or accelerated capital cost recovery for federal income tax purposes." A purchase of depreciable business equipment as described above meets this definition and the total cost of the equipment, including the cost of fabrication and installation, would therefore be subtracted from the taxpayer's gross receipts as a "purchase from other firms."

The investment tax credit (ITC) set forth in MCL 208.1403(3) is a separately calculated credit that incentivizes capital investment in property. Subject to the combined credit limitation in MCL 208.1403(1), for the 2008 tax year, the ITC is equal to 2.32% of the net calculation of the cost, including fabrication and installation, paid or accrued in the taxable year of depreciable tangible assets that are physically located in Michigan, less any recapture of ITC on assets that have been disposed of. The credit rate increases to 2.9% of the net calculation for tax years 2009 and after. MCL 208.1403(3). The ITC is applied against a taxpayer's total MBT liability (which includes the modified gross receipts tax, the business income tax, and the surcharge), subject to the combined credit limitation in MCL 208.1403(1). Nothing in the MBTA prohibits a taxpayer from deducting the cost, in the year of purchase, of an asset that qualifies as a "purchase from other firms" when calculating its modified gross receipts tax base, and then subsequently utilizing the same asset purchase to qualify for the ITC, a credit that is applied against total MBT liability. However, taxpayers should be aware that the MBT requires recapture of ITC when a sale, exchange, or other disposition of a qualifying asset, including the removal of the asset from the state, occurs.

C32. What expense items are included in compensation for purposes of the compensation credit provided for at MCL 208.1403(2)? What accounting method is used to determine compensation?

For the 2008 tax year, MCL 208.1403 provides a compensation credit equal to .296% of a taxpayer's Michigan compensation. For the 2009 tax year and beyond, the rate is increased to .370% of Michigan compensation. The compensation credit cannot exceed 50% of the taxpayer's liability imposed under the MBT before the imposition and levy of the surcharge under section 281 for the 2008 tax year. For the 2009 tax year and beyond, the credit cannot exceed 52% of liability before the imposition and levy of the surcharge.

Compensation payments made in the tax year on behalf of or for the benefit of employees, officers or directors is defined at MCL 208.1107(2). Generally, under this definition, compensation includes, but is not limited to, payments that are subject to or specifically exempt or excepted from withholding under sections 3401 to 3406 of the Internal Revenue Code including any earnings that are net earnings from self-employment as defined under section 1402 of the Internal Revenue Code. Similar to the SBT, wages, salaries, fees, bonuses, commissions,

and other payments made in the tax year on behalf of or for the benefit of employees, officers or directors as well as self-employment earnings must be reported on a cash basis.

Compensation includes expenses such as payroll taxes (exclusive of payments for state and federal unemployment compensation and federal insurance contributions) and all other fringe benefits made for the benefit of employees. Payments made to a pension plan, retirement or profit sharing plan, employee insurance plans and payments under health and welfare benefit plans as well as the administration fees paid for the administration of the health and welfare benefit plan are compensation. Compensation also includes certain payments made by licensed taxpayers that are statutorily identified. These compensation payments are calculated on a cash or accrual basis consistent with the taxpayer's method of accounting for federal income taxes. The statute provides for certain exclusions from compensation including employee discounts on merchandise and services purchased as well as payments made to independent contractors.

Expense incurred for the benefit of the taxpayer rather than for the benefit of employees of the taxpayer is not compensation. Non compensation expenses might include payments reported on a 1099 to an employee for the rental of a building or for interest income. Compensation computed using the methods described above will be used in computing the compensation credit.

C33. How are gross receipts computed on an installment sale of a capital asset? Is the realized installment sale gain included in the two tax bases? How is the investment tax credit (ITC) affected?

When calculating gross receipts and the tax bases under the MBT, taxpayers should consistently use the accounting method used in computing federal income taxes. Annual federal installment sale gain is realized by computing a gross profit rate on the sale and then applying that rate to the payments received in the year. The annual installment payments received on the sale of the capital asset and the gain realized for federal income taxes should be used in calculating the MBT gross receipts for that year.

Under the MBT, "gross receipts" are defined as the entire amount received by the taxpayer from any activity whether in intrastate, interstate, or foreign commerce carried on for direct or indirect gain, benefit, or advantage to the taxpayer or to others. MCL 208.1111(1) Excepted from the definition of gross receipts are the proceeds less any gain related to the disposition of a trade or business capital asset. Subsection (o) provides:

Proceeds from a sale, transaction, exchange, involuntary conversion, or other disposition of tangible, intangible, or real property that is a capital asset as defined in section 1221(a) of the internal revenue code or land that qualifies as property used in the trade or business as defined in section 1231(b) of the internal revenue code, less any gain from the disposition to the extent that gain is included in federal taxable income. MCL 208.111(1)(o).

The installment sale method prorates gain and recognizes it over the years in which payments are received. For federal income tax purposes, the installment method may only be used for nondealer sales of property other than inventory. Generally, dealers in real or personal property may not use the installment method to report gain. A "dealer disposition" includes, with some exceptions, any disposition of personal property by a person who regularly sells or otherwise disposes of such property on an installment plan and any disposition of real property which is held for sale to customers in the ordinary course of the taxpayer's business.

There are no other gross receipts exceptions under the MBT for gains received on sales of property other than capital assets. Nor are there any other exceptions that are computed using gains realized from transactions that are not from the sale of capital assets. Therefore, any

amount received that is attributed to installment sales and the gains that are realized in subsequent years are included in MBT gross receipts.

To the extent the installment sale gain is derived from the business activity of the taxpayer and included in federal taxable income it must also be included in the business income tax base. The gain realized in any tax year from the installment sale is included in both the business income and modified gross receipts tax base.

The MBT requires recapture of ITC when a sale, exchange, or other disposition of a qualifying asset, including the removal of the asset from the state, occurs. Similar to the SBT, a sale of qualifying property reported on the installment method for federal income tax purposes causes the recapture of the entire gross proceeds in the year of the sale, less any gain reported in federal taxable income in that year. Gain attributed to the installment sale that is realized in the seller's federal taxable income in subsequent years is subtracted in computing any ITC claimed against the MBT in those subsequent years.

The purchaser of a qualifying asset on an installment sale may claim ITC against total MBT liability using the entire amount paid or accrued in the taxable year pursuant to MCL 208.1403(3). Nothing in the MBTA prohibits a taxpayer from deducting the cost, in the year of purchase, of an asset that qualifies as a "purchase from other firms" when calculating its modified gross receipts tax base, and then subsequently utilizing the same asset purchase to qualify for the ITC.

C34. What kinds of expenses qualify for the MBT credit under MCL 208.1451 that applies to beverage distributors who originate deposits on beverage containers?

The Bottle Deposit Administration Credit was added to the MBT as part of 2007 PA 145. Section 451 provides that a distributor or manufacturer who originates a deposit on a beverage container in accordance with Michigan's Bottle Bill, MCL 445.571 to 445.576, may claim a credit against its MBT liability equal to (a) 30.5% of the taxpayer's expenses incurred during the tax year to comply with the Bottle Bill, if the section 281 surcharge is imposed in the same year, or (b) 25% of such expenses if the surcharge is not imposed in the same year. MCL 208.1451(1)(a) and (1)(b). If the amount of the allowed credit exceeds the taxpayer's tax liability for the tax year, the excess is not refunded and may not be carried forward as an offset against the taxpayer's tax liability in future years. MCL 208.1451(2).

Section 451 does not define "expenses" or specify the types of expenses that qualify for the credit. In order to comply with the Bottle Bill, distributors who originate deposits on beverage containers (meaning that they charge the deposit to their retailer customers) typically pick up empty beverage containers from retailers (usually at the same time that they distribute new product), process the returned containers as required, and sell the materials into the recycling market. Distributors also have reporting and payment obligations with respect to unclaimed bottle deposits. MCL 445.573a; 445.573b. Thus, distributors may incur expenses related to receiving and sorting empty containers, storing containers, cleaning or crushing containers, and recordkeeping. A distributor's compliance-related expenses will vary depending on whether the retailers it collects from use reverse vending machines. Reverse vending machines crush or shred the returned containers, eliminating or reducing the need (and cost) for distributors to collect and process the material recovered.

In order to qualify for the Bottle Deposit Administration Credit, expenses must be ordinary, necessary, and directly related to the taxpayer's compliance with the Bottle Bill. "Ordinary" means that another manufacturer or distributor who originates deposits would likely incur a similar expense in complying with the Bottle Bill. "Necessary" means that the expense is one the taxpayer would not have incurred absent the necessity of complying with the Bottle Bill. "Directly related" means that the main purpose of the qualifying expenditure was compliance with the

requirements of the Bottle Bill. For example, a can-crushing machine purchased in order to process the empty deposit beverage containers picked up from retailers would probably qualify for the credit in the year of purchase. A printer purchased for general office use, and which is also used to occasionally print reports related to bottle deposits, would not qualify.

Taxpayers claiming the Bottle Deposit Administration Credit must maintain adequate documentation, through business books and records, supporting all expenses for which the credit is claimed.

C35. If two shareholders of a C corporation ("X Corp") are themselves C corporations (Y Corp and Z Corp) and one of Y Corp's shareholders is paid a management fee for managing the business of X Corp, does the management fee factor into the disqualifiers for the Small Business Alternative Credit under MCL 208.1417?

No, a management fee paid by X Corp to a Y Corp shareholder would not be considered compensation or directors' fee of an X Corp shareholder in determining disqualification under MCL 208.1417(1)(b). A Y Corp shareholder providing management services to X Corp for a fee is an inter-corporate transaction whereby the fees paid are revenues for the performance of services as opposed to "compensation" under MCL 208.1417(1)(b). Compensation is defined generally to mean all wages, salaries, fees, bonuses, commissions, and other payments made in the tax year for the benefit of the taxpayer's employees, officers, and directors. MCL 208.1107(2). Thus, compensation implies an employment relationship. A C corporation providing management services to another C corporation is not an employment relationship, but is rather the provision of services by one corporation to another. Therefore, the management fee Y Corp shareholder receives from X Corp is not included in the determination of the compensation ceiling disqualifier for the Small Business Alternative Credit for X Corp.

The Small Business Alternative Credit "is available to any taxpayer with gross receipts that do not exceed $20,000,000.00 and with adjusted business income minus the loss adjustment that does not exceed $1,300,000.00 as adjusted annually for inflation using the Detroit consumer price index" and subject to certain disqualifiers. MCL 208.1417(1). One such disqualifier is that a corporation other than a subchapter S corporation is disqualified from receiving the credit if either of the following occur for the respective tax year: (1) compensation and directors' fees of a shareholder or officer of the corporation exceed $180,000 or (2) the sum of (a) compensation and directors' fees of a shareholder and (b) the product of the shareholder's ownership percentage multiplied by the difference between the sum of business income and, to the extent deducted in determining federal taxable income, a carryback or carryforward of a net operating loss or capital loss, minus the loss adjustment, exceeds $180,000. MCL 208.1417(1)(b). Since a management fee paid by X Corp to the Y Corp shareholder is not compensation, it would not be includable in the credit disqualifier compensation ceiling of $180,000 for X Corp.

It should be noted, however, that the management fee paid to the Y Corp shareholder could disqualify Y Corp for the credit if the amount of the management fee caused the corporation's gross receipts to exceed $20,000,000.00 or its adjusted business income minus the loss adjustment to exceed $1,300,000.00.

It also should be noted that the disqualifiers under MCL 208.1417(1)(a) and (b) apply to a taxpayer that is a unitary business group if such disqualifiers apply to any member of that unitary business group. In the example posed, it is not clear whether X Corp and Y Corp and Z Corp meet the control test and relationship test under MCL 208.1117(6) so as to constitute a unitary business group. However, if the X Corp and the two corporations do satisfy the control test and relationship test and thus constitute a unitary business group under MCL 208.1117(6), then compensation or directors' fees of an officer of any of the member corporations exceeding $180,000 for the tax year would disqualify the unitary business group from receiving the credit.

C36. Can a taxpayer use data from its SBT tax periods in calculating the loss adjustment for purposes of determining eligibility for the Alternative Small Business Credit under MCL 208.1417?
Yes, the Department will allow the use of a "loss adjustment" from a period prior to the start of the MBT for purposes of determining qualification for the Alternative Small Business Credit under MCL 208.1417. In computing eligibility for the Alternative Small Business Credit, the MBTA defines "loss adjustment" to mean, in pertinent part, "the amount by which adjusted business income was less than zero in <u>any</u> of the 5 tax years immediately preceding the tax year for which eligibility for the credit under this section is being determined." MCL 208.1417(9)(d) [Emphasis added]. Therefore, a taxpayer may utilize data for the respective tax years under the SBT to calculate eligibility for the Alternative Small Business Credit for MBT tax year 2008 through 2012.

C37. What is the proper treatment for an SBT carryforward credit which has only one year of carryforward remaining under the SBT dictated lifespan? Does MCL 208.1401 extend the life of the credit, or is it limited by the original SBT term?
An SBT carryforward with one year of carryforward remaining on the expiration of the SBT may be carryforward for one year under the MBT. MCL 208.1401 does not extend the life of the credit past its original SBT term.

C38. Do dividends that represent distribution of previously taxed S corporation earnings qualify as dividends for purposes of determining an "active shareholder"?
Yes, the MBT definitions of "active shareholder" and "shareholder" are essentially similar to the definitions under the SBTA. An "active shareholder" is a shareholder who receives, in any combination, at least $10,000 in compensation, director's fees, or dividends from the business, and who owns at least 5% of the outstanding stock or other ownership interest. MCL 208.1417(9)(a). A "shareholder" is a person who owns outstanding stock in a business or is a member of a business entity that files as a corporation for federal income tax purposes. An individual is considered as the owner of the stock owned, directly or indirectly, by or for family members as defined by section 318(a)(1) of the Internal Revenue Code. MCL 208.1115(2).

Whether a dividend received by a shareholder represents previously taxed S corporation earnings is irrelevant to the determination of whether a shareholder meets the definition of "active shareholder." The statutory definition merely requires that the shareholder receive compensation, director's fees, or dividends from the business.

C39. For purposes of the private equity fund credit under MCL 208.1453, if a private equity fund manager is an entity that is a member of a unitary business group, does the calculated credit percentage apply to the tax liability of the entire unitary business group, or the separate tax liability of the fund?
The credit is based on the tax liability of the private equity fund. If the unitary business group is comprised of members other than private equity funds, a pro forma may be used to calculate the tax liability of the private equity fund for purposes of determining the amount of the credit. The resulting credit is applied to the tax liability of the unitary business group.

C40. Is compensation under the MBT reported on a cash or accrual basis?
It depends on the compensation. "[W]ages, salaries, fees, bonuses, commissions, other payments made . . . on behalf of or for the benefit of employees, officers, or directors of the taxpayers, . . . any earnings that are net earnings from self-employment as defined under section 1402 of the internal revenue code of the taxpayer or a partner or limited liability company member of the taxpayer[, including, but not limited to,] payments that are subject to or specifically exempt or excepted from withholding under [IRC 3401 to 3406,]" must be reported on a cash basis. MCL 208.1107(2).

In contrast, "payments to a pension, retirement, or profit sharing plan other than those payments attributable to unfunded accrued actuarial liabilities, and payments for insurance for which employees are the beneficiaries, including payments under health and welfare and noninsured benefit plans and payment of fees for the administration of health and welfare and noninsured benefit plans," must be reported on a cash or accrual basis consistent with the taxpayer's method of accounting for federal income tax purposes. MCL 208.1107(2).

C41. How is the Small Business Alternative Credit under MCL 208.1417 calculated by a taxpayer that is a unitary business group? How do the disqualifiers and percentage reducers work?
The Small Business Alternative Credit "is available to any *taxpayer* with gross receipts that do not exceed $20,000,000.00 and with adjusted business income minus the loss adjustment that does not exceed $1,300,000.00 as adjusted annually for inflation using the Detroit consumer price index" and subject to certain additional disqualifiers. MCL 208.1417(1) (emphasis added). Specifically, if gross receipts exceed $19,000,000, the credit is reduced

"Taxpayer" is defined as "a person or a unitary business group." MCL 208.1117(5). The gross receipts and adjusted business income thresholds under MCL 207.1417(1) apply to taxpayers. Thus, for a taxpayer that is a unitary business group, the gross receipts and adjusted business income thresholds are those of the unitary business group.

The disqualifiers under MCL 208.1417(1)(a) and (b) apply to a taxpayer that is a unitary business group if such disqualifiers apply to any member of that unitary business group. For example, a taxpayer that is a unitary business group is disqualified from taking the Credit under MCL 208.1417 if that unitary business group includes a member that is a partnership and any one partner of that partnership receives more than $180,000.00 as a distributive share of the adjusted business income minus loss adjustment of the partnership.

Similarly, the reduction percentages under MCL 208.1417(1)(c) apply to a taxpayer that is a unitary business group if such reduction percentages apply to any member of that unitary business group. For example, the Small Business Alternative Credit of a taxpayer is reduced by 20% if the taxpayer is a unitary business group that includes a member that is a corporation and the compensation and directors' fees of an officer of that member corporation exceed $160,000.00 but are less than $165,000.00.

Finally, the amounts described in MCL 208.1417(1)(a) and (b) received by an individual, partner, member, shareholder, or officer of a member of a unitary business group are not combined with similar amounts received from other members of the unitary business group for purposes of the disqualifiers and reduction percentages.

C42. For purposes of the Small Business Alternative Credit under MCL 208.1417, do the rules of attribution attribute the allocated business income of one shareholder to a related shareholder to determine whether the taxpayer is disqualified from the credit?
So long as the related shareholders are not active shareholders, the shares of one shareholder and any corresponding allocated business income (the amount determined under MCL 208.1417(1)(b)(ii)(B)) will be attributed to the other.

The Small Business Alternate Credit is available to entities that meet certain statutory criteria. One such criterion is that the allocated business income of a shareholder of a corporation must not exceed $180,000. A "shareholder" is a person who owns outstanding stock in a business or is a member of a business entity that files as a corporation for federal income tax purposes. An individual is considered as the owner of the stock owned, directly or indirectly, by or for family

members as defined by section 318(a)(1) of the IRC. MCL 208.1115(2). For example, Husband and Wife each own 20% of the stock in Corporation A. The allocated business income for Husband and Wife from Corporation A is $100,000 each. Due to attribution, both the Husband and Wife will be deemed to own the stock of the other. Thus, Wife will be deemed to own 40% of the stock of Corporation A with a corresponding allocated business income of $200,000, and vice versa. Since the allocated business income of each of these shareholders – under the rules of attribution – exceeds $180,000, Corporation A is disqualified from the Small Business Alternative Credit.

However, the rules of attribution do not attribute the compensation and directors' fees of one shareholder to another. Furthermore, "an active shareholder's share of business income shall not be attributed to another active shareholder." MCL 208.1417(2). An "active shareholder" is a shareholder who receives, in any combination, at least $10,000 in compensation, directors' fees, or dividends from the business, and who owns at least 5% of the outstanding stock or other ownership interest. MCL 208.1417(9)(a). In the example above, if Husband and Wife were both active shareholders, then there would be no attribution between them. However, attribution would still apply if one spouse was an active shareholder and the other was not.

The Small Business Alternative Credit under the MBT operates similarly to the Small Business Credit that was provided for under the SBT. The analysis above is substantially similar to that used under the SBT.

C43. Is a staffing company as defined in section 113(6)(d)(ii) eligible for the section 403 compensation credit on wages etc. paid to the personnel it supplies to its customers?
Yes. A staffing company is an entity primarily engaged in supplying temporary or continuing help on a contract or fee basis. The help supplied is always on the payroll of the supplying establishment, but is under the direct or general supervision of the business to whom the help is furnished.

Regarding a staffing company and the compensation credit, section 403 of the Michigan Business Tax Act (MBTA) does not expressly address this type of entity. The compensation a staffing company pays to the personnel it supplies to its customers is recognized by the MBTA as falling under “purchases from other firms” and thus may be deducted in calculating the staffing company’s modified gross receipts tax base.

Section 403 provides in pertinent part that, subject to a capping amount:

[f]or the 2008 tax year a taxpayer may claim a credit against the tax imposed by this act equal to 0.296% of the taxpayer’s compensation in this state. For the 2009 tax year and each tax year after 2009, . . . a taxpayer may claim a credit against the tax imposed by this act equal to 0.370% of the taxpayer’s compensation in this state . . . .

The MBTA’s recognition of the compensation that a staffing company pays to the personnel it supplies to its customers as a “purchases from other firms” does not disqualify the staffing company from claiming that amount as a credit pursuant to the conditions provided in section 403.

C44. Are the MEGA credits under the MBT (MCL 208.1431) the same as the MEGA credits under the SBT?
No. Although many of the MEGA credits available under the SBT – such as those under MCL 208.37c(1), 208.38g(20)(a)(i), and 208.38g(20)(b)(i) – are also available under the MBT, the MBT also expands the available MEGA credits. For example, the SBT MEGA credit offered under MCL 208.37c(1) was limited to the payroll of the authorized business attributable to

employees who perform qualified new jobs multiplied by the IIT tax rate. Under the MBT, the credit limit is expanded to both payroll *and* health care benefits. MCL 208.1431(1)(a) (effective April 28, 2008). In addition, the MBT offers new MEGA credits to certain qualified high-technology businesses and businesses that would not have qualified for any MEGA credits under the SBT but meet alternative criteria set forth under section 8(9) and 8(11) of the MEGA Act (MCL 207.808). However, the MEGA Business Activity Credit available under the SBT is no longer available under the MBT.

Whether a taxpayer is eligible or authorized to claim a MEGA credit under the MBT is determined by the MEGA Act. This was also true under the SBT.

For further details on the MEGA credits available to taxpayers, please see MCL 208.1431.

C45. Under the MBT, does land qualify for the Investment Tax Credit ("ITC")?
No. Under MCL 208.1403(3), the only assets that qualify for an ITC are tangible assets, or mobile tangible assets, "of a type that are, or under the [IRC] will become, eligible for depreciation, amortization, or accelerated capital cost recovery for federal income tax purposes." The type of assets subject to depreciation are those assets defined as tangible property in Treas. Reg. 1.167(a)-2, which includes property such as buildings, machinery, trucks, and office furniture. However, it does not include intangible property, property subject to the federal income tax depletion allowance, or land apart from the improvements or physical development added to it.

C46. When computing the loss adjustment for the small business alternative credit provided under MCL 208.1417, are losses established under the SBT considered when looking at the adjusted business income from the 5 tax years immediately preceding the current tax year.
Yes, MCL 208.1417(9)(d) provides in part:

"Loss adjustment" means the amount by which adjusted business income was less than zero in any of the 5 tax years immediately preceding the tax year for which eligibility for the credit under this section is being determined. . . .

The Department will allow the use of a “loss adjustment” from a period prior to the start of the MBT for purposes of computing the loss adjustment in calculating the small business alternative credit. Therefore, in 2008, a calendar year taxpayer could look at years 2003 through 2007.

C47. Under the MBT, may unused Investment Tax Credits ("ITC") be carried forward to future tax years?
No. If the full amount of the ITC calculated under MCL 208.1403(3) cannot be used, the excess credit is extinguished; it may not be carried forward to subsequent years. The amount of the ITC in a tax year, coupled with the Compensation Credit, may not exceed 50% of the MBT liability (52% for the 2009 and subsequent tax years) before imposition of the surcharge under MCL 208.1281.

In contrast, unused carryforwards for any SBT credit may be applied to the MBT for the 2008 and 2009 tax years only.

C48. How is the private equity fund credit calculated?
In general. The private equity fund credit is based on the MBT liability of the private equity fund attributable to the fund's activities as an eligible taxpayer for the tax year – after claiming any other credit allowed under the MBT – apportioned to Michigan based on the activity and location of the private equity fund manager.

Michigan Business Tax Frequently Asked Questions

Who is the taxpayer? The private equity fund, defined as a pooled investment vehicle that is or holds itself out as being engaged primarily in the business of investing in private equity. Private equity funds are generally organized as limited partnerships. Private equity funds are exempt from registration as an investment company under the Investment Company Act of 1940. See 15 USC 80a-1, *et seq*.

What is an eligible taxpayer? "Eligible taxpayer" means "a taxpayer that is a private equity fund which serves as a conduit for the investment of private securities not listed on a public exchange by accredited investors or qualified purchasers at any time during which the investment is acquired or subsequently used to claim the credit under this section." MCL 208.1453. In other words, an eligible taxpayer is a private equity fund that serves as a conduit for the investment of private securities by accredited investors or qualified purchasers. The private securities must not be listed on a public exchange. To qualify as an eligible taxpayer, all of the above criteria must be met at the time the investment is acquired and sold. To the extent that a private equity fund conducts activity that does not satisfy the eligible taxpayer criteria, the tax liability attributable to such activity shall not qualify for the credit. Whether or not an investor or purchaser qualifies as an accredited investor of qualified purchasers is a matter of federal law. For example, whether a person that acquires an investment from a qualified purchaser by gift or bequest is resolved under 15 USC 80a-3(c)(7)(A).

How is the credit apportioned? The credit is apportioned to Michigan "by a fraction, the numerator of which is the total activity of the private equity fund manager conducted in this state during the tax year and the denominator of which is the total activity of the private equity fund manager conducted everywhere during the tax year." MCL 208.1453. The "total activity of the private equity fund manager" is measured by the receipts of the private equity fund acting as an "eligible taxpayer," and includes the sale of investment assets and investment related receipts. "[T]he location of the activity of the private equity fund manager is based on the location of the office from which the fund manager conducts management activity for the eligible taxpayer." MCL 208.1453. Thus, the apportionment formula is the receipts of the private equity fund derived from investments managed by the fund manager from offices in Michigan over receipts derived from investments managed by the fund manager everywhere. For example, a private equity fund purchased a 40% share in a private research company in 2008. The fund manager manages that investment from an office in Michigan. The private equity fund sells its stake in the research company in 2009 resulting in receipts of $200,000. For the 2009 tax year, the numerator will include that $200,000.

Note that the credit and apportionment is limited to the eligible taxpayer; the credit of an eligible taxpayer is <u>not</u> apportioned based on the activities a manager renders to all of its eligible taxpayers.

What does the term "securities" mean? The term "securities" is not generally defined under the MBT. For purposes of the private equity fund credit, the IRC does not define "securities" in any comparable context. However, the private equity fund credit relies on other definitions found in the Securities Act of 1933 and the Investment Company Act of 1940. Furthermore, private equity funds are generally governed under the provisions of federal security laws. Thus, the Department concludes that the definition of securities as found in the Securities Act of 1933 shall control for purposes of MCL 208.1453. In other words, for purposes of the private equity fund credit, "security" means:

any note, stock, treasury stock, security future, bond, debenture, evidence of indebtedness, certificate of interest or participation in any profit-sharing agreement, collateral-trust certificate, preorganization certificate or subscription, transferable share, investment contract, voting-trust

certificate, certificate of deposit for a security, fractional undivided interest in oil, gas, or other mineral rights, any put, call, straddle, option, or privilege on any security, certificate of deposit, or group or index of securities (including any interest therein or based on the value thereof), or any put, call, straddle, option, or privilege entered into on a national securities exchange relating to foreign currency, or, in general, any interest or instrument commonly known as a “security”, or any certificate of interest or participation in, temporary or interim certificate for, receipt for, guarantee of, or warrant or right to subscribe to or purchase, any of the foregoing. [15 USC 77b.]

C49. How are the small business alternative credit disqualifiers under the MBT calculated for a part-year shareholder?

A taxpayer that is a corporation other than an S-corporation will be disqualified from taking the small business alternative credit if a shareholder receives more than $180,000 in compensation or if the sum of the shareholder's share of business income and compensation exceed this amount. MCL 208.1417(1)(b). These disqualifiers are computed for the tax year. *Id*. Thus, a part-year shareholder will need to prorate its stock ownership to calculate the disqualifiers when reporting for a full tax year.

Note that a part-year shareholder of an S-corporation will also need to perform the following steps but the resulting disqualifier is computed only on the sum of the shareholder's compensation and share of business income.

For the compensation disqualifier, the part-year shareholder must annualize compensation for the length of time as a shareholder to reach what compensation would have been for the entire year. The annualized amount is then measured against the compensation disqualifier. To annualize, the part-year shareholder will take compensation for the period that it was a shareholder, multiply by 12, and then divide that result by the number of months as a shareholder.

The business income disqualifier is calculated by multiplying percentage of ownership by the business income (net of a carryback or carryover of a net operating loss or capital loss to the extent deducted in arriving at federal taxable income and the loss adjustment.) For a part-year shareholder this means that the shareholder must prorate its percentage of ownership for the year in order to determine its proper annual percentage of ownership and share of business income for the tax year. To prorate, the part-year shareholder will divide the number of shares it held for the year by the total shares, then multiply the result by a fraction, the numerator of which is the number of months that the part-year shareholder was a shareholder and the denominator of which is 12. The result will be the part-year shareholder's percentage of ownership for the tax year. This percentage of ownership is then applied to the adjusted business income of the taxpayer to determine the part-year shareholder's share of business income. Finally, the resulting share of business income is added to the part-year shareholder's annualized compensation.

The following examples illustrate the calculations:

1) Corporation A has 50,000 shares of outstanding stock for the 2009 calendar year and business income of $100,000 for the year. Individual C obtains 15,000 shares on July 1 of 2009. C also received $45,000 in compensation for July through December. Corporation A must compute the disqualifiers for the 2009 tax year.

1. Compensation: (45,000 x 12) /6 = $90,000

2. Percentage of Ownership: 15,000/50,000 = 30% x 6/12 = 15%

3. Share of Business Income: 15% x 100,000 = $15,000

4. Compensation combined with share of business income: $90,000 + $15,000 = $105,000

Corporation A is not disqualified on C's compensation alone, which is $90,000 for the tax year. Nor is it disqualified by compensation plus C's share of business income which equals $105,000 for the tax year. This part-year shareholder does not cause the taxpayer to be disqualified from the small business alternative credit.

2) Next, consider an S-corporation taxpayer. The taxpayer has 100,000 shares of outstanding stock and $300,000 in business income for the 2009 calendar year. Its employee, X, becomes a shareholder on November 1, 2009, obtaining 20,000 shares. X is paid $25,000 in compensation for November through December and is considered an active shareholder.

1. Compensation: (25,000 x 12) /2 = $150,000

2. Percentage of Ownership: 20,000/100,000 = 20% x 2/12 = 3.3%

3. Share of Business Income: 3.3% x 300,000 = $9,900

4. Compensation combined with share of business income: $150,000 + $9,900 = $159,900.

This part-year shareholder's combined compensation and share of business income do not cause the taxpayer to be disqualified.

C50. A "qualified taxpayer" for purposes of the Historic Preservation Credit is the person that either owns the historic resource or has a long-term lease agreement with the owner, and has paid or incurred the qualified expenditures for the rehabilitation. Pursuant to subsection 435(8), a qualified taxpayer who chooses to assign all or a portion of the Historic Preservation Credit must do so in the tax year in which the Certificate of Completed Rehabilitation is issued. What is the deadline by which the assignee must first claim the credit on its return?
An assigned Historic Preservation Credit amount may be claimed by the assignee against tax assessed under the MBTA or under the Income Tax Act of 1967, MCL 206.1 et seq. Section 435(8) directs that the assignee must first claim the credit on the annual return required to be filed for the tax year in which the assignment is made.

For example, a Certificate of Completed Rehabilitation is issued in February 2009 to a qualified taxpayer with a calendar year end of December 31, 2009. The qualified taxpayer, in March 2009, assigns the Historic Preservation Tax Credit to an assignee with a fiscal year end of June 30, 2009. After the assignee makes the election to apply the credit against either its Michigan Business Tax or its Income Tax, the assignee must claim the Historic Preservation Credit on the annual return required to be filed by the applicable tax for its tax year ending June 30, 2009.

C51. The Department has determined that a separately calculated Michigan depreciation amount is allowable for assets claiming IRC § 168(k) bonus depreciation from which Michigan has decoupled. When the asset is sold, will the Michigan book-value be used in determining what (if any) investment tax credit will be recaptured?
The adjusted MBT tax basis will be used in computing gain and any ITC recapture as provided by statute. The Department has determined that because the definition of "federal taxable income" decouples bonus depreciation, provided for under IRC §168(k), from the amount of taxable income computed for federal income taxes that a separate MBT depreciation amount would need

to be computed. The amount of depreciation that would have been allowed under federally accepted depreciation methods if §168(k) were not in effect will be allowed for determining MBT business income. The depreciation method used by the taxpayer to adjust MBT business income must be consistently used over the life of the asset until it is retired or otherwise disposed of. The depreciation allowed for MBT will be different than federal depreciation in instances where "bonus depreciation" was taken in reporting federal taxable income. Therefore, when bonus depreciation was taken on a federal return, a taxpayer under the MBT will have assets that will have different adjusted tax bases.

The MBT adjusted tax base should be used when computing any MBT gain on disposition of the asset. This adjusted MBT gain will consistently be used in the calculation of any ITC recapture under the MBT.

C52. For MBT Brownfield Redevelopment credits authorized by MCL 208.1437, if the Qualified Taxpayer has a limited MBT liability and has taken the credit against his MBT liability to the fullest extent, how is he paid for the balance of the unused credit if he elects to have the state pay him the $0.85 on the dollar? (An example of this is he has a $1.1M credit, used $200K toward his MBT liability and has $900K in an unused credit). Also, in what form does this payment come to the Qualified Taxpayer if he elects to have the state pay him the $0.85 on the dollar, a check in the full amount? Paid in one lump sum? Paid in installments?

A Brownfield Redevelopment credit is authorized by MCL 208.1437. For tax years ending on or after April 8, 2008, if the credit allowed for the tax year exceeds the qualified taxpayer's tax liability for the tax year, the qualified taxpayer may elect to have the excess refunded at a rate equal to 85% of that portion of the credit that exceeds the tax liability of the qualified taxpayer for the tax year and forgo the remaining 15% of the credit and any carryforward.

For a qualified taxpayer that chooses the refundable option, the excess portion of this credit, less the 15% discount, is treated on the annual return as a payment. The credit calculation is reported on 2008 MBT Form 4584, the amount carries to Form 4574, and then to Form 4567, Line 42.

The refundable amount will be subject to offsets (*e.g.*, other unpaid taxes) under the same rules as apply to any MBT tax refund. On the return the qualified taxpayer will identify how much of its total overpayment should be applied as a credit forward to the next tax year, and how much should be refunded. Of the total overpayment, after offsets, the portion for which the qualified taxpayer requests a refund will be refunded fully and promptly. If the refund is not made within 45 days, the standard rules under which the State must pay interest will apply. For the numerical example in the question, assuming no offsets, 85% of the $900,000 excess credit, or $765,000, would be available as a refund and/or credit forward.

Two additional items should be noted. First, the reference to "qualified taxpayer" indicates that an assignee does not have this election. Second, there is a type of Brownfield credit (*see* MCL 208.1437(4)) ranging from $10 to $30 million, in which 10% of the total credit is allowed each year for ten years. The statute granting the 85% refund option includes the phrase "if <u>the credit allowed under this section for the tax year</u> exceeds the qualified taxpayer's tax liability" (*emphasis added*). If a $20 million credit is approved under §1437(4), the credit allowed "for the tax year" will be $2 million each year. This refund option will not allow 85% of the entire $20 million to be refunded in a single year.

C53. The Michigan Business Tax Act (MBTA) expands the credit for donations to certified community foundations endowment funds provided by the prior Single Business Tax Act to include donations to certified education foundations endowment funds. MCL 208.1425.

Michigan Business Tax Frequently Asked Questions

The amount of the nonrefundable credit remains the same, which is 50% of the taxpayer's contribution limited to 5% of the taxpayer's tax liability before claiming any credits allowed under the MBTA or $5,000.00, whichever is less.

Is the certification process for an education foundation similar to that of a community foundation?

Yes. As the criteria for certification for a community foundation and education foundation are substantially similar, the Department of Treasury's Technical Services Division will administer the certification process for both types of foundations. An application for certification as a qualified education foundation (Form #4629) is made available on Treasury's web site each year no later than January 1st, remaining until the filing deadline of April 1st.

The Technical Services Division's review will include the criteria shared by each foundation that they must:

- Qualify for exemption from federal income taxation under sec. 501(c)(3) of the Internal Revenue Code (IRC);
- Maintain an ongoing program to attract new endowment funds from a wide range of potential donors in the community or area served;
- Meet federal treasury regulations for being publicly supported and treated as a single entity;
- Be incorporated or established as a trust at least 6 months before the beginning of the tax year for which the credit is claimed;
- Have an independent governing body representing the general public's interest and that is not appointed by a single outside entity;
- Be subject to a program review each year and an independent financial audit every 3 years, and provide copies of the same to the Department not more than 3 months after the review or audit is completed.

Criteria unique to a community foundation are that it must:

- Reach a minimum endowment value of $100,000.00 before the expiration of the 18month period after the community foundation was incorporated or established;
- Support a broad range of charitable activities within the specific geographic area that it serves;
- Submit to the Department annually documentation that it is publicly supported pursuant to federal treasury regulations;
- Not be a supporting organization as an organization is described in sec. 509(a)(3) of the IRC and in 26 Code of Federal Regulations 1.509(a)-4 and 1.509(a)-5;
- Have, before the expiration of 6 months after it is incorporated or established; at least 1 part-time or full-time employee and continually maintain the same;
- Submit to the Department annually an independent financial audit if it has an endowment value of 1 million dollars or more;
- Operate in a county of Michigan that was not served by a community foundation when the community foundation was incorporated or established after January 9, 2001, or operate as a geographic component of an existing certified community foundation.

The criterion unique to an educational foundation is that all funds are exclusively dedicated to a school district or public school academy.

A community foundation must apply to the Technical Services Division for certification on or before May 15 of the tax year for which the taxpayer is claiming the credit. The application deadline for certification for an education foundation is on or before April 1 of the tax year for which the taxpayer is claiming the credit. The application Form #4629 will be found under the "forms" tab on Treasury's web site at www.michigan.gov/treasury.

A taxpayer that is also subject to the Michigan Income Tax Act of 1967, MCL 206.1 et seq., who has made a contribution to a certified community foundation endowment fund, may choose to claim a credit on the individual income tax return or the Michigan Business Tax (MBT) return, but not both.

However, a credit for a contribution to a certified education foundation endowment fund is available only under the MBT.

C54. Do state tax liens attach to assigned MBT tax credits?
Yes. Section 29(1) of the Revenue Act, MCL 205.29(1), states in pertinent part:

> Taxes administered under this act [including the Michigan Business Tax], together with interest and penalties on those taxes, shall be a lien in favor of the state against all property and rights of property, both real and personal, tangible and intangible, owned at the time the lien attaches, or afterwards acquired by any person liable for the tax, to secure payment of the tax. The lien shall attach to the property from and after the date that any report or return on which the tax is levied is required to be filed with the department and shall continue for 7 years after the date of the attachment.

Thus, in order for a state tax lien to attach to an assignable tax credit, the credit must be "property" or "rights to property." Assignable tax credits conferred upon the taxpayer pursuant to statute may reasonably constitute "property and rights to property." Thus, under the Revenue Act, the Department of Treasury may cause a lien to attach against an assignable tax credit granted to the taxpayer in order to secure payment of any taxes owed by the taxpayer. The lien exercised by the Department attaches from and after the date on which a report or return on which the respective tax is levied is required to be filed and continues for at least 7 years after the attachment. Once perfected, the Department's lien generally has precedence and superior priority over all other liens and encumbrances, except where bona fide liens against the assignable credit are recorded before the date of the Department's lien is recorded and thus perfected. MCL 205.29(2); Revenue Administrative Bulletin 1989-50. Notices of state tax liens are made pursuant to the State Tax Lien Registration Act, 1968 PA 203, MCL 211.681 *et seq.*

An assignee to a tax credit takes the tax credit subject to the state's recorded tax lien. The assignee effectively stands in the shoes of the taxpayer assignor, taking only the property interest the assignor possesses. Consequently, the Department of Treasury may enforce a tax lien against the assignee on the amount of the tax credit for any tax debt or obligation of the assignor for which a tax lien is recorded prior to assignment of the tax credit. MCL 205.29(3).

C55. Does the step up in basis under Internal Revenue Code (IRC) section 754 election and 743 application qualify as "purchases from other firms" when calculating the modified gross receipts tax base? Does the step up in basis qualify for investment tax credit (ITC)?
No, a taxpayer may not subtract a step up in basis under IRC section 754 election and 743 application as "purchases from other firms" when calculating the modified gross receipts tax base. The step up in basis does not qualify for ITC.

"Purchases from other firms" are deducted from a taxpayer's gross receipts to calculate the modified gross receipts tax base. Purchases from other firms includes in relevant part:

(b) Assets, including the costs of fabrication and installation, acquired during the tax year of a type that are, or under the internal revenue code will become, eligible for depreciation, amortization, or accelerated capital cost recovery for federal income tax purposes. MCL 208.1113(6)(b).

The statute emphasizes that to qualify for this deduction, a taxpayer's purchase must be acquired during the tax year and be an asset of the type that is or will become eligible for depreciation, amortization, or accelerated capital cost recovery for federal income tax purposes.

An election by a partnership under IRC section 754 to apply section 743 (b) allows for the step up in the basis of partnership property for transfers of partnership interests. Section 743(b) requires the incoming partner increase his or her share of the partnership's basis in its assets by the excess of the investing partner's outside basis (i.e. what was paid for the partnership interest) over their proportionate share of the adjusted basis of the partnership property. This optional basis adjustment directly affects only the incoming investor partner. An election under IRC Section 754 permits an investor to claim depreciation deductions to the extent that any basis adjustment is allocated to depreciable property.

Under this election, the taxpayer/partnership has not acquired any assets in the year of the election nor has it acquired any assets from another firm. Rather, the assets of the partnership were continually maintained except that they have been revalued for the investing partner due to the change in ownership. Thus, the taxpayer/partnership does not qualify for and may not take a "purchases from other firms" deduction when computing the modified gross receipts tax base.

A taxpayer may claim an ITC against the MBT tax liability for a percentage of the net capital investment paid or accrued for qualifying assets physically located in Michigan for use in a business activity. MCL 208.1403(3). Because the taxpayer/partnership has not made any additional investment in qualifying assets, no ITC may be claimed on the incoming partner's increase to his or her share of the partnership's asset basis.

C56. When must a brownfield or historic preservation credit assignment be in place in order for the assignee to make the election to remain under the MBT?
Beginning January 1, 2012, an MBT taxpayer is either of the following:

> (a) A person or [UBG] that has been approved to receive, has received, or has been assigned a certificated credit but is not subject to the tax imposed under part 2 of the income tax act … and that elects under section 500 to file a return and pay the tax imposed under this act, if any.
>
> (b) A person or [UBG] that has been approved to receive, has received, or has been assigned a certificated credit and that elected under section 680 of the income tax act of 1967, … to file a return and pay the tax imposed under this act, if any. [MCL 208.1117(5)]

Thus, an assignee may be a taxpayer under the MBT so long as assignment is completed in accordance with the appropriate credit section of the MBT for the brownfield (section 437) or historic preservation (section 435) credits, and the taxpayer elects to file and pay the MBT.

For a brownfield credit, other than a multi-phase credit, assignment must be made in the same tax year in which a certificate of completion is issued. For a multiphase credit, the credit may be assigned by component, once a component completion certificate is issued. For the historic preservation credit, assignment is made in the year in which the certificate of completed

rehabilitation is issued. If a proper assignment is in place, the assignee may elect to remain under the MBT in accordance with the requirements of the certificated credit assigned, and the process of doing so varies by credit.

The statute provides for both non-accelerated (traditional) and accelerated brownfield and historic preservation certificated credits. An assignee with a non-accelerated brownfield or historic preservation certificated credit may make the election in the year in which a credit is available and is permitted to remain taxable under the MBT until the qualifying credit and any carryforward of that credit are extinguished. An assignee with a multiphase brownfield credit under MCL 208.1437(10) that makes the election is required to continue to file and pay the MBT until the certificated credit is complete and the credit is used up.

For an accelerated brownfield or historic preservation certificated credit, the certificate of completion, assignment certificate, or component completion certificate (for a brownfield credit), or the certificate of completed rehabilitation, assignment certificate, or reassignment certificate (for an historic preservation credit) must be issued for a tax year beginning after December 31, 2011. An accelerated credit may be claimed at any point in the tax year, or with the assignee's annual return.

C57. Under MCL 208.1403(2), a taxpayer may claim a credit against the MBT equal to a specified percentage of the taxpayer's "compensation in this state." What is the definition of "compensation in this state"?

For purposes of the compensation credit, "compensation in this state" means actual compensation for that portion of the services that each of the taxpayer's employees provided at one or more locations in Michigan during the applicable tax year. Compensation for any services provided by an employee at a non-Michigan location may not be used to calculate the credit. In order to be entitled to the credit, the taxpayer must maintain adequate records to permit determination of the portion of services that each employee provided in Michigan and at other, non-Michigan, locations.

C58. In order to claim the farmland preservation credit under the Michigan Business Tax (MBT) for a tax year ending after December 31, 2011, must an eligible owner of land subject to a Farmland Development Rights Agreement (FDRA) or agricultural conservation easement make the election to remain under the MBT?

Yes. MCL 324.36109(2) allows the farmland preservation credit against the MBT to qualifying farmland owners. The farmland preservation credit is a certificated credit as that term is defined under section 107 of the Michigan Business Tax Act. MCL 208.1107(g). Taxpayers holding certain certificated credits, such as farmland preservation credits, that have not been fully claimed or paid prior to January 1, 2012 may elect to file a return and pay the tax imposed by the MBT until the certificated credits and their carryforwards are used up. Except for taxpayers holding qualifying historic preservation or brownfield certificated credits, a taxpayer is required to make the election to continue under the MBT "for the taxpayer's first tax year ending after December 31, 2011." MCL 208.1500(1) and 206.680(1). The election is irrevocable.

Therefore, a taxpayer that wishes to claim an MBT farmland preservation credit must make an election for its first tax year ending after December 31, 2011, and file and pay under the MBT. A taxpayer that filed a Corporate Income Tax (CIT) return for its first tax year ending after December 31, 2011, did not make the MBT election and may not revoke its 2012 tax year CIT filing.

A purchaser of land with an existing FDRA, an owner of land that will be subject to a new FDRA, or the purchaser of an agricultural conservation easement, where the agreement begins after December 31, 2011, may be eligible for a farmland preservation tax credit for that agreement only if the taxpayer has a certificated credit—whether another certificated farmland preservation agreement or another certificated credit—for which it previously made a valid MBT election. The

certificated credit(s) that enabled the initial election and any carryforwards from such credit(s) must not yet be used up and the MBT election must still be in effect.

e-File

E1. Will I be able to send attachments with the MBT e-file return?
Yes. Treasury will accept certain Portable Document Format (PDF) attachments with MBT e-filed returns. A list of defined attachments is available on the e-file Web site at www.MIfastfile.org (select Business Taxpayer). You will need to follow your software instructions for submitting attachments with an e-filed return.

E2. Do I need a Customer Service Number (CSN) to e-file my MBT return?
No. Treasury is not issuing Customer Service Numbers (CSN) for MBT e-file. The CSN issued for Single Business Tax e-file cannot be used for MBT e-file return submissions.

For tax years 2009 and after, the signature process for MBT e-file returns is as follows:

Fed/State (Linked) Returns:

Michigan will accept the federal signature. No additional signature documentation is required.

State Stand Alone (Unlinked) Returns:

Tax Professionals:
Returns are signed by entering a PIN in the software after reading the perjury statement displayed in the software. The PIN will be selected by the taxpayer, or the taxpayer may authorize their tax preparer to select the PIN.

Form MI-8879-MBT (new for tax year 2009) will be printed and contain the PIN. The tax preparer will retain the MI-8879-MBT in their records as part of the taxpayer's printed return.

Taxpayers (Online):
Returns are signed by entering a PIN in the software after reading the perjury statement displayed in the software. The PIN will be selected by the taxpayer.

Form MI-8879-MBT will be printed and contain the PIN. Taxpayers will retain the MI-8879-MBT in their records.

MBT State Stand Alone (SSA) e-filings submitted without a PIN will be rejected by the Treasury. The PIN must be entered in the software and included in the electronic file for all SSA filings. Do not mail Form MI-8879-MBT to the Treasury and do not include Form MI-8879-MBT as an attachment with the e-file return. Form MI-8453-MBT was discontinued starting with tax year 2009.

For tax year 2008,The signature process for MBT e-file returns is as follows:
Fed/State (Linked) Returns:
Michigan will accept the federal signature (scanned Form 8453 or the Practitioner PIN option). As long as there is an IRS submission ID that links the two returns together, it is considered a Fed/State filing. Michigan does not require any additional signature documentation.

State Stand Alone (Unlinked) Returns:

Michigan Business Tax Frequently Asked Questions

State Stand Alone returns must be signed using the Michigan Business Tax e-file Authorization, Form 4665 (MI-8453-MBT). The completed MI-8453-MBT must be included as a scanned attachment when transmitting the MBT return electronically.

E3. What MBT forms are eligible for e-file?
Treasury will support the following forms, schedules for MBT Fed/State e-file for tax year 2010.

3581 Historic Preservation Tax Credit
4567 Annual Return
4568 Nonrefundable Credits Summary
4569 Single Business Tax (SBT) Credit Carryforwards
4570 Credits for Compensation, Investment, and Research and Development
4571 Common Credits for Small Businesses
4572 Charitable Contribution Credits
4573 Miscellaneous Nonrefundable Credits
4574 Refundable Credits
4575 Loss Adjustment Worksheet for the Small Business Alternative Credit
4577 Schedule of Shareholders and Officers
4578 Schedule of Partners
4580 Unitary Business Group Combined Filing Schedule for Standard Members
4582 Penalty/Interest Computation for Underpaid Estimated Tax
4583 Simplified Return
4584 Election of Refund or Carryforward of Credits
4585 Investment Tax Credit Recapture From Sale of Assets Acquired Under Single Business Tax
4586 Schedule of Business Activity Protected Under Public Law 86-272
4587 Schedule of Recapture of Certain Business Tax Credits and Deductions
4588 Insurance Company Annual Return for Michigan Business and Retaliatory Taxes
4590 Annual Return for Financial Institutions
4594 Farmland Preservation Tax Credit
4595 Renaissance Zone Credit Schedule
4596 Miscellaneous Credits for Insurance Companies
4752 Unitary Business Group Combined Filing Schedule for Financial Institutions

E4. I don't use software to prepare my MBT return. Am I required to e-file?
If you are preparing your MBT return yourself and do not use computer software, then you are not required to e-file. E-file provides the best possible level of service. MBT paper returns will take longer to process. Also, account resolution for MBT e-file returns is given priority over paper returns.

Beginning with the 2010 tax year, Michigan will have an enforced Michigan Business Tax (MBT) e-file mandate.

Developers producing MBT tax preparation software and computer-generated forms must support e-file for all eligible Michigan forms that are included in their software package. All eligible MBT returns prepared using tax preparation software or computer-generated forms must be e-filed.

Treasury will not process computer-generated paper returns that are eligible to be e-filed. A notice will be mailed to the taxpayer indicating that their return was not filed in the proper form and content and must be e-filed. Payment received with a paper return will be processed and credited to the taxpayer's account even when the return is not processed.

Michigan Business Tax Frequently Asked Questions

E5. Do I have to mail anything to Treasury?
If you are expecting a refund, there are no paper forms to mail to Treasury. If your return requires payment, you will need to include Form MBT-V, MBT e-file Annual Return Payment Voucher (Form 4576), with your payment.

You may also make your payment using the Electronic Funds Transfer (EFT) online payments process for ACH Debit filers. The existing touch tone telephone payment process will continue to be available. For more information about the online payments process, visit our Web site at www.michigan.gov/biztaxpayments.

E6. I have a Michigan-issued TR Number. Am I eligible for e-file?
No. MBT Fed/State e-file is only available to those taxpayers using a Federal Employer Identification Number (FEIN). Information and forms to apply for a FEIN may be obtained at www.irs.ustreas.gov/business or call the IRS at 1-800-929-4933 and register over the phone.

E7. My software does not support the State Stand Alone method for e-file and I am not e-filing my federal return. What should I do?
We encourage you to e-file both your federal and Michigan returns. However, if you are not e-filing your federal return and your software does not support State Stand Alone e-file, you will need to mail your return to the address provided in the instruction book.

E8. How do I know if my Michigan return was Accepted or Rejected?
Treasury will generate an acknowledgement for all returns received. The acknowledgement for the Michigan return will be made available to the transmitter within three business days after successful transmission to the IRS. Transmitters who transmit for EROs and preparers must notify taxpayers of the Michigan acknowledgment at the time of receipt.

E9. In previous years I have utilized the Direct portal for my SBT returns. Can I transmit my MBT return using the Direct portal?
No. All MBT returns will be transmitted through the IRS Modernized e-File (MeF) program. The Direct portal can only be utilized for prior year SBT filings as supported by your software.

E10. What should I do when I owe tax and want to e-file my Michigan Business Tax return?
The payment options available for MBT e-file returns are:

Electronic Funds Transfer (EFT). Online payments are now available for ACH Debit filers. Information on the EFT process as well as the EFT Debit Application (form 2248) and EFT Credit Application (form 2328) are available on Treasury's Web site at www.michigan.gov/biztaxpayments. Fax your completed application to (517) 636-4378. Please allow 4 weeks for processing.

Paper Payment Voucher. Taxpayers who choose to mail their payment must include form MBT-V, MBT E-file Annual Return Payment Voucher with the payment**. Copies of federal and Michigan returns or schedules should not be mailed with form MBT-V.**

E11. Is there a penalty for failing to comply with the MBT e-file mandate?
Treasury will not accept the paper filing of a computer-generated MBT return that is eligible for e-file. If a preparer or taxpayer submits a computer-generated paper MBT return that is eligible for e-file, Treasury will not process the return and notification will be mailed to the taxpayer. Payment received with a paper return will be processed and credited to the taxpayer's account even when the return is not processed.

E12. Where can the policy and language of the MBT e-file mandate be found?

Michigan Business Tax Frequently Asked Questions

Mandate information will be available on Treasury's Web site and in the appropriate forms and publications for tax year 2010.

E13. What should the taxpayer or preparer do when their e-filed MBT return is rejected?
Taxpayers and preparers should review the e-file acknowledgement rejection reason and if possible correct and retransmit the return electronically. If the return cannot be corrected and retransmitted, Form 4833, Michigan Business Tax E-file Exceptions, must be attached to the front of the paper filing or it will not be processed. Form 4833 will be generated by your software.

E14. What does Treasury expect software developers to do to help enforce the MBT e-file mandate?
Treasury is communicating the MBT e-file mandate to software developers with the expectation that they will support e-file for all eligible forms and inform their customers of the mandate requirements.

E15. Are there any waivers or exceptions to the mandate?
Treasury recognizes that there are conditions which make a return ineligible for e-file. When the computer-generated MBT return meets one or more of the Treasury-recognized e-file exceptions, the taxpayer may have to complete and attach Form 4833, Michigan Business Tax E-File Exceptions, to the front of their return or the paper filing will not be processed. Form 4833 will be generated by your software.

Attach Form 4833 to a computer-generated paper return that **meets** one or more of the Treasury-recognized e-file mandate exceptions. **Treasury-recognized exceptions at the time of this printing include, but are not limited to:**

- Taxpayer is filing one or more of the following forms:
  - Qualified Affordable Housing Seller's Deduction (Form 4579)
  - Tribal Agreement Ownership Schedule (Form 4597)
  - Tribal Agreement Apportionment (Form 4598)
- Return was prepared by a preparer who has been suspended or denied acceptance to participate in the IRS or does not have an Electronic Filing Identification Number (EFIN).
- Return was rejected by Michigan or IRS and there is no way to correct and resubmit the return electronically and software does not support State Stand Alone.
- Taxpayer's federal return contains a form that is not eligible for e-file and the software does not support State Stand Alone e-file.

The following are also Treasury-recognized exceptions. However, <u>do not attach</u> Form 4833 to an MBT paper return that meets one or more of the following conditions:

- The taxpayer is filing a Unitary Business Group (UBG) return. However, whenever possible, the preferred method is e-file.
- The taxpayer has an organization type of Individual or Fiduciary.
- The taxpayer does not have a Federal Employer Identification Number (FEIN).
- The return is completed by hand (with pen or pencil).
- The return is completed using forms from Treasury's Web site or Michigan tax instruction books.

Additional information will be published on Treasury's Web sites *www.michigan.gov/taxes* and *www.MIfastfile.org* as it becomes available.

Michigan Business Tax Frequently Asked Questions

E16. What types of companies/businesses are covered by the MBT e-file mandate?
All computer-generated MBT returns that are eligible for e-file must be e-filed. Treasury-recognized exceptions are noted on Form 4833, Michigan Business Tax E-file Exceptions. Form 4833 will be generated by your software.

E17. What legal authority is there for enforcing the mandate?
The Tax Act authorizes the State Treasurer to prescribe e-file as the only acceptable way of filing MBT returns that are eligible for e-file. The MBT Act 36 of 2007 states:

Sec. 505
(1) An annual or final return shall be filed with the department in the form and content prescribed by the department by the last day of the fourth month after the end of the taxpayer's tax year. Any final liability shall be remitted with this return. A taxpayer, other than a taxpayer subject to the tax imposed under chapter 2A or 2B, whose apportioned or allocated gross receipts are less than $350,000.00 does not need to file a return or pay the tax imposed under this act.

Sec. 509
(1) At the request of the department, a taxpayer required by the internal revenue code to file or submit an information return of income paid to others shall, to the extent the information is applicable to residents of this state, at the same time file or submit the information in the form and content prescribed to the department.

E18. Will Michigan offer a free solution for MBT e-file?
No, not at this time. Michigan will continue to exclusively support fed/state e-file for MBT

E19. Will there be a monetary penalty for failure to comply with the MBT e-file mandate?
No. However, if a preparer or taxpayer submits a computer-generated paper MBT return that is eligible for e-file, Treasury will not process the return and a notification will be mailed to the taxpayer. Payment received with a paper return will be processed and credited to the taxpayer's account even when the return is not processed.

E20. Will there be a penalty for software developers if they allow a taxpayer or preparer to file a paper MBT return prepared using their software?
No. However, a notice will be mailed to the taxpayer indicating the MBT return was not filed in the proper form and content and must be e-filed. Payment received with a paper return will be processed and credited to the taxpayer's account even when the return is not processed. To avoid a negative reaction from their customers, software developers will want to comply with the mandate and clearly market the mandate to their customers.

E21. Will all software companies be required to support MBT e-file?
Yes. If they do not support MBT e-file for the eligible forms that are included in their software package, we will not accept their paper returns unless they meet the criteria of one or more of the Treasury- recognized exceptions on Form 4833, Michigan Business Tax E-file Exceptions. Form 4833 will be generated by your software.

E22. If software is capable of computing a bottom line tax without supporting a necessary schedule, will the taxpayer be able to paper file the computer-generated MBT return and include a handwritten copy of the unsupported schedule, or will the entire MBT return have to be handwritten?
With the exception of MBT returns filed by fiduciary filers and sole proprietorships, e-filed returns that have been rejected and cannot be corrected and retransmitted, and Treasury-recognized exceptions from e-file, computer-generated paper returns or schedules will not be accepted for any e-file eligible MBT returns.

E23. Can rejected returns that cannot be corrected and retransmitted and returns that fall under one of the Treasury-recognized exceptions be paper filed on computer-generated forms?
Yes. Form 4833, Michigan Business Tax E-file Exceptions, must be attached to the front of the paper filing or it will not be processed. Form 4833 will be generated by your software.

E24. If Treasury sends a notice to the taxpayer for paper filing an MBT return, will the return be considered late if that taxpayer does not then submit the e-filed return before the filing due date?
As long as all tax due is paid by the due date, there will be no late penalty assessed.

E25. Will a rejection at the federal level allow an MBT return to be paper-filed?
Yes. If the MBT return was part of a Fed/State e-file submission, and

- the federal return was rejected by the IRS and there is no way to correct and resubmit the federal return, and/or
- the software does not support State Stand Alone.

E26. What if the federal return cannot be e-filed? Will an MBT State Stand Alone return be required?
If the federal return cannot be e-filed, Treasury will accept a paper MBT return for the 2010 tax year. A completed Form 4833, Michigan Business Tax E-file Exceptions, must be attached to the front of the return. Form 4833 will be generated by your software.

Beginning with the 2011 tax year, the MBT return must be e-filed as a State Stand Alone submission if the federal return cannot be e-filed.

E27. If an MBT return and attachments exceed the file size limitations, would Michigan prefer to receive the return electronically, without attachments, or would it be better to send a paper MBT return with attachments?
A paper return should be filed with a completed Form 4833, Michigan Business Tax E-file Exceptions, attached to the front. Form 4833 will be generated by your software.

E28. How will Treasury ensure that all developers are complying with the MBT e-file requirements?
With the cooperation and assistance from both preparer groups and software developers, we anticipate the volume of taxpayers not complying with the mandate to be very small. Further, with the assistance of software developers in advising their customers about the mandate we do not foresee compliance with the mandate being an issue. However, Treasury will monitor paper-filed MBT returns for compliance.

E29. Is the MBT e-file mandate on the taxpayer, the preparer or the software developer?
Beginning with the 2010 tax year, Michigan will have an enforced Michigan Business Tax (MBT) e-file mandate.

Developers producing MBT tax preparation software and computer-generated forms must support e-file for all eligible Michigan forms that are included in their software package. All eligible MBT returns prepared using tax preparation software or computer-generated forms must be e-filed.

Treasury will not process computer-generated paper returns that are eligible to be e-filed. A notice will be mailed to the taxpayer indicating that their return was not filed in the proper form

and content and must be e-filed. Payment received with a paper return will be processed and credited to the taxpayer's account even when the return is not processed.

For this process to be successful and have the least possible impact will require participation by taxpayers, preparers and the software developers.

E30. Will Treasury still provide fillable MBT forms on the Web?
No. Fillable MBT forms will not be provided on the Web.

E31. Will Treasury mail MBT instruction booklets to taxpayers for the 2010 tax year?
No. However, MBT forms and instruction booklets are available on Treasury's Web site at *www.michigan.gov/mbt*.

E32. Will Treasury provide a form allowing the taxpayer to opt out?
No. The taxpayer's method for opting out is to file a handwritten paper MBT return.

E33. Does the MBT e-file mandate include sole proprietorship returns filed by individuals?
No. Sole proprietorship returns filed by individual and fiduciary MBT filers who are not part of a Unitary Business Group (UBG) will not be subject to the e-file mandate.

E34. No. Sole proprietorship returns filed by individual and fiduciary MBT filers who are not part of a Unitary Business Group (UBG) will not be subject to the e-file mandate.
Yes. However, whenever possible, the preferred method is e-file. Software developers will not be required to support e-file for the following forms: Unitary Business Group Combined Filing Schedule for Standard Members (Form 4580) and Unitary Business Group Combined Filing Schedule for Financial Institutions (Form 4752).

E35. Is developer testing required if I am a large taxpayer that develops proprietary software to prepare and e-file my MBT return?
Yes. Please see publications 4672, Michigan Business Tax Fed/State e-file Specifications, and Software Developer Guide and 4673, Michigan Business Tax (MBT) MeF Test Package for Software Developers, located on the software developer secure Web site for more information.

For access to the secure Web site, review Policy ET-03066 Substitute Printed, Computer-Generated, Electronic Filing, and 2-D Barcode Forms/Software and follow the instructions for requesting a username and password. New usernames and passwords are assigned each year for access to the secure Web site.

Film Credits

Fi1. The MBT's film production credit (MCL 208.1455) provides, in part, a credit calculated as a specified percentage of "direct production expenditures". How will the criteria expressed in the definition of "direct production expenditures" (MCL 208.1455(12)(c)) be applied?
A qualifying "direct production expenditure" must satisfy four criteria. It must be i) made in this state, ii) not a qualified personnel expenditure, iii) directly attributable to the production or distribution of a "qualified production," and iv) subject to taxation in this state. MCL 208.1455(12)(c).

Michigan Business Tax Frequently Asked Questions

All four criteria must be met for the expenditure to qualify for the film production credit. This FAQ will focus on the first criteria: that the expenditure be "made in this state".

The phrase "made in this state" is not defined in the statute. The term "made in this state" requires that the expenditure have a substantive relationship to the State of Michigan to achieve the overarching purpose of the film industry tax credits: stimulation and growth of Michigan's economy. This means generally that Michigan's economy must directly benefit in some way from the expenditure, and particularly, that Michigan-based businesses are benefited rather than out-of-state businesses.

The phrase "made in this state" is generally interpreted to require that eligible expenditures meet the following standards:

1) Tangible personal property and services must be acquired by the production company from a source within Michigan.
2) Services must be wholly performed within Michigan.
3) A "source within Michigan" requires an established level of physical presence that includes both a non-temporary "bricks and mortar storefront", and at least one full time permanent employee. "Non-temporary" and "permanent" will generally be indicated by a presence of at least one year. The one year standard would be met with a prior presence as well as a planned future presence evidenced by a documented commitment such as entering into a one year lease for office space.
4) The requisite physical presence of a qualified vendor business, and the transaction at issue must have a nexus. Michigan physical presence unrelated to the transaction would not satisfy the criteria of "made in this state".
5) Simple pass through transactions will not qualify as "direct production expenditures" "made in this state". Generally, the existence of an added markup by the Michigan business that is consistent with industry norms will give evidence the transaction has economic substance in Michigan and is not merely a pass through transaction.

Fi2.

a) Is a fee paid to a business located outside Michigan for processing a film production company's payroll at a location outside Michigan a qualified expense?

b) If not, does the answer change if an employee or agent is present in Michigan to handle the data transfer?

c) Does the answer change if the payroll processing business is the "employer of record" for the employees whose payroll is being processed?

a) No, a fee paid to a business located outside Michigan for processing a film production company's payroll at a location outside Michigan is not a qualified expense. To qualify as a "direct production expenditure" the expenditure for a service must be made in this state. To be "made in this state" a service must be wholly performed within Michigan. The payroll processing business does not have the required physical presence in Michigan.

b) The answer would not change if the payroll processing business caused an employee or agent to be present in Michigan to handle the data transfer. The payroll processing business would still not have the required level of physical presence in Michigan and would not have any substantive relationship to Michigan. If the payroll processing business did establish the required level or physical presence in Michigan, the expenditure would qualify only if the payroll services were entirely performed in Michigan.

c) The answer would not change if the payroll processing business is the "employer of record" for the employees. The nature of the transaction remains substantially that of payroll processing because the true employer of the employees whose payroll is being processed is the film production company.

Fi3. Is the expense for production insurance paid to an out-of-state insurance company through a Michigan based broker/agent a qualified direct production expenditure?
Yes, this expenditure would qualify under the specific language in the statute. "Payments to vendors doing business in this state" is defined in the statute to include expenditures for insurance coverage or bonding, "if purchased from an insurance agent based in this state." MCL 208.1455(12)(c)(i)(G). "Based in this state" will be interpreted to mean that the insurance agent must have a bricks and mortar storefront in Michigan with at least one full time employee. The general one year standard will also apply to the insurance agent's physical presence.

Fi4. Does the purchase of tangible personal property through an 800 number answered outside of Michigan and delivered from a warehouse outside of Michigan qualify as a direct production expenditure if the seller collects and remits Michigan sales/use tax?
While a qualifying direct production expenditure must be subject to taxation in this state, the company from whom the tangible personal property is purchased must have the required physical presence in Michigan to meet the standard of being an expenditure "made in this state". Purchases of tangible personal property generally are "made in this state" if acquired from a source established for at least one year within Michigan that has a bricks and mortar storefront and at least one full time employee. It is not sufficient that the transaction is subject to Michigan sales/use or other tax if the other requirements are not also satisfied. However, if the seller does have the required physical presence in Michigan, and as long as the tangible personal property is shipped to the seller's Michigan storefront or the transaction has some other nexus with the seller's physical presence, it is irrelevant that the 800 number phone call may have been answered outside of Michigan, or that the tangible personal property is shipped from a warehouse that is located outside Michigan.

Fi5. Is the rental of specialized motion picture equipment from a vendor located outside Michigan (and whose inventory is also located outside Michigan) a qualified direct production expenditure if the rental is handled by a Michigan based rental vendor?
Rentals of equipment are not treated differently from sales/purchases of equipment. As such, if the transaction occurs between the qualified film production company and a Michigan based rental business that has the required level of physical presence in Michigan, the expenditure would qualify for credit. Among the standards that must be met is the existence of a Michigan bricks and mortar storefront and at least one employee for at least one year. It would also require demonstration that the transaction had some economic substance and was not merely a pass through transaction. This standard is generally met by existence of an industry norm markup by the Michigan vendor, and would be further demonstrated if the Michigan vendor and vendor outside Michigan were unrelated.

Fi6. Tax Return Filing: a) Is a taxpayer required to file an MBT tax return in order to obtain a film credit or refund?; b) If so, may the return be filed early (before the end of the return year)?
a) Yes, a taxpayer is required to file an MBT return in order to obtain a film credit or refund.
b) No, the MBT return may not be filed early before the end of the return year. A taxpayer may only claim the credit, and any refund may be obtained, only upon the filing of the annual return at the end of the return year.

In order to qualify for and to claim the film production credit and to determine whether a refund amount is due, the eligible production company must determine its tax liability for the tax year, and must claim the credit only after all other credits under the MBT are claimed. The determination of the company's tax liability for the tax year and the exercise of other MBT credits can only be accomplished through the filing of an MBT tax return with the Department. Therefore, an eligible production company seeking to claim a film production credit or to obtain a refund from the credit must file a return with the Department.

Further, a taxpayer may not file an early MBT return in order to claim the credit or obtain a refund. As discussed above, the tax liability for the tax year must be determined and all other credits available to the taxpayer must be taken before any of the film credits can be taken. MCL 208.1455(7), MCL 208.1457(7) and (8), and MCL 208.1459(7) and (8). This effectively can be accomplished only in a final annual return. An early return would not enable the qualifying taxpayer to determine its tax liability for the tax year nor permit the application of all other credits. Early filing of a return is also not feasible for unitary business groups due to additional complexity calculating tax bases and obligations for these unitary groups on the required combined return. Accordingly, a taxpayer seeking to claim a credit or obtain a refund may not file an early return.

Fi7. Does a production company that fails to withhold or insure that the personal services company ("PSC") or professional employment organization ("PEO") withholds lose an otherwise available film credit?

Yes, an eligible production company that fails to withhold individual income taxes as required under MCL 206.351, or fails to insure that the PSC or PEO the production company uses withholds, may be denied the otherwise available film credit. Failure by the eligible production company to properly withhold would be deemed a delinquency on the part of the eligible production company as to a debt or obligation to the state of Michigan, and is cause to disqualify the company for the tax credit. However, the eligible production company could still qualify for the tax credit if the company cures the delinquency prior to and as a pre-requisite condition of the Film Office entering into an agreement for the provision of the credit and the issuance of the certificated credit.

One of the requirements to qualify for film credits is that the production company (or taxpayer, in the case of the infrastructure credit) "not be delinquent in a tax or other obligation owed to this state or be owned or under common control of an entity that is delinquent in a tax or other obligation owed to this state." MCL 208,1455(1)(e); MCL 208.1457(1)(e); and MCL 208.1459(1)(e). For each of these credits, the "no delinquency" requirement must be met in order for the Film Office both to enter into an agreement with the eligible production company (or taxpayer, in the case of the infrastructure credit) and to give the certificated credit to an eligible production company. Therefore, if an eligible production company (or taxpayer, in the case of the film infrastructure credit) fails to withhold taxes, an agreement may not be entered into for the credit nor may a credit certificate be issued.

However, where an eligible production company (or taxpayer, in the case of the film infrastructure credit) fails to withhold, and thus is delinquent on a tax or other obligation to the state, the occurrence of the delinquency is not forever fatal to the company (or taxpayer) qualifying for the tax credit. The eligible production company (or taxpayer) can cure the delinquency by paying the withholding taxes (and any interest and penalties) as a pre-requisite condition for entering into an agreement for a credit or having the credit certificate issued. Once the delinquency no longer exists, the eligible production company (or taxpayer, in the case of the infrastructure credit) satisfies the "no delinquency" requirement for qualifying for the credit.

To the extent a PSC or PEO does not withhold payments to it for services of a performing artist or crew member that qualify for the credit, such payments are subject to withholding by the eligible production company. Accordingly, an eligible production company must ensure that any PSC or PEO with which it contracts to provide personnel to a production must withhold for such personnel provided in order to obtain the credit. The state's grant of a credit or refund is premised upon the agreement and relationship with the eligible production company (or taxpayer) for the credit, and it is the eligible production company's (or taxpayer's) obligation to ensure compliance with the withholding requirement in order to qualify for the credit.

Fi8. Do non-permanent fixtures such as honeywagons (a type of multi-room trailer used by film and television productions) and star trailers (larger trailers typically used by celebrities) qualify for the infrastructure credit?

No, the infrastructure credit is designed to promote the building of a film and digital media industry infrastructure in Michigan. The credit is not available for mobile tangible assets, such as honeywagons and trailers that are designed to be moved from location to location.

The film infrastructure credit is available for 25% of a taxpayer's "base investment" in a "qualified film and digital media infrastructure project" in Michigan. MCL 208.1457(2). Base investment is defined as the cost of depreciable tangible assets and includes the cost of fabrication and installation,

> provided that the assets are physically located in this state for use in a business activity in this state and <u>are not mobile tangible assets</u> expended by a person in the development of a qualified film and digital media infrastructure project. MCL 208.1457(11)(a) [emphasis added].

The term "qualified film and digital media infrastructure project" means

> a film, video, television, or digital media production and postproduction facility located in this state, <u>movable and immovable property and equipment</u> related to the facility, and any other facility that is a necessary component of the primary facility. A qualified film and digital media infrastructure project does not include a movie theater or other commercial exhibition facility…. MCL 208.1457(11)(d) [emphasis added].

Thus, the infrastructure credit is intended for immovable or movable but not mobile property or equipment located in this state. The terms "immovable", "movable" and "mobile" are not defined in the credit or elsewhere in the MBT but have distinct meanings. The Department will use the common meanings of these words as follows:

"Immovable" property is "property that cannot be moved; an object so firmly affixed to the land that is it regarded as part of the land." Blacks Law Dictionary, 8 ed. This is property that *will not* or *cannot* be removed from the real estate to which it is fixed without significant damage to the property. Generally, this will mean buildings, such as soundstages or backlots that will remain affixed to the land after a film project is completed.

"Movable" property is "property that can be moved or displaced." *Id*. This is property that can be moved but may not move easily or on its own. This category will typically include personal property that can be built for use in a particular film project but then could be removed if necessary, with some disassembly, once the project is complete. Examples of this category might include dolly tracks and collapsible stages.

"Mobile" property is property "normally used in more than one jurisdiction . . ." Blacks Law Dictionary, 8th ed. There is also a key difference between "movable" and "mobile." Movable denotes capacity for being moved without implying great facility for movement. Mobile stresses such facility. Mobile is designed expressly for ready movement.

Mobile, thus, means personal property that either can move under its own power, such as a motor-home type trailer with wheels and an engine, or personal property that can be easily moved or is designed for easy movement, such as a non-affixed trailer which is designed to be hauled away. A further distinction between mobile and movable, which is recognized by the statute, is that fabrication and/or installation costs will be associated with movable property but not mobile property.

Honeywagons, which are large motor-homes, or trailers that can be readily transported to other jurisdictions and larger trailers that are equally mobile do not qualify for the credit. Furthermore, the movable/mobile distinction applies to all assets that are a part of the "base investment." Therefore the credit is not available for any asset, including equipment that is a mobile asset.

Fi9. Are fringe benefits paid to crew members such as the employer's share of FICA, health insurance, and so forth eligible for the Film Production Credit? If so, are these expenditures considered "direct production expenditures" eligible for a 40% - 42% credit, or are they "qualified personnel expenditures" eligible for a 30% credit?
Fringe benefits such as those described are eligible for the Film Production Credit, but whether they qualify as "direct production expenditures" or "qualified personnel expenditures" depends upon whether the crew members are above or below the line, and whether they are residents of Michigan.

Section 455 of the MBT, the Film Production Credit, contemplates two types of expenditures by production companies that are eligible for the credit: "direct production expenditures" and "qualified personnel expenditures." Direct production expenditures are eligible for a 40% - 42% credit while qualified personnel expenditures are eligible for a 30% credit. MCL 208.1455(2). Both types of expenditures include a compensation component.

A "qualified personnel expenditure" is defined under the statute as:

> an expenditure made in this state directly attributable to the production or distribution of a qualified production that is a transaction subject to taxation in this state and is a payment or compensation payable to below the line crew for below the line crew members who were not residents of this state for at least 60 days before approval of the agreement … not to exceed $2,000,000 for any 1 employee or contractual or salaried employee who performs services in this state for the production of a qualified production, including … :
>
> (*i*) Payment of wages, benefits, or fees.

MCL 208.1455(12)(j).

A "direct production expenditure" is defined under the statute as:

> [an] expenditure made in this state that is not a qualified personnel expenditure directly attributable to the production or distribution of a qualified production that is a transaction subject to taxation in this state, including … :
>
> (*ii*) Payments and compensation, not to exceed $2,000,000 for any 1 employee or contractual or salaried employee who performs services in this state for the production or distribution of a qualified production, including … :

(A) Payment of wages, benefits, or fees for talent, management, or labor.

MCL 208.1455(12)(c).

"Below the line crew" is defined in section 459 of the MBT, and generally refers to technical crew members such as camera operators, best boys, lighting technicians, set dressers, sound editors, and similar personnel. Below the line crew does not include producers, directors, writers, or actors. MCL 208.1455(10)(a).

Accordingly, reading the various definitions together, fringe benefits paid by a production company to below the line crew members who were not residents of Michigan for at least 60 days before approval of the agreement between the production company and the Michigan Film Office (described in subsection 3 of the Film Production Credit) will be qualified personnel expenditures eligible for a 30% credit. Fringe benefits paid to above the line crew members, such as producers, directors, writers, and actors, as well as fringe benefits paid to below the line crew members who were residents of Michigan for 60 days or more before approval of the agreement between the production company and the Film Office will be direct production expenditures eligible for a 40% - 42% credit. In both cases, total payments to any one employee are capped for purposes of the credit at $2,000,000. MCL 208.1455(12)(c)(*ii*); 208.1455(12)(j). The differences between the compensation components of the two types of expenditures were designed, in part, to encourage production companies to employ Michigan residents when hiring below the line crew members.

Fi10. MCL 208.1455 provides for an MBT Film Production Credit "equal to 42% of direct production expenditures for a state certified qualified production in a core community." What exactly does "in a core community" mean?" Where the production is filmed? Where the production office is located? Where the production expenditures are made?
The phrase "in a core community" shall generally be interpreted to require that qualifying expenditures meet the following standards:

1. Tangible personal property and services must be acquired by the production company from a source within a core community (although the tangible personal property may then be used elsewhere.)

2. Qualifying services must be both procured from a source within a core community and wholly performed in a core community.

3. Being "in a core community" requires an established level of physical presence of a vendor that includes both a non-temporary "bricks and mortar storefront" and at least one full time permanent employee. "Non-temporary" and "permanent" will generally be indicated by a presence of at least one year. The one year standard would be met with a prior presence as well as a planned future presence evidenced by a documented commitment such as entering into a one year lease for office space.

4. The requisite physical presence of a qualified vendor business and the transaction at issue must have an actual connection with the core community. A physical presence in the core community unrelated to the transaction would not satisfy the criteria of "in a core community." For example, transactions with a vendor that had retail outlets in a core community devoted to providing film development and digital media film prints to a consumer market would not qualify for the higher core community credit percentage for transactions where movie quality film is sold to a film production company from a vendor location outside the core community.

5. Simple pass through transactions will not qualify as "direct production expenditures" "in a core community." Generally, the existence of an added markup by the business in the core community that is consistent with industry norms will give evidence the transaction has economic substance in the core community and is not merely a pass through transaction.

Fi11. For purposes of the Film Production Credit, a production company or its designated payroll company has an obligation to withhold Michigan payroll taxes on wages paid to

employees working on a Michigan production. Similarly, a production company must also withhold from payments made to a PEO or PSC if the PEO or PSC does not withhold for their employees. If an employee on the production is a resident of a state with a reciprocal tax agreement with Michigan (*i.e.* Illinois, Indiana, Ohio, Kentucky, Wisconsin, and Minnesota), and no Michigan tax is withheld, are wages paid to the employee eligible for the film credits even though there is no withholding as a result of the reciprocal agreement?

Yes. The Film Production Credit provides that compensation-related payments to performing artists and crew members will qualify as "direct production expenditures" or as "qualified personnel expenditures" eligible for the tax credit if individual income taxes (payroll taxes) are withheld from all payments received by the performing artists or crew members "that are subject to taxation under the income tax," and that the taxes withheld are properly paid to the state of Michigan. MCL 208.1455(12)(c)(*ii*)(B); 208.1455(12)(j)(*ii*). Similarly, a production company is required to withhold on payments made to a PEO or PSC if the PEO or PSC does not withhold for their employees.

If an employee of an eligible production company, PEO or PSC is a resident of a reciprocal state, payments made to that employee would be "subject to taxation under the income tax", however pursuant to reciprocal agreements Michigan has entered into with other states there would be no obligation for the production company, PEO, PSC, or a designated payroll company to withhold Michigan income taxes on compensation payments made to that employee. Accordingly, even though Michigan payroll taxes would not have been withheld on payments made to that employee, those payments would still be eligible for the Film Production Credit.

Fi12. Does a production company's interest expense associated with production financing qualify as a direct production expenditure that is eligible for the Film Production Credit? If so, does capitalized interest qualify? Does interest that continues to accrue post-Michigan activity qualify?

Yes, a production company's interest expense associated with production financing will qualify as an expenditure eligible for the Film Production Credit, if the expense otherwise satisfies the established requirements for a "direct production expenditure" as expressed in FAQ #Fi1. However, capitalized interest would <u>not</u> qualify, unless it has actually been paid. Continuing interest on the loan would continue to qualify, as long as the expense continued to satisfy the requirements stated in FAQ #Fi1 for a "direct production expenditure."

With respect to a production loan, these standards require (i) that the financing be obtained from a bank or other lender with a bricks and mortar storefront and at least one full time employee and one year of physical presence in Michigan, (ii) that all loan services are performed in Michigan, and (iii) that an appropriate rate of interest is charged to the production company. However, because only <u>expenditures</u> qualify for the credit, only production loan interest that has actually accrued and been paid by the production company will be eligible for the credit. Also, if a production company obtains a qualified Michigan production loan, shoots a limited part of the production in Michigan, and then applies for its postproduction certificate shortly after the Michigan portion of the production is finished, but before the loan is fully repaid, only interest paid up to that point will be an eligible expenditure. Similarly, capitalized interest will not be eligible for the credit, since payment of such interest is deferred to a future date.

Fi13. Film production companies with existing credit agreements that were approved have found that they have underestimated their Michigan budgets. What is the process to address this situation, and what procedure should be followed?

Production companies should submit a simple addendum in a letter format to the Michigan Film Office that references the original agreement (i.e., by date and unique project number) and contains a) a statement that the addendum is a modification to the expenditures listed in the

existing agreement and the reasons why the original budget will be exceeded, b) a revised budget (utilizing the same categories as those that appear in the agreement), c) revised projections for Michigan production expenditures and total production expenditures, d) a revised estimated credit amount identifying the increase in credit amount, and e) new signatures by authorized representatives of the production company. Approval of the request is not automatic, and the State will respond with a letter authorizing additional film production credit amounts if approved. The approval request must be made in advance of the additional expenditures being made (i.e. before the initial approved budget has been fully expended) to qualify for additional credit. Expenditures made prior to written approval of additional credit by the state will not qualify for credit.

Fi14. Are per diem expenses, living allowances, and car and meal allowances eligible for the Film Production Credit?

Although a qualifying expenditure does not necessarily have to be taxable to the production company itself, the expenditure must nevertheless be "subject to taxation in this state" in order to comply with the statutory requirement. MCL 208.1455(12)(c). In general, per diems are not taxable as compensation at the federal level, therefore they do not get taxed at the state level in Michigan. Additionally, per diems and allowances themselves are not subject to sales, use or other Michigan taxes. As such, while per diem expenses and living, car and meal allowances all constitute payments from a production company directly to employees, in most cases such payments are not "subject to taxation in this state." Therefore, they will not qualify as "direct production expenditures" eligible for the film production credit.

It is important to note, however, that the federal exclusion from income tax of per diems is a preferential tax treatment with certain dollar thresholds on their non-taxability. When those thresholds are exceeded, the excess payment amount becomes taxable compensation at the federal level which will flow through to Michigan's income tax, also as taxable compensation. Because this excess per diem payment amount is "subject to taxation in this state" the excess payment amount would qualify for film production credit if it meets all other qualifying criteria.

Fi15. A "box rental" occurs when an employee of a production company charges the company a weekly fee for the use of his or her own tools. For instance, a makeup person may charge the production company a weekly fee for the use of the brushes, mirrors, and other supplies that she owns and uses on the job. Or, an electrician might provide his own tools and equipment. Do such costs qualify as "direct production expenditures" that are eligible for the Film Production Credit? Must the employee charge the company sales tax in order for the box rental to qualify? Is the answer different if the employee provides his or her services through a loan-out company? What if the box rental includes supplies that are fully expended during the production?

Because a qualifying expenditure must be "subject to taxation in this state", box or kit rentals will be eligible for the film production credit, provided that the employee in question receives compensation for his or her provision of tools or other equipment to the production company that is reported on the employee's W-2 form, or on a separate Form 1099, and is subject to Michigan income tax. This requirement holds whether the employee is employed directly by the production company, or indirectly through a loan-out company. Provided that the taxability requirement stated above is met, it is not necessary for the employee to charge the production company sales tax on the rental fee. Also, it makes no difference for credit eligibility purposes whether some or all of the supplies provided pursuant to the box rental may be fully expended during the course of the production.

Fi16. Are workers' compensation insurance expenditures eligible for film production credit?

Compensation expenditures, including expenditures for fringe benefits, are eligible for the film production credit as either “direct production expenditures” or “qualified personnel expenditures”. This is described in more detail in Treasury’s Michigan Business Tax (MBT) FAQ #Fi 9. Worker’s compensation insurance is considered a fringe benefit, whose eligibility for the film production credit generally follows the eligibility of the wages or compensation that the insurance is related to.

Fi17. Must a Michigan Business Tax annual return be filed to obtain a refund of a film production credit?

Yes, a Michigan Business Tax (MBT) annual return must be filed after the tax year of the film production company to whom the film production credit agreement was issued has ended. Annual returns are due “by the last day of the fourth month after the end of the taxpayer’s tax year.”

The film production credit is a business tax credit; thus, a tax refund, and not a rebate check, will be issued. Once the production company has completed all production related work in Michigan, it must request a post-production certificate from the Michigan Film Office. After all submitted expenditures have been certified to qualify for the credit, the Film Office will issue the certificate, which sets forth the dollar amount of the credit. The production company must file an MBT return to claim its credit, attaching a copy of the post-production certificate to its tax return. MCL 208.1455(7). Error-free returns claiming refundable film production credits are expected to be processed in 3 – 4 weeks.

Fi18. When will expenditures made prior to approval of a film production credit agreement by the State qualify for credit?

Statute states that, except for a qualified production for which production was initiated after February 29, 2008, and before the effective date of the film production credit (which was April 7, 2008), direct production expenditures and qualified personnel expenditures incurred prior to approval of an agreement are not eligible for the credit. MCL 208.1455(3).

If certain productions had been in contact with the Michigan Film Office regarding this issue prior to the effective date of the film production credit, clearly initiated production during the time period specified in the statute, filed an application and agreement promptly after those forms became available, and later received approval of that application and agreement, then qualifying expenditures incurred before that approval will be eligible for the credit, as provided in the statute. However, in no case will pre-approval expenditures be eligible for any production initiated after April 6, 2008, the day before the effective date of the film production credit.

Fi19. Under the Michigan Income Tax Act, MCL 206.367, a film production company that seeks a film production credit must either withhold Michigan income tax on the payments it makes to a PEO/PSC or, alternatively, it must insure that the PEO/PSC has paid the withholding taxes due to Michigan. How will the film production company that withholds Michigan income tax from payments to a PEO/PSC report and pay the amount withheld to the State of Michigan?

It is expected that a film production company seeking a film production credit in Michigan will have a physical presence and employees in this state. An accompanying registration with the Michigan Department of Treasury should exist to enable the film production company to submit the Michigan income tax withheld from employee wages. The film production company should report and pay Michigan income tax withheld from payments made to PEO/PSCs using the same returns and payment processes used for reporting and paying their employee withholding.

A PEO/PSC should issue W-2s to their employees with an allocated portion of the amount withheld by the film production company reported on the W-2 for each employee. A PEO/PSC

should also submit copies of those W-2s to the Michigan Department of Treasury accompanied by a letter explaining the situation and identifying the film production companies that withheld and submitted payment to the Department.

Fi20. A production company owns the rights necessary to produce a video game, but plans to license use rights to a well-known cartoon character so that the character can appear in the game. Would the fees or costs associated with licensing this character from its creator qualify as direct production expenditures that are eligible for the Film Production Credit?

No. Pursuant to the MBT Film Production Credit, a qualifying "direct production expenditure" must be i) made in this state, ii) not a qualified personnel expenditure, iii) directly attributable to the production or distribution of a "qualified production," and iv) subject to taxation in this state. MCL 208.1455(12)(c). With respect to intellectual property such as a cartoon character, the Film Production Credit provides that the following expenditures, if made to a vendor doing business in this state, are "direct production expenditures":

Expenditures for optioning or purchasing intellectual property including, but not limited to, books, scripts, music or trademarks relating to the development or purchase of a script, story, scenario, screenplay, or format, including all expenditures generally associated with the optioning or purchase of intellectual property, including option money, agent fees, and attorney fees relating to the transaction, but not including deferrals, deferments, royalties, profit participation, or recourse or nonrecourse loans negotiated by the eligible production company to obtain the rights to the intellectual property.

MCL 208.1455(12)(c)(*i*)(A). While the term "intellectual property" is sufficiently broad to include cartoon characters, the language of the statute is clear that only expenditures related to "optioning or purchasing" the intellectual property at issue will qualify as "direct production expenditures." "Purchasing" means acquiring full rights to the intellectual property outright, while "optioning" means purchasing the right to acquire full rights to the intellectual property at a later date, usually after financing for a production has been obtained. Licensing the use of a cartoon character to appear in a video game is not equivalent to "purchasing or optioning" the underlying intellectual property.

Moreover, the section expressly provides that "royalties" do <u>not</u> qualify as "direct production expenditures." "Royalties" are commonly defined as usage-based payments made by a licensee to a licensor for ongoing use of an intellectual property right or other intangible asset. The payments made by the production company to the licensor for the use of the licensed cartoon character in the video game would be characterized as royalties. Accordingly, these payments would not qualify as "direct production expenditures" eligible for the Film Production Credit.

If the production company determined to purchase or option the acquisition of full rights to the cartoon character, however, such expenditures might qualify as "direct production expenditures." In that case, however, the expenditures for such rights would also have to be "made in this state," meaning, procured from a source within this state.

Fi21. A company that is the lessee of a building in Michigan intends to make capital improvements to the leased property to convert it into studio space to be used by the film and/or video game production industries. Would the expenditures associated with these improvements qualify as the lessee's "base investment," making the lessee eligible for the Infrastructure Credit?

No. The Infrastructure Credit is not available to lessees of real property, even though planned improvements to the real property may be capital in nature and would be depreciable by the

lessee for federal income tax purposes. Only the owner of the real property is eligible to apply for the Infrastructure Credit with respect to improvements made to the real property.

Fi22. When may an eligible production company claim a film production tax credit pursuant to section 455 of the Michigan Business Tax Act ("MBTA"). MCL 208.1455.
In order to claim a film production tax credit, an eligible production company must submit a postproduction certificate of completion signed by the Film Commissioner to the Department of Treasury, together with its Michigan Business Tax ("MBT") return for the applicable tax year. MCL 208.1455(7). The Michigan Film Office will issue a postproduction certificate signed by the Film Commissioner – the document that actually entitles the production company to a film production tax credit in a specified dollar amount – to an eligible production company after a thorough review of that company's written request. Eligible production companies must submit form "MFO 004-2008" titled "Post-Production Certificate of Completion Request" to the Michigan Film Office to obtain a signed postproduction certificate. Both the form and information on audit requirements are available at the Film Office web site at http://www.michiganfilmoffice.org/For-Producers/Incentives/Default.aspx.

The Department of Treasury has determined that an eligible production company must claim or assign a film production tax credit received pursuant to section 455 of the MBTA in the tax year in which the postproduction certificate, signed by the Film Commissioner, is issued by the Michigan Film Office. An eligible production company may not claim the credit on its MBT tax return for a prior tax year (whether or not an MBT return for that year has already been filed), and similarly, the company may not choose to hold onto the credit and claim or assign it in a later tax year.

In recognition of the confusion that appears to exist in the business community at the time this FAQ is being published, the Department of Treasury will consider written requests from eligible production companies seeking exceptions to the policy expressed above in instances where the eligible production company can demonstrate significant hardship as the result of following the policy; however, exceptions will be granted only for tax years that begin prior to December 1, 2009. The expressed policy will be adhered to for all tax years beginning on or after December 1, 2009, with exceptions granted only in instances where delay in issuance of the postproduction certificate is caused by an error of the Michigan Film Office or Department of Treasury.

Once eligible production companies have submitted their applications for a postproduction certificate, they should allow approximately 60 days for review of the application as provided in statute (MCL 208.1455(5)), assuming the application and required supporting documentation is complete and additional information is not required. Statute also provides that should additional information be required, the review may take longer than 60 days (MCL 208.1455(5)).

Fi23. Does a typical sound recording (for instance, the production of a music CD) qualify as a "qualified production" that is eligible for the Film Production Credit?
Yes. As long as it is produced in a digital media format, a typical sound recording will meet the statutory definition of a "qualified production" and be eligible for the Film Production Credit. Pursuant to the MBT Film Production Credit, a "qualified production" is defined as:

> single media or multimedia entertainment content created in whole or in part in this state for distribution or exhibition to the public in 2 or more states by any means and media in any digital media format, film, or video tape, including, but not limited to, a motion picture, a documentary, a television series, a television miniseries, a television special, interstitial television programming, long-form television, interactive television, music videos, interactive games, video games, commercials, internet programming, an internet video, a sound recording, a video, digital animation, or an interactive website.

MCL 208.1455(12)(k) (emphasis added). The statutory definition further includes a detailed listing of production types that are specifically excluded from the meaning of "qualified production," such as television news programs, live sporting event broadcasts, talk shows and game shows. MCL 208.1455(12)(k)(*i*) – (*xiv*). None of these exclusions relates to the production of a "sound recording," which is separately defined as "a recording of music, poetry, or spoken-word performance, but does not include the audio portions spoken and recorded as part of a motion picture, video, theatrical production, television news coverage, or athletic event." MCL 208.1455(12)(l).

Accordingly, as long as the project is not one of the specifically prohibited types of sound recordings and it otherwise meets applicable statutory requirements (for example, the requirement that the production company spend at least $50,000 in this state on production costs, MCL 208.1455(1)(a)), the production of a typical sound recording, such as a music CD, will be eligible for the Film Production Credit. However, the definition of "qualified production" specifies that the content be created "by any means and media in any digital media format, film, or video tape . . . ." Because productions of sound recordings do not utilize film or video tape, an eligible sound recording would have to be produced using a digital media format.

Fi24. When may an eligible production company claim a film infrastructure tax credit pursuant to section 457 of the Michigan Business Tax Act ("MBTA"). MCL 208.1457?
In order to claim a film infrastructure tax credit, an eligible production company must submit an investment expenditure certificate signed by the Film Commissioner to the Department of Treasury, together with its Michigan Business Tax ("MBT") return for the applicable tax year. MCL 208.1457(7). The Michigan Film Office will issue an investment expenditure certificate signed by the Film Commissioner - the document that actually entitles the production company to a film infrastructure tax credit in a specified dollar amount - to an eligible taxpayer after a thorough review of that taxpayer's written request. Eligible taxpayers must submit form "MFO 005-2008" titled "Film Infrastructure Investment Expenditure Certificate" to the Michigan Film Office to obtain a signed investment expenditure certificate. Both the form and information on audit requirements are available at the Film Office web site at http://www.michiganfilmoffice.org/For-Producers/Incentives/Default.aspx.

The Department of Treasury has determined that an eligible taxpayer must claim or assign a film infrastructure tax credit received pursuant to section 457 of the MBTA in the tax year in which the investment expenditure certificate, signed by the Film Commissioner, is issued by the Michigan Film Office. An eligible taxpayer may not claim the credit on its MBT tax return for a prior tax year (whether or not an MBT return for that year has already been filed), and similarly, the company may not choose to hold onto the credit and claim or assign it in a later tax year.

Once eligible taxpayers have submitted their applications for an investment expenditure certificate, they should allow approximately 60 days for review of the application as provided in statute (MCL 208.1457(5)), assuming the application and required supporting documentation is complete and additional information is not required. Statute also provides that should additional information be required, the review may take longer than 60 days (MCL 208.1457(5)).

Fi25. If all or part of a film infrastructure credit is assigned, and the production facility that was the subject of the credit is later sold, triggering a recapture under the statute, which entity will be responsible for the recapture? The entity that was originally awarded the credit, or the assignee?
The recipient of a film infrastructure credit may assign all or part of that credit to one or more assignees. MCL 208.1457(8). Certain subsequent events, including a sale of the production facility, may trigger a provision in the statute that effectively operates as a recapture of the credit. MCL 208.1457(3)(i). The Department has determined that any recapture of an assigned film

infrastructure credit will be the responsibility of the assignor (the taxpayer that originally received the credit), and not the assignee(s).

Fi26. MCL 208.1457(2)(b) requires that the facility be "complete" before an infrastructure credit may be claimed. But, MCL 208.1457(3)(g) contemplates that only 25% of base investment be expended before credit may be claimed. Given this, can interim tax credit certificates be issued and the tax credits claimed prior to final completion of the project? If so, what happens to interim tax credits if the project is not completed?

Other than the exception specified at MCL 208.1457(2), an investment expenditure certificate for a film and digital media infrastructure credit may be requested and interim credit amounts approved prior to final completion of the project. MCL 208.1457(3)(g) provides that a taxpayer may not claim an infrastructure credit until it expends at least 25% of the base investment approved in the agreement. The Department interprets MCL 208.1457(3)(g) to mean that an investment expenditure certificate need not be issued until after the project has been completed, but may be issued and the credit claimed in increments of at least 25% or more of the total base investment of the project that is expended. While only one investment expenditure certificate is authorized, it may be issued when requested by the taxpayer in the form of a maximum of four increments of the investment expenditure certificate. A first investment expenditure certificate increment cannot be requested until at least 25% of the total base investment authorized under the agreement has been expended. Similarly, second and succeeding investment expenditure increments cannot be requested until at least an additional 25% of the original total base investment has been expended since the preceding investment expenditure certificate increment was authorized. Only the final investment expenditure certificate increment may be issued when less than 25% of the original total base investment is expended. The Film Infrastructure Investment Expenditure Certificate (MFO Form 005-2008), which can be found on the Film Office's website (www.michiganfilmoffice.org), provides for 4 increment certificate amounts.

The requirement for facility completion under MCL 208.1457(2) relates to a specific circumstance where all or a portion of a qualified project is a facility that may be used for purposes unrelated to production or postproduction activities. Such a project is eligible for the infrastructure credit only if the Department determines that "the facility will support and be necessary to secure production or postproduction activity for the production and postproduction facility" and that, in the agreement for the infrastructure credit, the taxpayer agrees both that "the facility will be used as a state of the art production or postproduction facility or as support and component of the facility for the useful life of the facility" and " a credit will not be claimed…until the facility is complete." MCL 208.1457(2). Therefore, the requirement that a project facility be completed before an infrastructure credit may be claimed is limited to that particular situation.

Where a taxpayer requests and receives approval for incremental amounts of an investment expenditure certificate under MCL 208.1457(3)(g) or the amount for the completion of the project under MCL 208.1457(2), and claims a credit against tax liability for such amounts, and there is a subsequent later sale or other disposition of the tangible assets comprising the project, the original taxpayer obtaining the investment expenditure certificate is penalized. The penalty requires the original taxpayer that generated the credit to repay an amount equal to 25% of the gross proceeds or benefit derived from the sale or other disposition of the tangible assets minus the gain, multiplied by the apportionment factor for the taxable year as prescribed in chapter 3, and plus the loss, multiplied by the apportionment factor for the taxable year as prescribed in chapter 3 from the sale or other disposition reflected in federal taxable income and minus the gain from the sale or other disposition added to the business income tax base in section 201. MCL 208.1457(3)(i).

If the infrastructure credit is assigned to another party, the penalty will be the responsibility of the assignor (the taxpayer that originally received the credit) and not the assignee(s). See MBT FAQ Fi25.

Where the project is otherwise not completed in accordance with the agreement for the infrastructure project pursuant to MCL 208.1457, then the taxpayer would be required to repay the state the entire amount of the net tax credit provided. Any agreement for an infrastructure project under MCL 208.1457 necessarily implies that the taxpayer will complete the construction of a functioning and operating film and digital media infrastructure facility. MCL 208.1457(3)(f) and 208.1457(5). If the taxpayer fails to complete the project, it is in breach of the agreement entered into under MCL 208.1457, and the taxpayer would be required to repay the amount of the credit previously claimed and issued.

Fi27. Please confirm that an assignment of a film infrastructure credit can be made any time prior to the return filing deadline for the year in which the Investment Expenditure Certificate is issued. Please also confirm that an assignee wishing to further assign a credit must do so prior to the return filing deadline for the year in which the Investment Expenditure Certificate is issued.

For the taxpayer that generated the Investment Expenditure Certificate, the deadline to claim or assign all or a portion of the infrastructure credit is the end of the taxpayer's tax year in which the original Investment Expenditure Certificate is issued by the Film Office. With regard to the reassignment of the infrastructure credit, the assignee must claim or re-assign the infrastructure credit before the end of the tax year in which that assignee (now assignor) was assigned the infrastructure credit from the immediately prior assignor.

Example: Company X, a calendar year taxpayer, receives an assignment of an infrastructure credit in November 2010. Company X must claim the infrastructure credit on its 2010 MBT return, or re-assign the infrastructure credit no later than December 31, 2010.

Exception: Department of Treasury instructions for the 2009 MBT form 4589 "2009 Michigan Business Tax Film Credit Assignment" state: "The deadline to assign the credit is the return filing deadline of the assignor's tax year in which the certificate is issued. The deadline to reassign the credit is the return filing date for the tax year in which the assignee received the credit." While this policy is being revised as expressed in this FAQ and for future form 4589 instructions, the Department will honor those infrastructure credit assignments that take place in accordance with 2009 instructions.

Fi28. MCL 208.1457(8) contemplates that a film and digital media infrastructure credit may be assigned to an assignee, and also contemplates that such assignee can re-assign to one or more assignees. Can the secondary assignees from the original assignee further re-assign if necessary?

Yes, there is no restriction on the number of re-assignments that may be made. MCL 208.1457(8) provides that a taxpayer eligible to claim the film and digital media infrastructure credit may assign all or a portion of an infrastructure credit to any assignee. It further specifies that an assignee may subsequently re-assign a credit or any portion of the credit assigned to one or more assignees. MCL 208.1457(8). The statute does not limit the number of re-assignments that may be made. All assignments of the credit are irrevocable. The deadline for re-assignment is the end of the tax year in which the assignee (now assignor) received its credit through assignment. Each assignor must complete Form 4589 after the date the Film Office issues Investment Expenditure Certificate and must file the Form 4589 with the Department before the deadline established to assign or re-assign, as applicable. Once the assignment is approved by the Department, the Department's signed Form 4589 will be returned to the assignor. The assignor must furnish each assignee with a copy of the approved form to attach to the assignee's MBT tax return. A separate Form 4589 must be completed for each project and each assignee.

Fi29. MCL 208.1457(9) calls for a credit application and redemption fee of 0.5% of a film and digital media infrastructure credit claimed. How is this fee charged? Is the fee paid in cash or via a reduction of the credit percentage of 25% to 24.5%?

MCL 208.1457(9) provides in pertinent part that "[t]he amount of the [film and digital media infrastructure] credit…shall be reduced by a credit application and redemption fee equal to 0.5% of the credit claim, which shall be deducted from the credit otherwise payable to the taxpayer claiming the credit[.]" The Department interprets this to mean that the credit amount approved for an infrastructure project is reduced via an adjustment of 0.5% to arrive at a net credit amount of 24.5%. Therefore, the amount of the credit to be issued by the Film Office on a taxpayer's investment expenditure certificate and thus the net amount of the credit that a taxpayer may use to offset MBT tax liability will reflect a 0.5% reduction for the credit application and redemption fee. Moreover, if the infrastructure credit issued to a taxpayer is issued incrementally pursuant to MCL 208.1457(3)(g), as provided for in Film Infrastructure Investment Expenditure Certificate (MFO Form 005-2008), then each credit increment will reflect a reduction of the incremental amount approved by the 0.5% application and redemption fee.

Fi30. Is the vintage year of an infrastructure credit the year in which the investment expenditure certificate is approved?

Because the infrastructure credit may be carried forward to offset MBT tax liability for a specified period of years or until used up, whichever is less, the Department presumes that the use of the term "vintage year" in the question is intended to mean the year in which the tax credit may first be used to offset tax liability and when the period of time the carryforward of the credit amount begins. To that end, the infrastructure credit must be claimed in the tax year in which the investment expenditure certificate is issued (i.e. approved) by the Michigan Film Office. The tax year in which the certificate is issued would be the "vintage year." The portion of the credit that exceeds the tax liability of the taxpayer for the tax year may be carried forward to offset MBT tax liability in subsequent tax years subsequent to the "vintage year" for a period not to exceed 10 years or until used up, which occurs first. MCL 208.1455(7).

Fi31. My production company is in a hurry to start pre-production in Michigan, even though our application for the film incentive has not yet been approved. If we have services performed or construction materials delivered, but then wait to make payment for those services or purchases until after the application is approved and an agreement has been entered into, can we later claim those services and purchases as eligible "direct production expenditures"?

No. The MBT Film Production Credit states that "direct production expenditures and qualified personnel expenditures incurred prior to approval of an agreement under this section are not eligible for the credit under this section." MCL 208.1455(3); see also, Michigan Film Office, *Audit Instructions and Expenditure Certification Guidelines*. While the film incentive is calculated based upon expenditures made by a production company that are directly related to the qualified production, the quoted language makes clear that, in order to be eligible for the incentive, qualifying expenditures must be incurred, as well as paid, after the date of the agreement providing for the film incentive. A production-related expenditure is "incurred" on the date that the production company undertakes the obligation to pay. Accordingly, if a production company has services performed or construction materials delivered prior to the date that a film incentive agreement is entered into, the company has undertaken the obligation to pay for such services and materials, and the expenditures have therefore been "incurred" prior to the agreement date, regardless of the fact that they may physically be paid for at a later date.

Similarly, a production company may not "prepay" an anticipated expenditure – for postproduction special effects services, for example – that will actually be incurred after the date that the company requests its Post-Production Certificate of Completion. Because the obligation to pay does not arise until the services are performed, the expenditure has been paid but not incurred within the

relevant time frame. In order to be eligible for the film incentive, qualifying expenditures must be both incurred and paid after the date that the film incentive agreement has been entered into, and prior to the date that the Post-Production Certificate has been requested.

Fi32. How do the Film Office and Treasury determine whether a company is a proper applicant for the film production credit?

The film production credit statute requires that the applicant be an "eligible production company." MCL 208.1455(12)(d). The statute defines an "eligible production company" as the "entity in the business of producing qualified productions …" In other words, with respect to a particular production project it is the entity in charge of making or producing the overall film, video game or other digital media project. As a practical matter, this concept of overall control means that the applicant must have ownership of, and/or legal control over, all of the intellectual property and other rights necessary to complete the production in its entirety, and convert the intellectual property into a finished, concrete media product ready for distribution or exhibition. An applicant with less than overall control over the project is not an "eligible production company" eligible for the credit.

For motion pictures, television series, documentary television, and similar productions, a production company that has been engaged to produce a project pursuant to a "work for hire" type contract is a vendor of the company engaging the "work for hire," and therefore would not be an eligible production company. Production services companies are generally considered vendors for the same reason. In these situations, the company contracting for the "work for hire" likely owns or controls all of the necessary rights to make the overall production, and would be the "eligible production company." For video games, the "eligible production company" with respect to a particular video game project is generally the video game publisher, and not the external development company that has been hired by the publisher to develop the game.

Fi33. What guidelines should an eligible production company follow when requesting a post-production certificate and an independent auditor follow when verifying and performing an audit of the expenditures for a film or digital media production tax credit?

All expenditures incurred and paid by an eligible production company in connection with a state-certified qualified production must satisfy the statutory requirements set forth in MCL 208.1455, particularly the definitions of "direct production expenditure" and "qualified personnel expenditure" set forth in MCL 208.1455(12)(c) and (j), respectively. The Michigan Film Office ("Film Office") and the Michigan Department of Treasury ("Department") require an audit, not simply a review, in connection with every request for a post-production certificate, performed by an independent Michigan Certified Public Accountant ("independent auditor"). The eligible production company and the independent auditor should verify that the expenditures adhere to these requirements and to guidance issued by the Film Office and the Department with regard to MCL 208.1455 and the definitions and scope of direct production expenditures and qualified personnel expenditures under the statute. Guidance currently available – including Frequently Asked Questions, the *Notice to Taxpayers Regarding Film Production Credit Qualified Vendors*, the *Auditing Standards Relating to MBT Film Credit Reports*, and the *Michigan Film Office Audit Instructions and Expenditure Certificate Guidelines* ("*Audit Instructions and Guidelines*") – may be found on the Department's website at www.michigan.gov/taxes concerning the Michigan Business Tax. The *Audit Instructions and Guidelines* may also be found on the Film Office's website at www.michiganfilmoffice.org.

The *Audit Instructions and Guidelines* prescribes standards and procedures that the eligible production company and the independent auditor must follow when verifying expenditures for the film and digital media production tax credit. Generally, these *Audit Instructions and Guidelines* state how expenditures may qualify as direct production expenditures or qualified personnel expenditures eligible for certification. The *Audit Instructions and Guidelines* also address whether and how various types or categories of expenditures may qualify or how they should be treated for purposes of determining certification of qualified production costs. Such categories include:

- Loan or financing interest expense attributed to financing of the qualified production
- Refunds, insurance claim recoveries and purchase discounts and rebates arising out of the qualified production
- Proceeds from sale of equipment, props, production assets and other tangible personal property purchased for use in the qualified production
- Costs allocable to the qualified production of props, equipment, production assets and other tangible personal used in the qualified production and inventoried for use in future productions or activities

The *Audit Instructions and Guidelines* also discuss how the audited cost report submitted to the Film Office in connection the eligible production company's request for a post-production certificate must be formatted and what information the independent auditor must present in the report. The *Audit Instructions and Guidelines* further prescribe that the audit must be performed in accordance with U.S. generally accepted auditing standards and that the auditor must have sufficient knowledge of accounting principles and practices generally recognized in the film, television and digital media industry. It should be noted that the costs attributed to the audit for the request for the post-production certificate do not qualify for the tax credit.

The *Audit Instructions and Guidelines* set forth an acceptable methodology that may be used by the independent auditor to certify that expenditures satisfy the criteria to qualify as direct production expenditures or qualified personnel expenditures, as applicable, for the tax credit. However, the prescribed methodology may not be appropriate for all circumstances. In all cases, the independent auditor must determine and adhere to procedures required to comply with the tax statute and must exercise the auditor's professional judgment when certifying expenditures for the tax credit.

Fi 34. (Answer rescinded, replacement located at Fi 37) What amount of finance fees and interest qualifies for film production credit, and how is it calculated?

Fi35. Are expenditures paid by an eligible production company for shipping and delivery eligible for the film production tax credit?
Shipping and delivery expenditures incurred and paid by an eligible production company that are directly attributable to a qualified production may be eligible for the film production credit. As noted in FAQ Fi1, expenditures paid for services directly attributable to a qualified production may be considered a "direct production expenditure" under MCL 208.1455(13) eligible for the film production credit if, among other criteria also satisfied, the services are wholly performed within the state of Michigan. Like other services, expenditures for shipping and delivery services may qualify for the film production credit if such services are purchased from a Michigan vendor and are wholly performed within the state of Michigan. Accordingly, payments made to a Michigan vendor for shipments or deliveries that took place entirely within Michigan would qualify for the credit. However, shipments that either originate or terminate outside the state of Michigan, or where any portion of such shipment or delivery occurs outside the state of Michigan, would not be a "direct production expenditure" and would not qualify for the credit.

Fi36. Would a new TV network dedicated to a single topic be eligible for the film production credit?
No. However, programming content created for such a new TV network might be eligible.

The television network in the question above is dedicated to a single topic and is of a type that follows more recent trends as a nationwide cable television programming service. Examples of this type of TV network might include The Food Channel and The Golf Channel.

A “qualified production” eligible for the MBT Film Production Credit is defined in pertinent part in the statute as:

[S]ingle media or multimedia entertainment content, created in whole or in part in this state for distribution or exhibition to the general public in 2 or more states by any means and media in any digital media format, film, or video tape, including, but not limited to, a motion picture, a documentary, a television series, a television miniseries, a television special, interstitial television programming, long-form television, interactive television, music videos, interactive games, video games, commercials, internet programming, an internet video, a sound recording, a video, digital animation, or an interactive website.

MCL 208.1455(13)(k). The statute also contains a number of specific exceptions to the definition of “qualified production,” including live sporting events, weather shows, talk shows, game shows, and awards shows. MCL 208.1455(13)(k)(*i*) - (*xiv*).

Expenditures associated with the creation and start-up of a single topic TV network would not be eligible for the Film Production Credit, because the network (channel) itself is not entertainment content, and does not meet the statutory definition of a “qualified production.” However, it is possible that at least some of the actual programming content that may be created to air on the single topic TV network would be eligible for the Film Production Credit.

Fi 37. What amount of finance fees and interest qualifies for film production credit, and how is it calculated?

To qualify for film production credit, finance fees and interest must be “direct production expenditures” as that term is defined in statute, FAQs and other issued guidance. FAQs #Fi1 and #Fi12 provide some general guidance concerning “direct production expenditures” and interest.

Finance fees and interest must satisfy four “direct production expenditure” criteria to qualify for film production credit. They must be i) made in this state, ii) not a qualified personnel expenditure, iii) directly attributable to the production or distribution of a “qualified production, and iv) subject to taxation in this state.

Finance fee and interest expenditures are made in this state if they meet the criteria identified in FAQs and other issued guidance. Finance fees and interest by their nature are not qualified personnel expenditures. Finance fees and interest received for loan services performed in Michigan are subject to taxation in this state.

In addition to the fact that finance fees and interest expenditures that qualify for film production credit must be related to “development, preproduction, production, or postproduction” activity, two general calculation principles are applicable. Because finance fees and interest are generally expenses predicated upon the time value of money, and because the expenditures must also be made in this state, the qualifying activity to which the finance fees and interest relate must take place in Michigan. Finance fees and interest not related to the time during which an otherwise qualifying activity that is being financed takes place in Michigan will not qualify for film production credit.

- Calculation principle #1: Finance fees are prepaid interest and are treated as interest for purposes of this FAQ. Finance fee and interest expenses recorded in the production company’s accounting records in accordance with generally accepted accounting principles qualify for credit. The eligible portion of the accrued and paid interest and fees begins the later of the date of the loan disbursement or when the production activity starts in Michigan and ends when the request for a post

production certificate is submitted to the Film Office or the date the loan is paid, whichever is sooner.

If a production is only partially financed through loans with third party financiers, loan finance fees and interest relate to Michigan activity only in a proportional manner. In other words, funds from loans are not used first to finance Michigan activity any more than self financed funds are.

- Calculation principle #2: Properly recorded finance fee and interest expense can be allocated to Michigan on a prorated basis to the extent Michigan expenditures relate to total expenditures for the production. Estimates of future expenditures to arrive at total expenditures will be acceptable provided they are reasonable and based upon sound estimating principles.

Like other direct production expenditures, only finance fees and interest that have been accrued and paid will qualify for film production credit. Calculation of qualifying finance fees and interest will generally start with finance fees and interest that have been expensed in the accounting records of the production company in accordance with generally accepted accounting principles ("GAAP").

Qualifying "direct production expenditure" finance fees and interest should be calculated using the following formula prescribed by the State:

FORMULA:

Booked Finance Fee and Interest Expense x Spend Ratio

- "*Booked Finance Fee and Interest Expense*" are finance fees and interest expensed in the accounting records of the production company in conformance with generally accepted accounting principles through the date the request for post production certificate was made
- "*Spend Ratio*" is the ratio of Michigan spend to total projected production spend (both net of finance fee and interest expenditures)

SCENARIO #1:

1. Loan documents signed and loan disbursed on May 15th
   - $1,000,000 principal
   - 6% APR
   - 2 year term
2. Agreement approved on May 15th
3. Michigan production activity began on June 1st
4. Request for post production certificate made on September 15 with a total spend of $2,000,000 and Michigan spend of $1,000,000
5. Booked Finance Fee and Interest Expense June 1st through September 15th included in request for post production certificate in the amount of $ $17,589 ($1,000,000 x 6% x 107/365) (note: 30 days in June + 31 days in July + 31 days in August + 15 days in September = 107 days)

Qualifying Finance Fee and Interest Calculation:

$17,589 x ($1,000,000/$2,000,000) = $8,794

SCENARIO #2 (PREPAID INTEREST):

Michigan Business Tax Frequently Asked Questions

1. Loan documents signed and loan disbursed on May 15th
   - $1,000,000 principal
   - 6% APR
   - 2 year term
2. Agreement approved on May 15th
3. Michigan activity began on June 1st
4. Request for post production certificate made on September 15 with a total spend of $2,000,000 and Michigan spend of $1,000,000
5. $120,000 interest for the full 2 year loan term prepaid on May 15th ($1,000,000 x 6% x 730/365) booked as a prepaid interest expense asset
6. Booked Finance Fee and Interest Expense (by accounting entries reducing the prepaid interest account) June 1st through September 15th included in request for post production certificate in the amount of $17,589 ($1,000,000 x 6% x 107/365)

(note: 30 days in June + 31 days in July + 31 days in August + 15 days in September = 107 days)

Qualifying Finance Fee and Interest Calculation:

$17,589 x $1,000,000/$2,000,000 = $8,794

SCENARIO #3 (FINANCE FEES)

1. Loan documents signed and loan disbursed on May 15th
   - $1,000,000 principal
   - 6% APR
   - 2 year term
   - $6,000 finance fees paid at closing and amortized over the term of the loan
2. Agreement approved on May 15th
3. Michigan activity began on June 1st
4. Request for post production certificate made on September 15 with a total spend of $2,000,000 and Michigan spend of $1,000,000
5. Interest expense through September 15th included in request for post production certificate in the amount of $17,589 ($1,000,000 x 6% x 107/365)

(note: 30 days in June + 31 days in July + 31 days in August + 15 days in September = 107 days)

6. Finance fee expense through September 15th included in request for post production certificate in the amount of $ 879 ($6,000 x [107/730])

Qualifying Finance Fee and Interest Calculation:

($17,859+ $879) x $1,000,000/$2,000,000 = $9,369

For more Film Credit information, visit the Michigan Film Office website (No longer available).

Financial Institutions Tax

F1. Do nonresident financial institutions located outside Michigan whose only activity in Michigan consists of an ownership interest in loans secured in whole or in part by real property located in Michigan have nexus under the MBT?

A nonresident financial institution located outside Michigan whose only activity in Michigan consists of an ownership interest in loans secured in whole or in part by mortgages on real property located in Michigan will not have physical presence nexus under the MBT. However, nexus is determined by evaluating all facts and circumstances. To the extent that the nonresident financial institution, or its employee, agent, or independent contractor acting in a representative capacity, has physical presence in Michigan for more than one day, nexus is established. In addition, nexus also exists if the nonresident financial institution actively solicits sales in Michigan as described under RAB 2007-6 and has Michigan gross receipts of $350,000 or more.

F2. The surcharge of the Michigan Business Tax Act, found at MCL 208.1281, exempts "a person subject to the tax imposed and levied under chapter 2B that is authorized to exercise only trust powers." What type of taxpayer fits this description?

Of the types of institutions that qualify as financial institutions in the MBT at section 261(f), those that are organized either as a bank under the Michigan Banking Code of 1999 (MBC) or a savings bank under the Michigan Savings Bank Act of 1996 (SBA) and which are authorized to exercise exclusively trust powers are exempt from the surcharge. A bank or savings bank exercising additional powers or performing additional duties beyond those trust powers authorized in the MBC by MCL 487.14401 through 487.14405 and in the SBA by MCL 487.3421 through 487.3426 does not qualify for the MBT surcharge exemption.

F3. How does a unitary business group ("UBG") composed of financial institutions that includes a bank authorized to exercise only trust powers, which is exempt from the MBT surcharge under MCL 208.1281(4)(b), calculate the surcharge?

Financial institution entities authorized to exercise only trust powers do not lose their identity when they are a part of a unitary business group. When a financial institution authorized to exercise only trust powers is unitary with other financial institutions it maintains its identity as an entity exempt from the surcharge, even though it will file a combined return with other financial institutions. Financial institutions authorized to exercise only trust powers will file a combined return with the UBG but will be removed from the surcharge calculation and not from overall liability. This computation will be performed in calculating Form 4590, 2008 Michigan Business Tax Annual Return for Financial Institutions.

F4. The MBT franchise tax provides financial institutions with a tax base deduction for "the average daily book value of United States obligations and Michigan obligations." MCL 208.1265(1). Does "average daily book value" include the premiums and discounts for U.S. obligations?

Yes, where the premiums and discounts are reflected in the book value of the U.S. obligations.

The MBT defines United States obligations as

> all obligations of the United States exempt from taxation under 31 USC 3124(a) or exempt under the United States constitution or any federal statute, including the obligations of any instrumentality or agency of the United States that are exempt from state or local taxation under the United States constitution or any statute of the United States. MCL 208.1261(s).

Michigan obligation is defined as a bond, note, or other obligation issued by a governmental unit described in section 3 of the shared credit rating act, 1985 PA 227, MCL 141.1053. MCL 208.1261(k).

"Average daily book value" is not a defined term in the MBT or the Federal IRC. "Book value" is commonly understood to be the value at which an asset is carried on the taxpayer's balance th sheet. Black's Law Dictionary, 8 ed. Thus, in order to reach the average daily book value of U.S.

obligations a financial institution will calculate the daily value of the obligation as it appears on the institution's balance sheet and average this value over the days in the financial institution's tax year. If the book value of the U.S. obligation is affected by premiums and discounts on the institution's balance sheet then these amounts will also be included in the computation of average daily book value for purpose of the tax base calculation.

F5. Financial Institutions must calculate the net capital tax base five year look-back period to find the average of net equity and certain deductions. The MBT provides guidance in the case of a merger or acquisition of a financial institution for future tax years only. How does a financial institution that has combined with another financial institution by acquisition calculate the five year averaging period for the year prior to an acquisition? The net capital of each of the combined entities should be included separately in the tax base look back period for years prior to the acquisition. The sum of these separate calculations should then be combined to reach net capital of the surviving financial institution entity. Net capital from the look back period for both the surviving and acquired entities should be included in the calculation of the tax base.

F6. Financial Institutions pay tax under the MBT on net capital. Computation of this tax base requires a financial institution to average the past five years of net equity with certain deductions. How does a unitary business group of financial institutions perform this calculation for entity members that have not been a part of the UBG for five years but became members of the group sometime within the five year look-back period? The term "financial institution" includes a unitary business group of financial institutions. MCL 208.1261(f). A financial institution must compute the current tax year tax base by taking a five year average of net capital. MCL 208.1265(2). For a UBG of financial institutions each member entity of the group must compute net capital, using the five year average, individually. Instructions for Form 4580, MBT Unitary Business Group Combined Filing Schedule. The group then sums the results of the entities' calculations to reach net capital for the group. *Id*. This requirement applies equally to the first year of the MBT, when no members of a UBG of financial institutions will have been members for five years, as it does to tax years ten years out from the first year. Once a member entity is considered a part of a UBG of financial institutions it must compute its individual net equity in accordance with this requirement. This means that an entity that was newly added to the UBG will compute its net capital by using the average of five years of net capital and then adding this result to the results of the other member entities of the group. A shorter look-back period may apply if the new UBG member has not itself been in existence for five years. MCL 208.1265(2).

Insurance Companies Tax

I1. How must a foreign insurer file for purposes of the retaliatory tax when the insurer's state of incorporation requires unitary filing?
A foreign insurer must calculate its burden for purposes of the Michigan retaliatory tax according to the laws of its state of incorporation. If the insurer's state of incorporation requires filing on a unitary basis, the insurer should compute its retaliatory tax burden using this method.

The retaliatory tax is calculated by first computing the burden to the foreign insurer doing business in Michigan and then computing the burden that would be imposed upon a hypothetical Michigan insurer as if it was performing the identical business activity in the foreign state. When making this calculation it should be assumed that the hypothetical Michigan insurer would calculate its liability in the same manner required of the foreign insurer.

I2. Does a unitary group of insurance companies have to file a combined MBT return?

No. Insurance companies are not specifically excluded from the definition of a unitary business group, found at MCL 208.1117(6), and thus may constitute a unitary business group. In practice, however, there is no practical effect of this possibility. The tax on authorized insurance companies is equal to 1.25% of gross direct premiums written on property or risk located or residing in Michigan. MCL 208.1235. Because the tax is only on property or risk located in Michigan there will be no traditional apportionment for insurance companies. Thus, even if an authorized insurance company is unitary with another authorized insurance company under MCL 208.1117(6), this will have no effect in calculating the tax. A combined return will not be necessary.

Misc.

Mi1. (Answer rescinded, replacement located at Mi40) Revenue Administrative Bulletin 2001-2 describes provisions of the SBT related to the tax base of a foreign person for tax years beginning in or after 2000. Does RAB 2001-2 apply to the MBT?

Mi2. How are Professional Employer Organizations and Staffing Companies defined for the MBT and how do the two differ?
Under MCL 208.1113(4) a PEO is defined as an entity that manages and provides human resource assistance for another entity under contract. The PEO must retain "substantial employer rights and responsibilities," as well as several common law rights, as listed in MCL 208.1113(4)(a)-(d), that demonstrate the control of the PEO over the managed entity.

A staffing company is defined under MCL 208.1113(6)(d)(ii) as an entity whose "business activities are included in industry group 736" of the Federal Department of Labor Industrial Classification Code. This industry group represents "establishments primarily engaged in providing employment services."

MCL 208.1113(5) states specifically that a PEO is not a staffing company.

The main business purpose of a PEO, generally, is to provide a client with human resource and human resource management services. PEOs are also typically responsible for payroll, withholding and remitting employment taxes and benefits management for clients. These PEO/client relationships often involve shared control or co-employer agreements. However, as the MBT recognizes, the PEO must maintain the ultimate control in the relationship to be treated as a PEO under the tax.

In contrast, staffing companies generally supply temporary employees to supplement a customer's workforce. Staffing companies have nearly complete control of these employees. In the staffing company situation, the recipient of employees generally has no more control over the employee than direction of daily tasks or rejection of the proffered individual.

Mi3. Is sales tax collected by a retail business considered part of its modified gross receipts under the Michigan Business Tax?
Yes. The seller of tangible personal property is the person legally liable for payment of sales tax. A seller that is reimbursed sales tax by the purchaser of tangible personal property must include in its gross receipts the “entire amount received" from "any activity" unless the amount received is statutorily exempted under MCL 208.1111. Therefore, a taxpayer that receives sales tax from a purchaser as part of a transaction not otherwise exempt under the Michigan Business Tax must include in gross receipts the amount received from the sale of tangible personal property as well as the sales tax received.

Michigan Business Tax Frequently Asked Questions

Mi4. How is the modified gross receipts tax base calculated for professional employment organizations and staffing companies? What is the significance of these different treatments?
MCL 208.1203(3) provides the general rule that the modified gross receipts tax base equals a taxpayer's gross receipts minus purchases from other firms.

For a PEO, gross receipts is defined under MCL 208.1111(t) as "the entire amount received by the taxpayer from any activity" except for amounts charged by a PEO to a client under a PEO arrangement that represent "wages and salaries, benefits, worker's compensation, payroll taxes, withholding, or other assessments paid to or on behalf of a covered employee." Thus, a PEO excludes wages and the cost of wages from gross receipts.

In contrast, a staffing company treats "compensation of personnel" supplied to its customers as "purchases from other firms" when calculating its modified gross receipts tax base. Compensation is defined in MCL 208.1107(2).

Mi5. (Answer rescinded, replacement located at Mi28) Are limited liability companies subject to the MBT?

Mi6. (Answer rescinded, replacement located at Mi34) What is the meaning of the acronym FIRE which appears in the presentation entitled MBT Overview – August 1, 2007 on the Michigan Business Tax Website?

Mi7. For developers in the trade or business of selling real property, does the definition of inventory as used in "purchases from other firms" include real property? No. "Purchases from other firms" means:

(a) Inventory acquired during the tax year, including freight, shipping, delivery, or engineering charges included in the original contract price for that inventory.

(b) Assets, including the costs of fabrication and installation, acquired during the tax year of a type that are, or under the internal revenue code will become, eligible for depreciation, amortization, or accelerated capital cost recovery for federal income tax purposes.

(c) To the extent not included in inventory or depreciable property, materials and supplies, including repair parts and fuel. [MCL 208.1113(6).]

"Inventory" means:

(a) The stock of goods held for resale in the regular course of trade of a retail or wholesale business, including electricity or natural gas purchased for resale.

(b) Finished goods, goods in process, and raw materials of a manufacturing business purchased from another person. [MCL 208.1111(4).]

Neither "stock of goods" nor "finished goods, goods in process, and raw materials" include real property. Furthermore, developers do not generally constitute a "retail or wholesale business" or a "manufacturing business."

Mi8. Will shareholders of S corporations and partners in partnerships be liable for Michigan individual income tax on their share of flow-through income from entities subject to MBT? Does it matter whether the shareholders or partners are residents or

nonresidents?
Both residents and nonresidents of Michigan are subject to Michigan income tax on their share of income from partnerships and S corporations to the extent the income is attributable to Michigan under the allocation and apportionment provisions of the Michigan Income Tax Act (MCL 206.111 - 115) and included in adjusted gross income on the partner or shareholder's federal income tax return. The imposition of the Michigan business income tax on a flow through entity under section 201 of the Michigan Business Tax Act does not affect the imposition of the Michigan income tax under section 51 of the Michigan income tax act (MCL 206.51) on the individual partners or shareholders of the flow through entity.

Mi9. Is the deduction provided under MCL 208.1201(2)(i) altered by the MBT surcharge?
No. The deduction provided in section 201(2)(i) functions to offset the book-to-tax difference or deferred tax liability resulting from the change from the SBT to the MBT. The credit is taken in defined percentages beginning in tax year 2015. MCL 208.1201(2)(i).

MCL 208.1201(3) states that the deduction is only available in "the amount necessary to offset the net deferred tax liability" which would result under the business income tax under section 201 and the modified gross receipts tax under section 203. The amount of the deferred tax liability and the corresponding deduction will be calculated without reference to the surcharge**,** and the deduction will therefore remain the same as calculated prior to the enactment of 2007 PA 145.

The Department recognizes that this is a significant issue for the business community creating a need for guidance upon which it can rely. While the business community may rely on this form of guidance, the Department also intends to issue a Revenue Administrative Bulletin in the near future that further explains the position described above.

Mi10. Does the deduction provided under MCL 208.1201(2)(i) reduce the MBT surcharge imposed under MCL 208.1281(1)?
Yes. MCL 208.1201(3) directs that the deduction "is intended to flow through and reduce the surcharge imposed and levied under section 281." (Emphasis added). This same section explains that the deduction is calculated as the "the amount necessary to offset the net deferred tax liability" which would result under the business income tax under section 201 and the modified gross receipts tax under section 203. MCL 208.1201(3). The surcharge is calculated against a "taxpayer's liability under [the MBT] after allocation or apportionment to this state under this act but before calculation of the various credits." The surcharge is, thus, calculated against a taxpayer's business income and gross receipt liabilities. Therefore, the deduction, which reduces the business income tax base upon which the surcharge is calculated, will flow through and reduce the surcharge.

The Department recognizes that this is a significant issue for the business community creating a need for guidance upon which it can rely. While the business community may rely on this form of guidance, the Department also intends to issue a Revenue Administrative Bulletin in the near future that further explains the position described above.

Mi11. Will an Employee Stock Ownership Plan ("ESOP"), a tax exempt trust under federal laws, be liable for Michigan income tax under the Michigan Income Tax Act ("ITA"), 1967 P.A. 281, for it's share of flow-through income from a S corporation that is subject to MBT?
No. An ESOP that is a qualified retirement plan under section 401(a) of the Internal Revenue Code (26 U.S.C.A. 1 et seq) is exempt from federal income tax under section 501(a) of the code. If an S corporation establishes an ESOP for it's employees, the ESOP retirement trust fund will consist primarily or exclusively of stock from the S corporation. As long as the retirement plan

maintains it's tax exempt status under §501, the trust's pro-rata or flow-through share of earnings from the S corporation are exempt from federal income tax.

The Michigan income tax is imposed on the taxable income of a person who is an individual, an estate, or a trust pursuant to section 51 of the ITA (MCL 206.51). Under section 201 of the ITA (MCL 206.201), a person who is exempt from federal income tax pursuant to the provisions of Internal Revenue Code shall be exempt [from the tax imposed by the ITA] except for the unrelated business income of the exempt person as determined under the Internal Revenue Code. Therefore, an ESOP that is exempt from federal income tax under §501 of the Internal Revenue Code and has no unrelated business income is exempt from Michigan income tax pursuant to MCL 206.201. Any unrelated business income of the ESOP that is subject to federal income tax would also be subject to the Michigan income tax imposed on trusts under MCL 206.51.

Mi12. Can new motor vehicle and watercraft dealers who separately itemize and collect the modified gross receipts (MGR) tax from customers, in addition to the sales price, collect amounts in excess of the amount of taxes remitted to the Department?

No. Section 203(5) of the MBT Act permits new motor vehicle dealers licensed under the Michigan vehicle code, 1949 PA 300, MCL 257.1 to 257.923, and dealers of new or used personal watercraft to collect the modified gross receipts tax in addition to the sales price. MCL 208.1203(5). The Act states that the "amount remitted to the Department for the [modified gross receipts tax]…shall not be less than the stated and collected amount." MCL 208.1203(5). Therefore, the entire amount of MGR taxes stated and collected by new motor vehicle dealers and new and used watercraft dealers in addition to sales price must be remitted to the Department. There should be no instance where a dealer would be collecting amounts of MGR taxes from customers in excess of the amount of taxes remitted to the Department.

Mi13. Are cooperatives organized under IRC 1381(a)(2) exempt from the MBT?

Cooperatives organized under IRC 1381(a)(2) include any corporation operating on a cooperative basis other than tax-exempt organizations; mutual savings banks, cooperative banks, and domestic savings associations; insurance companies; and organizations engaged in furnishing electric or telephone service to rural communities. IRC 1381(a)(2).
Under the MBT, relevant exemptions from tax include:

> (b) A person who is exempt from federal income tax under the internal revenue code . . .
>
> * * *
>
> (c) A nonprofit cooperative housing corporation. As used in this subdivision, "nonprofit cooperative housing corporation" means a cooperative housing corporation that is engaged in providing housing services to its stockholders and members and that does not pay dividends or interest on stock or membership investment but that does distribute all earnings to its stockholders or members. The exemption under this subdivision does not apply to a business activity of a nonprofit cooperative housing corporation other than providing housing services to its stockholders and members.
>
> * * *
>
> (e) Except as provided in subsection (2), a farmers' cooperative corporation organized within the limitations of section 98 of 1931 PA 327, MCL 450.98, that was at any time exempt under subdivision (b) because the corporation was exempt from federal income taxes under section 521 of the internal revenue code and that would continue to be exempt under section 521 of the internal revenue code except for either of the following activities:
>
> (i) The corporation's repurchase from nonproducer customers of portions or components of commodities the corporation markets to those nonproducer customers and the corporation's subsequent manufacturing or marketing of the repurchased portions or components of the commodities.

(ii) The corporation's incidental or emergency purchases of commodities from nonproducers to facilitate the manufacturing or marketing of commodities purchased from producers.

(f) That portion of the tax base attributable to the direct and indirect marketing activities of a farmers' cooperative corporation organized within the limitations of section 98 of 1931 PA 327, MCL 450.98, if those marketing activities are provided on behalf of the members of that corporation and are related to the members' direct sales of their products to third parties or, for livestock, are related to the members' direct or indirect sales of that product to third parties.

* * *

(2) Subsection (1)(e) does not exempt a farmers' cooperative corporation if the total dollar value of the farmers' cooperative corporation's incidental and emergency purchases described in subsection (1)(e)(ii) are equal to or greater than 5% of the corporation's total purchases.

(3) Except as otherwise provided in this section, a farmers' cooperative corporation that is structured to allocate net earnings in the form of patronage dividends as defined in section 1388 of the internal revenue code to its farmer or farmer cooperative corporation patrons shall exclude from its adjusted tax base the revenue and expenses attributable to business transacted with its farmer or farmer cooperative corporation patrons. [MCL 208.1207.]

In other words, certain cooperatives exempt from federal income tax, nonprofit cooperative housing corporations, and qualifying farmers' cooperative corporations are exempt from the MBT. No further exemptions under the MBT are permitted for cooperative corporations. Since cooperatives under IRC 1381(a)(2) do not include tax-exempt organizations, a cooperative organized under IRC 1381(a)(2) is only exempt under the MBT to the extent that it is a nonprofit cooperative housing corporation under MCL 208.1207(1)(c) or a farmers' cooperative corporation under MCL 208.1207(1)(e), (f).

Finally, the exemption provisions applicable to cooperative corporations under the MBT are generally the same as those found under the SBT. Thus, a cooperative exempt from the SBT under MCL 208.35 is likely to be exempt from the MBT under MCL 208.1207.

Mi14. Will charitable trusts be subject to the MBT?

Generally, no. A charitable trust that is exempt from federal income tax under section 501(a) of the Internal Revenue Code would be exempt from MBT under section 207(1)(b) of the MBT act (MCL 208.1207(1)(b)). However, any unrelated business income of the trust that is subject to federal income tax under the Internal Revenue Code would also be subject to MBT if the applicable filing thresholds and nexus standards are met.

Mi15. If an entity is subject to the Business Income Tax, will the entity's members/shareholders be subject to Michigan personal income tax?

Yes. Michigan income tax is imposed under section 51 of the Michigan Income Tax Act (MCL 206.51) on the taxable income of an individual as defined under section 30 of the Michigan Income Tax Act, MCL 206.30. "Taxable income" under section 30 means adjusted gross income as defined under the Internal Revenue Code, 26 U.S.C.A. 1 et seq., subject to a specific series of statutory additions and subtractions, including adjustments for allocation and apportionment. Since there is no specific adjustment allowed for income subject to the MBT under MCL 206.30, and there is no applicable pre-emption language in the MBT, an individual shareholder, partner, or other member of an entity subject to MBT will also be subject to Michigan income tax on a distributive or pro-rata share of such income that is included in the members adjusted gross income, attributable to Michigan under the allocation and apportionment provisions of the Michigan Income Tax Act, and not otherwise subject to removal (*e.g.* income from U.S. obligations) under MCL 206.30.

Mi16. Are small businesses exempt from the imposition of the surcharge?

There is no specific exemption from the MBT surcharge for small businesses. However, as was the case before the MBTA was amended to include the imposition of the surcharge, a taxpayer (except a financial institution or insurance company) whose apportioned or allocated gross receipts are less than $350,000 "does not need to file a return or pay the tax imposed under this act." MCL § 208.1505(1). A gross receipts filing threshold credit is available to taxpayers whose apportioned or allocated gross receipts are between $350,000 and $700,000. MCL § 208.1411. In addition, a small business alternative credit is available to eligible taxpayers under section 417 of the MBTA. MCL § 208.1417. Depending upon facts and circumstances, the small business alternative credit can be utilized to mitigate up to 100% of an eligible taxpayer's MBT liability. MCL § 208.1417(5).

Mi17. Under the MBTA, is the section 281 surcharge imposed before or after available credits are applied? Does the surcharge apply to both the modified gross receipts tax and the business income tax? Can the alternative small business credit eliminate liability for the surcharge?

Section 281(1) of the MBTA provides as follows:

(1) In addition to the taxes imposed and levied under the act …, to meet deficiencies in state funds an annual surcharge is imposed and levied on each taxpayer equal to the following percentage of the taxpayer's tax liability under this act after allocation or apportionment to this state under this act but before calculation of the various credits available under this act:

(a) For each taxpayer other than a person subject to the tax imposed and levied under chapter 2B, 21.99%.

MCL § 208.1281(1). Thus, the surcharge is imposed on each taxpayer subject to the MBT *after* allocation or apportionment under section 301, but *prior to* the calculation and application of any available credits, including SBT credits carried forward by the taxpayer. Section 281(5) provides that the surcharge "shall constitute a part of the tax imposed under this act and shall be administered, collected, and enforced as provided under this act." MCL § 208.1281(5).

Under the statutory language quoted above, the surcharge is imposed upon "the taxpayer's tax liability under this act." MCL § 208.1281(1). Subject to filing thresholds, nexus standards, and exemptions, both the modified gross receipts tax and the business income tax are components of a taxpayer's MBT liability. Accordingly, the surcharge applies to both the modified gross receipts tax and the business income tax.

The various credits available under the MBT can be utilized to mitigate a taxpayer's tax liability only to the extent specified in the statute. With respect to the small business alternative credit, section 417(1) provides that this credit is to be taken *after* the credits provided for in sections 403 and 405. MCL § 208.1417(1). The combined compensation and investment tax credits allowed under section 403 may not exceed 50% of the taxpayer's total MBT liability in tax year 2008 and 52% of the taxpayer's total MBT liability in tax years 2009 and beyond, while the research and development credit allowed under section 405, combined with the taxpayer's total section 403 credits, cannot exceed 65% of the taxpayer's total tax liability under the MBT. MCL §§ 208.1403(1); 208.1405.

If the taxpayer is then eligible for and calculates the section 417 small business alternative credit, the amount of the credit "shall not exceed 100% of the tax liability imposed under this act." MCL § 208.1417(5). Since the surcharge (which constitutes a part of the taxpayer's tax liability imposed under the act) is imposed *prior to* the calculation of any credits, including the section 417 small business alternative credit, it is possible that the application of that credit could totally

eliminate the taxpayer's tax liability for that tax year, including the amount of that liability that is attributable to the surcharge.

Mi18. (Answer rescinded, replacement located at Mi28) Are limited liability companies subject to the MBT?

Mi19. Under the Michigan Business Tax Act (MBTA) will corporations still be able to deduct the statutory exemption from the adjusted tax base before calculating tax as was available under the Single Business Tax Act (SBTA)?
No. The statutory exemption provided by section 35 of the SBTA, MCL 208.35(1)(a), is not available under the MBTA. Section 207 of the MBTA, MCL 208.1207, which lists the exemptions from the Michigan Business Tax, does not contain a statutory exemption for any type of business entity.

Mi20. Is the MBT going to accept the federal treaty benefit on the 1120F?
For the calculation of the business income tax base under section 201 (MCL 208.1201), the starting point is federal taxable income derived from business activity (MCL 208.1105(2)). To the extent a foreign corporation is able to exclude income from the calculation of federal taxable income under the provisions or terms of an executed tax treaty between the U.S. and a foreign country, that same income will be excluded from the business income tax base on the MBT return, and not subject to the income tax imposed under section 201 of the MBT.

For the calculation of the modified gross receipts tax base under section 203 (MCL 208.1203), gross receipts is defined under section 111 (MCL 208.1111) to mean "the entire amount received from any activity whether in intrastate, interstate, or foreign commerce carried on for direct or indirect gain, benefit, or advantage to the taxpayer or to others," subject to specifically enumerated exceptions. Gross receipts sourced to Michigan but exempt from the calculation of federal taxable income under the terms of a tax treaty with a foreign country are *not* one of the specifically enumerated exceptions, and are therefore subject to the modified gross receipts tax imposed under section 203 of the MBT.

Mi21. Will a taxpayer whose final SBT return is for a period of less than four months need to remit SBT estimates? For example, will a taxpayer with a fiscal year end of September 30, 2008, whose final SBT return is for the period October 1, 2007 through December 31, 2007, be required to file an SBT estimate?
No. An SBT estimate is not required when a taxpayer's final SBT return is for a period of less than four full calendar months. Payment for all taxpayers' final SBT return will be due on April 30, 2008.

Mi22. For purposes of calculating the $350,000 filing threshold in section 505(1); will "gross receipts" as defined in section 111 be used, or will the filing threshold be determined by "sales" as defined in section 115? What meaning is given to the term "apportioned or allocated gross receipts"?
The definition of "gross receipts" will be used to calculate the $350,000.00 filing threshold <u>not</u> the definition of "sales." This is based upon the express language of section 505(1) that the filing threshold is determined by "apportioned or allocated <u>gross receipts</u>." The term "apportioned or allocated" has the same meaning as in the Michigan Business Tax Act. When a taxpayer's business activity is subject to tax within and outside of Michigan its tax base is apportioned, and business activity confined solely to this state results in the tax base being allocated to Michigan.

Mi23. Can a unitary group, as defined in the MBT, enter into a voluntary disclosure agreement with the Department of Treasury under MCL 205.30c if one member of the group would be disqualified on its own?

No, apart from nexus, a disqualification present for one member of a unitary business is imputed to the entire group. As a threshold matter, a person must make an application, be a non-filer, have nexus with Michigan and/or have a reasonable basis to contest liability. MCL 208.30c(2). "Person" is defined at MCL 205.30c(15)(c) as

> an individual, firm, bank, financial institution, limited partnership, copartnership, partnership, joint venture, association, corporation, limited liability company, limited liability partnership, receiver, estate, trust, <u>or any other group or combination acting as a unit</u>. [Emphasis added].

A unitary group is a "group or combination acting as a unit." Thus, if one member of the group cannot meet the qualifications for an agreement neither can the unitary group.

Mi24. If a taxpayer is disqualified from voluntary disclosure, available at MCL 205.30c, under the Single Business Tax, is the taxpayer disqualified under the Michigan Business Tax? Specifically, if a taxpayer filed SBT returns, is it considered a filer for voluntary disclosure purposes under the MBT?

No, a taxpayer is not disqualified for voluntary disclosure purposes under the Michigan Business Tax because of disqualification under the Single Business Tax. The MBT is a distinct and separate tax from the SBT. The provisions of the revenue act apply to the two taxes independently.

Mi25. (Answer rescinded, replacement located at Mi44) Does the MBT follow the federal check-the-box regulations?

Mi26. When is the final SBT return due for a fiscal year taxpayer? Can a fiscal year filer request an extension for the final SBT return?

A fiscal year SBT taxpayer must file a short year return for the period from the beginning of its 2007-08 fiscal year through December 31, 2007. The filing deadline for that final SBT return is April 30, 2008.

An extension of time to file the return may be requested. For the final SBT return only, if a properly prepared application along with appropriate estimated tax payments are received by April 30, 2008, the Department will adjust the deadline for filing the final return to the last day of the fourth month after the end of the fiscal year reported on the federal return (2007-08), and will grant an extension of 180 days from that date to file the tax return. If the taxpayer indicates they have been granted an extension to file their federal income tax return, the Department of Treasury will grant the same length of time as the federal extension plus an additional 60 days. MCL 208.73(4)

For example, a taxpayer reporting a fiscal year on their federal return beginning June 1, 2007 and ending May 31, 2008 must file a short period SBT return for the period beginning June 1, 2007 and ending December 31, 2007. This return will be due April 30, 2008. Upon request, an extension will be granted to March 31, 2009, which is 180 days after September 30, 2008, the date that the federal return ending May 31, 2008 would be due for SBT purposes. A taxpayer with a federal extension would be extended to May 31, 2009.

If the standard SBT extension period is not sufficient to allow a fiscal year taxpayer to gather necessary information for its final SBT return, the Department will, upon request, grant a special extension appropriate to the circumstances.

However, an extension of time to file is not an extension of time to pay. Any tax due on the annual return must be paid by the original due date, which is the last day of the fourth month after the end of the fiscal year, in this case April 30, 2008.

Mi27. (Answer rescinded, replacement located at Mi45) Are controlled foreign corporations ("CFC's") under IRC 957 taxpayers under the MBT? Can controlled foreign corporations be members of a unitary business group? What if the controlled foreign corporation is a disregarded entity of a U.S. parent?

Mi28. (Answer rescinded, replacement located at Mi46) Are single member limited liability companies and qualified subchapter S subsidiaries ("QSubs") disregarded for federal tax purposes also disregarded under the MBT?

Mi29. Are condominium, homeowners, and timeshare associations taxed under IRC 528 or IRC 277 exempt from the MBT?
Under the MBT, relevant exemptions include:

A person who is exempt from federal income tax under the internal revenue code . . . except the following:
* * *
(iii) The tax base attributable to the activities giving rise to the unrelated taxable business income of an exempt person. [MCL 208.1207(b).]

Under IRC 528, qualified condominium management, residential real estate management, and timeshare associations are exempt from federal income tax on their exempt function income for each year in which the taxpayer makes the proper election under IRC 528(c)(1)(E). Thus, condominium management, residential real estate management, and timeshare associations taxable under IRC 528 are generally exempt from the MBT under MCL 208.1207(b). However, condominium management, residential real estate management, or timeshare associations are subject to the MBT on any taxable income under IRC 528 – or if such associations decline to make the IRC 528(c)(1)(E) election.

In contrast, by definition, organizations subject to tax under IRC 277 are not exempt from federal income tax under the IRC. IRC 277(a). Thus, organizations subject to tax under IRC 277 are not exempt from the MBT.

The exemption language governing condominium, homeowners, and timeshare associations under the MBT is essentially identical to that used in the SBT. In other words, to the extent an association taxed under IRC 528 was exempt from the SBT, that taxpayer is likely exempt under the MBT as well.

Mi30. Will Voluntary Disclosure continue with the Michigan Business Tax?
Yes, the Department is required to administer the Michigan Business Tax under the Revenue Act, 1941 PA 122. See MCL 208.1513(1). Voluntary Disclosure agreements are provided for under the Revenue Act at MCL 205.30c. The State Treasurer, or a representative, is authorized to enter into a voluntary disclosure agreement with non-filers that have a nexus filing responsibility and who meet certain other statutory criteria. Under a voluntary disclosure agreement, eligible persons may file returns and pay taxes and interest for a limited lookback period of four years without imposition of penalties, in exchange for future tax compliance.

While Voluntary Disclosure will continue with the Michigan Business Tax a taxpayer must still meet the statutory qualifications to enter into an agreement.

Michigan Business Tax Frequently Asked Questions

Mi31. Does the MBT provision which states that the MBT is imposed, "[i]n addition to all other taxes for which the taxpayer may be liable," MCL 208.1513(4), mean the MBT is imposed upon oil and gas activity also subject to the Severance Tax?
No.

Mi32. Can a taxpayer use data from its SBT tax periods in calculating the loss adjustment for purposes of determining eligibility for the Alternative Small Business Credit under MCL 208.1417?
Yes, the Department will allow the use of a "loss adjustment" from a period prior to the start of the MBT for purposes of determining qualification for the Alternative Small Business Credit under MCL 208.1417. In computing eligibility for the Alternative Small Business Credit, the MBTA defines "loss adjustment" to mean, in pertinent part, "the amount by which adjusted business income was less than zero in <u>any</u> of the 5 tax years immediately preceding the tax year for which eligibility for the credit under this section is being determined." MCL 208.1417(9)(d) [Emphasis added]. Therefore, a taxpayer may utilize data for the respective tax years under the SBT to calculate eligibility for the Alternative Small Business Credit for MBT tax year 2008 through 2012.

Mi33. What kinds of expenses qualify for the MBT credit under MCL 208.1451 that applies to beverage distributors who originate deposits on beverage containers?
The Bottle Deposit Administration Credit was added to the MBT as part of 2007 PA 145. Section 451 provides that a distributor or manufacturer who originates a deposit on a beverage container in accordance with Michigan's Bottle Bill, MCL 445.571 to 445.576, may claim a credit against its MBT liability equal to (a) 30.5% of the taxpayer's expenses incurred during the tax year to comply with the Bottle Bill, if the section 281 surcharge is imposed in the same year, or (b) 25% of such expenses if the surcharge is not imposed in the same year. MCL 208.1451(1)(a) and (1)(b). If the amount of the allowed credit exceeds the taxpayer's tax liability for the tax year, the excess is not refunded and may not be carried forward as an offset against the taxpayer's tax liability in future years. MCL 208.1451(2).

Section 451 does not define "expenses" or specify the types of expenses that qualify for the credit. In order to comply with the Bottle Bill, distributors who originate deposits on beverage containers (meaning that they charge the deposit to their retailer customers) typically pick up empty beverage containers from retailers (usually at the same time that they distribute new product), process the returned containers as required, and sell the materials into the recycling market. Distributors also have reporting and payment obligations with respect to unclaimed bottle deposits. MCL 445.573a; 445.573b. Thus, distributors may incur expenses related to receiving and sorting empty containers, storing containers, cleaning or crushing containers, and recordkeeping. A distributor's compliance-related expenses will vary depending on whether the retailers it collects from use reverse vending machines. Reverse vending machines crush or shred the returned containers, eliminating or reducing the need (and cost) for distributors to collect and process the material recovered.

In order to qualify for the Bottle Deposit Administration Credit, expenses must be ordinary, necessary, and directly related to the taxpayer's compliance with the Bottle Bill. "Ordinary" means that another manufacturer or distributor who originates deposits would likely incur a similar expense in complying with the Bottle Bill. "Necessary" means that the expense is one the taxpayer would not have incurred absent the necessity of complying with the Bottle Bill. "Directly related" means that the main purpose of the qualifying expenditure was compliance with the requirements of the Bottle Bill. For example, a can-crushing machine purchased in order to process the empty deposit beverage containers picked up from retailers would probably qualify for the credit in the year of purchase. A printer purchased for general office use, and which is also used to occasionally print reports related to bottle deposits, would not qualify.

Taxpayers claiming the Bottle Deposit Administration Credit must maintain adequate documentation, through business books and records, supporting all expenses for which the credit is claimed.

Mi34. What is the meaning of the acronym FIRE which appears in the presentation entitled MBT Overview–August 1, 2007 on the MBT Website?

The acronym FIRE, at slide 12 of the presentation, stands for Financial Sector, Insurance Sector and Real Estate Sector. The presentation, which was one of the Department's earliest overviews of the newly enacted Michigan Business Tax Act (MBTA), indicated that these industries may pay more under the MBT than under the SBT.

Insurance companies will pay a gross direct premiums tax of 1.25% under the MBT, as addressed in Chapter 2A of the MBTA. Financial institutions will pay a tax on net capital at a rate of 0.235%, as explained in Chapter 2B. Real estate entities, like all taxpayers not taxed under Chapters 2A or 2B, are subject to the Business Income and Modified Gross Receipts taxes found in MCL 208.1201 and MCL 208.1203, respectively.

On December 1, 2007, the MBTA was amended to impose, in addition to the taxes described above, an annual surcharge on each taxpayer, except insurance companies. The surcharge is equal to a specified percentage of the taxpayer's MBT liability, after allocation or apportionment to Michigan, but before calculation of the various credits in the MBTA.

For a financial institution, the MBT surcharge is 27.7% for tax years ending in 2008, and 23.4% for tax years ending in 2009 and later. Financial institutions authorized to exercise only trust powers are not subject to the surcharge.

For real estate entities, like all taxpayers other than insurance companies and financial institutions, the MBT surcharge is equal to 21.99% of MBT liability.

The amount of the surcharge imposed on any taxpayer, other than financial institutions, cannot exceed $6,000,000.00 for any single tax year.

Mi35. Will public libraries receive any moneys from the Michigan Business Tax? There was a provision in the Single Business Tax Act that directly funded public libraries, will this continue under the MBT?

There is no provision in the Michigan Business Tax Act that directly funds public libraries, nor did such a provision exist in the Single Business Tax Act. At the time of its repeal, the revenue generated from the SBT was distributed to the General Fund, with no amounts earmarked for particular programs. The revenue generated from the MBT will be distributed to the School Aid Fund and General Fund per MCL 208.1515, again with no amounts earmarked for particular programs.

The State Revenue Sharing program distributes sales tax collected by the State of Michigan to local governments as unrestricted revenues. The distribution of funds is authorized by the State Revenue Sharing Act, Public Act 140 of 1971, as amended (MCL 141.901).

As part of the legislation associated with the adoption of the Single Business Tax in 1975, Michigan exempted business inventories from the property tax. To hold local units harmless for this change, a portion of SBT revenue at that time was earmarked for distribution to local units through the revenue sharing process. In 1996 Public Act 342 changed both the basis on which the funds are distributed and the source of revenue-sharing funds, removing income tax and SBT revenue and replacing it with additional sales tax revenue.

Generally, revenue distributed under the Act is unrestricted: Local units have complete control over how the funds are used. However, local units that collect property taxes for eligible authorities were required under Section 912a of the Revenue Sharing Act to remit a portion of any payments received under the Act to the eligible authorities for which they collected taxes, generally the amount received by the eligible authority for the 1997-1998 state fiscal year. This section of the State Revenue Sharing Act expired September 30, 2007.

Mi36. If a taxpayer that is a unitary business group has a business loss carry forward under MCL 208.1201(5), what happens to the business loss carry forward if membership in the unitary business group changes?

When the membership of a taxpayer that is a unitary business group changes, the business loss carryforward of the unitary business group is divided among the unitary business group and the departing members in proportion to the losses the members would have generated had each member filed separately. Specifically, the portion of the business loss carryforward of a taxpayer that is a unitary business group attributable to a departing member is an amount equal to the business loss carryforward of the unitary business group multiplied by a fraction, the numerator of which is what would have been the business loss of that member had that member filed a separate return, and the denominator of which is the sum of what would have been the separate business losses of all members of the group in that year having business losses if those members filed separate returns.

Example. Taxpayer LMNOP is a unitary business group comprised of Corporations L, M, N, O, and P. The 2008 tax year generated an apportioned business loss of $100 to be carried forward to the 2009 tax year. However, due to a change in ownership, Corporation P is not part of the unitary business group for the 2009 tax year. If each member calculated their business income tax base on a separate basis for 2008, only Corporations N, O, and P showed losses of 50, 70, and 30 respectively. P gets a business loss carryforward of $20 [(30/(50+70+30))*100) for the 2009 tax year. Taxpayer LMNO retains a business loss carryforward of $80.

Mi37. Are mortgage companies financial institutions under the Michigan Business Tax?

MCL 208.1261(f) defines a financial institution as

(i) A bank holding company, a national bank, a state chartered bank, an office of thrift supervision chartered bank or thrift institution, or a savings and loan holding company other than a diversified savings and loan holding company as defined in 12 USC 1467a(a)(F).

(ii) Any person, other than a person subject to the tax imposed under chapter 2A, who is directly or indirectly owned by an entity described in subparagraph (i) and is a member of the unitary business group.

(iii) A unitary business group of entities described in subparagraph (i) or (ii), or both.

Thus, even though a mortgage company is not expressly defined as a financial institution, it will be considered a financial institution if it is owned directly or indirectly by a financial institution and is a member of the unitary business group that the parent financial institution is also a member. If a mortgage company meets these criteria, it is a financial institution under the MBT.

Mi38. Are regulated investment companies subject to the Michigan Business Tax? If so, does the MBT provide a deduction for dividends paid similar to Federal Form 1120-RIC, U.S. Tax Return for Regulated Investment Companies?

Yes. Regulated Investment Companies (RIC) are subject to the MBT. An RIC is any domestic corporation that registers or files an election to be an RIC and meets specific criteria in Section

851 of the IRC. These corporations are taxable in both the business income and modified gross receipts tax bases of the MBT.

"Business income" is defined generally as "that part of federal taxable income derived from business activity." MCL 208.1105(2). This means, for the business income tax base, that the federal return flows through to the MBT return to the extent the federal return represents income from business activity. Because Form 1120-RIC allows a deduction for dividends paid (defined at IRC 561) that deduction will flow through to the MBT return. There is no additional deduction for this expense in the MBT.

The modified gross receipts tax base is gross receipts less "purchases from other firms," as defined in MCL 208.1113(6), before apportionment. MCL 208.1203(3). "Purchases from other firms" does not include the dividends paid expense. There is not a deduction for dividends paid in this tax base.

Mi39. MCL 208.1201(2) provides a deduction for the book-to-tax difference or deferred liability resulting from the change from the SBT to the MBT. Is the deduction available to a privately held, cash-basis partnership that is not required to (and does not) maintain its books in accordance with generally accepted accounting principles?
No. The deduction provided under MCL 208.1201(2), commonly know as the FAS 109 deduction, does not apply to a taxpayer that does not keep its books in accordance with GAAP.

The plain language of the statute makes clear that only taxpayers that use GAAP qualify for the credit. Section 201(3) states

The deduction … shall not exceed the amount necessary to offset the net deferred tax liability of the taxpayer as computed in accordance with generally accepted accounting principles.

A cash method or cash basis taxpayer may take the deduction to offset the book-to-tax difference or deferred tax liability if that taxpayer keeps its books in accordance with GAAP.

Mi40. RAB 2001-2 describes provisions of the SBT related to the tax base of a foreign person for tax years beginning in or after 2000. Does RAB 2001-2 apply to the MBT? No, RAB 2001-2 does not apply to the MBT as the MBT's statutory provisions are distinctly different from those in the SBT.

Additionally, RABs issued to provide guidance under the SBT are not directly applicable to the MBT.

Mi41. (This FAQ has been amended due to 2011 PA 305.) Is interest, dividend and capital gains investment income generated by an LLC, the members of which are trusts and which was set up solely for the purpose of pooling and investing money gifted to children's and grandchildren's trusts, subject to MBT?
Probably not. Interest, dividend, and capital gains investment income are generally included in business income and gross receipts unless an enumerated exception applies. One such exception is for receipts from investment activity of a taxpayer that is an individual, estate or other person organized for estate or gift planning purposes that are derived from transactions, activities or sources other than those in the regular course of the person's trade or business. MCL 208.1105(2) and 208.1111(1)(w). Interest income, dividends and capital gains investment income receipts generated by an LLC set up for the purpose of pooling and investing money gifted to children and grandchildren trusts are likely not subject to the business income tax and the modified gross receipts tax under sections 201 and 203 of the MBT, MCL 208.1201 and 208.1203, respectively,

to the extent such income and receipts are not derived from investment activity that is part of the LLC's trade or business.

However, if the LLC is treated as a corporation for federal income tax purposes, then its interest, dividends and capital gains investment income would be subject to tax.

Mi42. Are farms exempt under the MBT? Are agricultural activities taxed under the MBT? What about a taxpayer that has both retail and farm activities?

Farms are not expressly exempt under the MBT. However, the tax base attributable to the production of agricultural goods by a person whose primary activity is the production of agricultural goods is exempt. MCL 208.1207(1)(d). The production of agricultural goods means "commercial farming, including, but not limited to, cultivation of the soil; growing and harvesting of an agricultural, horticultural, or floricultural commodity; dairying; raising of livestock, bees, fish, fur-bearing animals, or poultry; or turf or tree farming, but does not include the marketing at retail of agricultural goods except for sales of nursery stock grown by the seller and sold to a nursery dealer licensed under section 9 of the insect pest and plant disease act . . . ." MCL 208.1207(1)(d). Thus, so long as the primary activity of the taxpayer is the production of agricultural goods, those agricultural activities will be exempt from the MBT. However, any retail activities that do not constitute the production of agricultural goods will be subject to the MBT.

Other farming-related persons and activities are also exempt from the MBT, such as:

- Certain farmers' cooperatives formerly exempt from federal income tax under IRC 521, unless "the total dollar value of the farmers' cooperative corporation's incidental and emergency purchases described in subsection (1)(e)(ii) are equal to or greater than 5% of the corporation's total purchases."
  MCL 208.1207(1)(e), (2).

- The tax base attributable to the direct and indirect marketing activities of a farmers' cooperative corporation organized within the limits of MCL 450.98 if those marketing activities are provided on behalf of the members of that cooperative and are related to the members' direct sale of their products to third parties or, for livestock, are related to the members' direct or indirect sales of that product to third parties. MCL 208.1207(1)(f).

In addition, farmers' cooperatives that are structured to allocate net earnings in the form of patronage dividends to its farmer or farmers' cooperative patrons exclude the revenue and expenses attributable to business transactions with its farmer of farmer cooperative patrons from its adjusted tax base.

Mi43. Will case law concerning the retaliatory tax, such as *TIG Ins Co v Dep't of Treasury*, and *Prudential Property & Cas Ins Co v Dep't of Treasury*, which were decided in SBT years, be applied equally to the MBT?

The Michigan Insurance Code imposes the retaliatory tax on a foreign insurer when that insurer's state of incorporation would impose a total tax burden on a Michigan insurer that is "greater in the aggregate" than the total tax burden that Michigan would impose on the foreign insurer. MCL 500.476a. Though the total tax burden is calculated by reference to one of Michigan's business taxes, the retaliatory tax is a stand-alone tax. It is administered <u>in connection with</u> the SBT or the MBT but is <u>not a part of</u> either tax. Both *TIG* and *Prudential* were decided under the retaliatory tax imposed by the Insurance Code. 464 Mich 548 (2001); 272 Mich App 269 (2006); *cert denied* at 480 Mich 863 (2007).

Therefore, existing case law will control to the extent it discusses and interprets the retaliatory tax. The relationship between the retaliatory tax and the MBT is similar to that of the retaliatory tax and SBT making existing case law relevant to the MBT.

Mi44. Does the MBT follow the federal check-the-box regulations?
Yes. Effective January 1, 1997, a separate business entity that is not required to be classified as a corporation for tax purposes is permitted to elect its entity classification under the federal "check-the-box" provisions of the Federal Income Tax Regulations, Treas Reg § 301.7701-3. These check-the-box regulations allow an unincorporated entity, such as a limited liability company ("LLC"), to elect to be taxed as a corporation. An unincorporated entity with at least two members that fails to elect corporate tax treatment will, by default, be taxed as a partnership. An unincorporated entity with one member that fails to elect corporate tax treatment will, by default, be disregarded as an entity separate from its owner for federal tax purposes. A single member entity, such as a single member LLC ("SMLLC"), that is disregarded for federal tax purposes will be treated as a sole proprietorship, branch, or division of its owner.

For MBT purposes, a person is defined in MCL 208.1113(3) to include various types of entities, including partnerships, corporations, and LLCs. An entity that has elected or is required to file as a corporation or partnership under the Internal Revenue Code is by definition a corporation or partnership under the MBT act. MCL 208.1107(3) and 208.1113(2). These statutory definitions effectively adopt the federal check-the-box regulations for MBT purposes.

If a SMLLC or other entity is a disregarded entity for federal tax purposes, the SMLLC or other entity will be similarly classified as a disregarded entity for MBT purposes. Consequently, the owner of the SMLLC or other entity is the MBT taxpayer, with the SMLLC or other entity treated as either a sole proprietorship or as a branch or division of its owner. MCL 208.1512(1). See *Notice to Taxpayers Regarding Federally Disregarded Entities and the Michigan Business Tax*, issued January 26, 2012, for further details and exceptions.

Mi45. Are controlled foreign corporations ("CFC's") under IRC 957 taxpayers under the MBT? Can controlled foreign corporations be members of a unitary business group? What if the controlled foreign corporation is a disregarded entity of a U.S. parent? CFC's as Taxpayers. Under the MBT, taxpayer means "a person or a unitary business group liable for a tax, interest, or penalty." MCL 208.1117(5). "Person" means "an individual, firm, bank, financial institution, insurance company, limited partnership, limited liability partnership, copartnership, partnership, joint venture, association, corporation, subchapter S corporation, limited liability company, receiver, estate, trust, or any other group or combination of groups acting as a unit." MCL 208.1113(3). Other than the definition of unitary business group under MCL 208.1117, which is limited to U.S. persons, the MBT does not distinguish between foreign and U.S. persons. Thus, controlled foreign corporations are taxpayers under the MBT.

CFC's as Members of a Unitary Business Group. A unitary business group is defined, in part, as:

> a group of United States persons, other than a foreign operating entity, 1 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 United States persons . . . . [MCL 208.1117(6) (emphasis added).]

"United States person" means "that term as defined in [IRC] 7701(a)(30)." MCL 208.117(7). Under IRC 7701(a)(30), "United States person" means:

> (A) a citizen or resident of the United States,

(B) a domestic partnership,
(C) a domestic corporation,
(D) any estate (other than a foreign estate, within the meaning, of paragraph (31)), and
(E) any trust if -
  (i) a court within the United States is able to exercise primary supervision over the administration of the trust, and
  (ii) one or more United States persons have the authority to control all substantial decisions of the trust. [IRC 7701(a)(30).]

A controlled foreign corporation means:

any foreign corporation if more than 50 percent of –
(1) the total combined voting power of all classes of stock of such corporation entitled to vote, or
(2) the total value of the stock of such corporation, is owned (within the meaning of section 958(a)), or is considered as owned by applying the rules of ownership of section 958(b) , by United States shareholders on any day during the taxable year of such foreign corporation. [IRC 957(a).]

As a foreign corporation, a controlled foreign corporation is not a U.S. person and is thus excluded from the definition of unitary business group under the MBT.

CFC's as Disregarded Subsidiary of U.S. Parent. A controlled foreign corporation that is a disregarded entity for federal income tax purposes is classified as a disregarded entity for MBT purposes. MCL 208.1512. That is, the disregarded entity is treated as a branch or division of its owner and will be included in a unitary business group as part of its owner if the owner is a member of a unitary business group. However, a controlled foreign corporation that is a disregarded entity for federal income tax purposes that filed separate from its owner under MCL 208.1512(2) or (3) is treated as a person separate from its owner for MBT purposes. Therefore, the controlled foreign corporation that files separate from its owner is a foreign person and would not be includable in any unitary business group.

Mi46. Are single member limited liability companies and qualified subchapter S subsidiaries ("QSubs") disregarded for federal tax purposes also disregarded under the MBT?
Yes, except for the circumstances prescribed under MCL 208.1512(2) and (3), a single member limited liability company ("SMLLC") and a QSub disregarded for federal income tax purposes are classified as disregarded for MBT purposes. See *Notice to Taxpayers Regarding Federally Disregarded Entities and the Michigan Business Tax*, issued January 26, 2012, for a more complete explanation regarding the treatment under the MBT for federally disregarded entities.

Modified Gross Receipts

M1. (Answer rescinded, replacement located at M26) Does the Modified Gross Receipts Tax component of the Michigan Business Tax Act tax capital gains of investors, including trusts, Family Limited Partnerships and individuals?

M2. How are gross receipts, rents etc. received from real property apportioned? Receipts from real property are apportioned based on location of the real property.

Rental income received from real property is included in both the business income from business activity tax base and modified gross receipts tax base of the taxpayer. Business activity includes the rental of property. MCL 208.1105(1).

Under MCL 205.1301(1) each tax base is apportioned or allocated in accordance with the rules under Chapter 3 of the Act. Sales confined solely to Michigan are allocated to Michigan. Sales within and outside of Michigan are apportioned based on a sales factor calculated under section 303. MCL 208.1301(2).

The sales factor is a fraction, the numerator is Michigan sales and the denominator is sales everywhere. MCL 208.1303(1). Receipts from the sale, lease, rental or licensing of real property are Michigan sales if the property is located in Michigan. MCL 208.1305(1)(b).

M3. Is rental income included in gross receipts?
Yes. The Michigan Business Tax Act (MBTA) defines "gross receipts" as, "[t]he entire amount received by the taxpayer from any activity whether in intrastate, interstate, or foreign commerce carried on for direct or indirect gain, benefit, or advantage to the taxpayer or to others." [MCL 208.1111(1)] Section 111(1) of the MBTA contains specified exceptions to the definition of "gross receipts" but rental income is not listed among the exceptions.

M4. The modified gross receipts tax base means the gross receipts of the taxpayer less "purchases from other firms." The definition of "purchases from other firms" includes "materials and supplies" to the extent not included in inventory and assets as defined. What, specifically, is the definition of "materials and supplies"? Under MCL 208.1113(6), "purchases from other firms" means:

(a) Inventory acquired during the tax year, including freight, shipping, delivery, or engineering charges included in the original contract price for that inventory.

(b) Assets, including the costs of fabrication and installation, acquired during the tax year of a type that are, or under the internal revenue code will become, eligible for depreciation, amortization, or accelerated capital cost recovery for federal income tax purposes.
(c) To the extent not included in inventory or depreciable property, materials and supplies, including repair parts and fuel.

As used in MCL 208.1113(6)(c), "materials and supplies" means tangible personal property acquired during the tax year to be used or consumed in – and directly connected to – the production or management of inventory under MCL 208.1113(6)(a) or the operation or maintenance of assets under MCL 208.1113(6)(b). "Materials and supplies" includes repair parts and fuel.

M5. Will a Single Business Tax (SBT) business loss carry forward carry over to the Michigan Business Tax (MBT)? Is the deduction before or after apportionment?
The MBT provides for a limited deduction of SBT business loss carry forward in the 2008 MBT tax year in calculating the Modified Gross Receipts tax base only. MCL 208.1203(4) provides that 65% of any SBT business loss carry forward that was actually incurred in the 2006 or 2007 SBT tax years and that was not previously deducted in tax years beginning before January 1, 2008 may be deducted against the Modified Gross Receipts tax base. Any business loss carry forward incurred before January 1, 2006 is not eligible for the deduction.

If the taxpayer is a unitary business group, the business loss carry forward may only be deducted against the Modified Gross Receipts tax base of the person included in the unitary business group that generated the loss.

The deduction for the business loss carry forward is taken against the Modified Gross Receipts tax base after apportionment.

M6. Is sales tax collected by a retail business considered part of its modified gross receipts under the Michigan Business Tax?
Yes. The seller of tangible personal property is the person legally liable for payment of sales tax. A seller that is reimbursed sales tax by the purchaser of tangible personal property must include in its gross receipts the "entire amount received" from "any activity" unless the amount received is statutorily exempted under MCL 208.1111. Therefore, a taxpayer that receives sales tax from a purchaser as part of a transaction not otherwise exempt under the Michigan Business Tax must include in gross receipts the amount received from the sale of tangible personal property as well as the sales tax received.

M7. Is labor deductible from gross receipts as a "purchase from other firms?" Generally, no. Under MCL 208.1113(6), "purchases from other firms" means:

(a) Inventory acquired during the tax year, including freight, shipping, delivery, or engineering charges included in the original contract price for that inventory.

(b) Assets, including the costs of fabrication and installation, acquired during the tax year of a type that are, or under the internal revenue code will become, eligible for depreciation, amortization, or accelerated capital cost recovery for federal income tax purposes.

(c) To the extent not included in inventory or depreciable property, materials and supplies, including repair parts and fuel.

(d) For a staffing company, compensation of personnel supplied to customers of staffing companies.
* * *
(e) For a person included in major groups 15, 16, and 17 under the standard industrial classification code as compiled by the United States department of labor that does not qualify for a credit under section 417, payments to subcontractors for a construction project under a contract specific to that project.

That is, for taxpayers other than staffing companies and contractors (persons included in SIC codes 15, 16, and 17), labor is not included in "purchases from other firms." For staffing companies, labor may be deductible to the extent that it constitutes compensation of personnel supplied to its customers. For contractors, labor may be deductible to the extent that it is included in payments made to subcontractors under a contract specific to a project.

M8. Do shipping and delivery charges not included in the contract price for inventory constitute "purchases from other firms?" For example, are shipping charges paid to a third party to deliver inventory purchased from a vendor deductible from gross receipts?
No. Under MCL 208.1113(6), "purchases from other firms" means:

(a) Inventory acquired during the tax year, including freight, shipping, delivery, or engineering charges included in the original contract price for that inventory.
* * *
(c) To the extent not included in inventory or depreciable property, materials and supplies, including repair parts and fuel.

In other words, "purchases from other firms" includes shipping and delivery charges related to inventory only when such charges are "included in the original contract price for that inventory." MCL 208.1113(6). Furthermore, shipping and delivery charges are not included in "materials and supplies."

M9. Are amounts paid by a taxpayer to a staffing company deductible from gross receipts as "purchases from other firms?"

No. Under MCL 208.1113(6), "purchases from other firms" includes:

(d) For a staffing company, compensation of personnel supplied to customers of staffing companies. As used in this subdivision:

(i) "Compensation" means that term as defined under section 107 plus all payroll tax and worker's compensation costs.

(ii) "Staffing company" means a taxpayer whose business activities are included in industry group 736 under the standard industrial classification code as compiled by the United States department of labor.

Thus, a staffing company may deduct compensation paid to personnel supplied to its clients. But payments to a staffing company by a client do not constitute "purchases from other firms."

M10. Are capital gains that are included in the Modified Gross Receipts tax base also included in the Business Income tax base?

Yes, the Business Income tax base is a separate and distinct tax base from the Modified Gross Receipts tax base. A taxpayer's Business Income tax base is its business income subject to certain statutory adjustments before allocation or apportionment. MCL 208.1201(2). Business income is generally defined as "that part of federal taxable income derived from business activity." MCL 208.1105(2). "Business activity" is defined in part as "a transfer of legal or equitable title to or rental of property, whether real, personal, or mixed, tangible or intangible, . . . , made or engaged in, or caused to be made or engaged in, whether in intrastate, interstate, or foreign commerce, with the object of gain, benefit, or advantage, whether direct or indirect, to the taxpayer or to others, ..." MCL 208.1105(1).

MCL 208.1201 of the MBT makes no provision for the adjustment of capital gains that may be included in federal taxable income derived from business activity. As a result, to the extent the capital gain is derived from the business activity of the taxpayer it must also be included in the business income tax base.

M11. Are system software royalties, excluded from the determination of tax liability under the Single Business Tax Act ("SBTA") (see MCL 208.9(4)(g)(viii) and (7)(c)(vii)), likewise excluded from the determination of tax liability under the Michigan Business Tax Act ("MBTA")?

No. System software royalties are included in the determination of the Business Income tax base and the Modified Gross Receipts tax base under the MBTA. Unlike in the SBTA, there is no language in the MBTA which excludes such royalties from the calculation of either of these taxes.

Under the MBTA, a taxpayer (other than a financial institution or insurance company) is subject to two separate and distinct taxes, a Business Income tax and a Modified Gross Receipts tax. A taxpayer's Business Income is subject to certain statutory adjustments before allocation or apportionment. MCL 208.1201(2). Business income is generally defined as "that part of federal taxable income derived from business activity." MCL 208.1105(2). "Business activity" is defined in part as "a transfer of legal or equitable title to or rental of property, whether real, personal, or

mixed, tangible or intangible, . . . , made or engaged in, or caused to be made or engaged in, whether in intrastate, interstate, or foreign commerce, with the object of gain, benefit, or advantage, whether direct or indirect, to the taxpayer or to others, ..." MCL 208.1105(1). MCL 208.1201(2)(f) states that "Except as otherwise provided under this subsection, to the extent deducted in arriving at federal taxable income, [a taxpayer must add to the Business Income tax base] any royalty, interest, or other expense paid to a person related to the taxpayer by ownership or control for the use of an intangible asset if the person is not included in the taxpayer's unitary business group." MCL 208.1201(2)(f). There is no language in the MBTA excluding system software royalties from Business Income.

Likewise, there is no language in the MBTA excluding system software royalties from the Modified Gross Receipts tax base. Generally, a taxpayer's Modified Gross Receipts tax base is "a taxpayer's gross receipts less purchases from other firms before apportionment…." MCL 208.1203(3). "Gross Receipts" is defined in part as "the entire amount received by the taxpayer from any activity whether in intrastate, interstate, or foreign commerce carried on for direct or indirect gain, benefit, or advantage to the taxpayer or to others…." MCL 208.1111(1). There is no language in the MBTA excluding system software royalties from Gross Receipts.

M12. (This FAQ has been amended due to 2011 PA 305.) Do the business income tax and modified gross receipts tax components of the MBT apply to individuals, estates, and trusts or family limited partnerships that are specifically established for estate planning purposes, on income from investments, such as capital gains, interest, dividends, or other sources of personal income?

No. The definitions of "business income" and "gross receipts" as used in the MBT specifically exclude this type of income received by these types of entities from the MBT tax bases and threshold amounts. Investment income, gains from the sale of personal assets or other assets not used in a trade or business, and any other income not specifically derived from a trade or business that is earned, received, or otherwise acquired by certain entities expressly enumerated by the statute are not included in gross receipts for purposes of determining the filing thresholds under sections 200, 411, or 505 (MCL 208.1200, 208.1411, or 208.1505), and are not included in the business income tax base or modified gross receipts tax base under sections 201 and 203, respectively, (MCL 208.1201 and 208.1203). This exclusion only applies to the following types of entities listed under MCL 208.1105(2) and 208.1111(4)(w) and (x) in the statute: (1) an individual; (2) an estate; (3) a person organized for estate or gift planning purposes; (4) a person organized exclusively to conduct investment activity and that does not conduct activity for any person other than an individual or a person related to that individual; or (5) a common trust established under the Collective Investment Funds Act, 1941 PA 174. Investment income and any other types of income earned or received by all other types of persons or entities not specifically referenced in these revised definitions must be included in the gross receipts and business income of the taxpayer.

M13. If an individual owns 100% of an S corporation law practice with gross receipts of $500,000, net income of $100,000 after wages of $250,000, and also has the following income not related to the S corporation or any other trade or business: dividends - $100,000, interest $250,000, capital gain $750,000, and pension of $100,000. Is he liable for the MBT taxes on a combined basis as an individual and owner of a S corporation?

The definitions of "business income" and "gross receipts" as used in the MBT act were amended on December 1, 2007 by PA 145. Under the new definitions, personal investment income, gains from the sale of personal assets, and other income received by an individual not specifically derived from a trade or business are not included in the MBT tax bases as defined in sections 201 and 203 (MCL 208.1201 and 208.1203), and are not included gross receipts for purposes of determining the MBT filing thresholds under section 505 (MCL 208.1505).

Therefore, the taxpayer in this example would only consist of the S corporation. The MBT tax liability of the S corporation would be determined by reference to gross receipts of $500,000 and business income of $100,000. The wage, pension, interest, dividend, and capital gain income of the individual owner of the S corporation are not subject to MBT.

M14. (Answer rescinded, replacement located at M67) What are purchases from other firms?

M15. If a business or unitary group taxpayer has a negative business income tax base, is the 4.95% tax rate applied to the negative business income base, with the result then netted against a positive modified gross receipts tax to determine Michigan Business Tax ("MBT") liability?

No. Other than for an insurance company under Chapter 2A and a financial institution under Chapter 2B, the Michigan Business Tax Act ("MBTA") imposes two taxes on a taxpayer: one on business income and one modified gross receipts. The Business Income tax base is a separate and distinct tax base from the Modified Gross Receipts tax base. In determining a taxpayer's total tax liability under the MBTA, one tax base is not netted, partially or wholly, against the other tax base. If the arithmetic calculation of a taxpayer's business income tax base for a tax year results in a negative value, then the business income tax base used for purposes of determining total MBT liability is zero. Thus, the 4.95% tax rate for business income applied against a zero tax base produces a business income tax liability of zero. The modified gross receipts tax, calculated by multiplying the modified gross receipts tax rate of 0.80% against the modified gross receipts tax base after apportionment and allocation, would be added to the zero value business income tax to produce the taxpayer's total MBT liability for the tax year before credits.

Even though a taxpayer may not offset a negative business income tax against a positive marginal gross receipts tax in a given tax year, the taxpayer may, under MCL 208.1201(4), carry forward the negative business loss after allocation or apportionment into the tax year immediately succeeding the loss year as an offset to the allocated or apportioned business income tax base for that succeeding tax year. Such losses may be carried forward up to 10 years following the loss year or until the loss is used up, whichever comes first. Any loss remaining after the 10 year carryforward period specified in MCL 208.1201(4) will expire unused.

M16. Should a taxpayer use the cash or accrual method when determining gross receipts under the MBT?

Similar to the SBT, a taxpayer should compute its gross receipts using the accounting method that it used in the computation of its net income for federal tax purposes.

Under the accrual method, income is "received" and recorded on the books when all the events that establish the "right to receive" the income has occurred. Under the cash method, income is not recorded until payment is actually received, and expenses are not counted until they are actually paid.

A taxpayer that computes its federal taxable income using the accrual method should consistently compute both its Business Income tax base and Modified Gross Receipts tax base using the accrual method. A federal cash basis taxpayer would compute both the MBT Business Income and Modified Gross Receipts tax bases using the cash basis method.

M17. Does the "materials and supplies" provision in the definition of "purchases from other firms" at MCL 208.1113(6)(c) apply to service providers?

Yes. A taxpayer's modified gross receipts (MGR) tax base under the Michigan Business Tax Act (MBTA) is the taxpayer's "gross receipts" less "purchases from other firms" before apportionment. MCL 208.1203. "Gross receipts" is defined in the MBTA, in pertinent part, as the "entire amount

received by the taxpayer from any activity whether in intrastate, interstate, or foreign commerce carried on for direct or indirect gain, benefit, or advantage to the taxpayer or to others [with certain prescribed exceptions]." MCL 208.1111. "Purchases from other firms" includes all of the following items pertinent to this question:

(a) Inventory acquired during the tax year, including freight, shipping, delivery, or engineering charges included in the original contract price for that inventory.
(b) Assets, including the costs of fabrication and installation, acquired during the tax year of a type that are, or under the internal revenue code will become, eligible for depreciation, amortization, or accelerated capital cost recovery for federal income tax purposes.
(c) To the extent not included in inventory or depreciable property, materials and supplies, including repair parts and fuel. MCL 208.1113(6)(a) – (c).

Therefore, a taxpayer whose business activity is the provision of services may calculate its MGR by deducting from its gross receipts the amount attributed to "materials and supplies" under MCL 208.1113(6)(c), to the extent used or consumed in and directly connected to the production or management of inventory or the operation or maintenance of the depreciable assets described above.

To the extent that a taxpayer who is a service provider maintains an inventory of goods for sale or has depreciable assets, any tangible personal property acquired by the taxpayer during the tax year that is used or consumed in, and directly connected to, the management of taxpayer's inventory or the operation or maintenance of depreciable assets is a "purchase from other firms" for purposes of calculating MGR. For example, a physician's or dentist's purchase of sterilizing solution during the tax year that is used to sterilize examination equipment, such as an X-ray machine, may be considered materials and supplies under MCL 208.1113(6)(c).

M18. (This FAQ has been amended due to 2011 PA 305.) Must a company that receives dividend and interest income from a partnership include those amounts in gross receipts?
Generally, yes. The Michigan Business Tax Act (MBTA) defines "gross receipts" as, "[t]he entire amount received by the taxpayer from any activity whether in intrastate, interstate, or foreign commerce carried on for direct or indirect gain, benefit, or advantage to the taxpayer or to others." MCL 208.1111(1). This is similar to the SBT. Section 111(1) of the MBTA contains specified exceptions to the definition of "gross receipts." There is no general exception for the receipt of dividends and interest. Unless a corporate taxpayer meets one of the statutory exceptions, dividend and interest income must be included in the corporation's gross receipts. This interpretation would apply to the gross receipts of other entity types as well.

A statutory exception is made for an individual, estate or person organized for estate or gift planning purposes that earns or receives dividend and interest income from investment activity that is derived from transactions, activities and sources that are not in the regular course of the person's trade or business. MCL 208.1111(w).

M19. Is use tax collected by a retail business considered part of its modified gross receipts under the Michigan Business Tax?
Yes, to the extent received. The Use Tax Act places the ultimate use tax liability on consumers of tangible personal property and certain services; however, out-of-state sellers and registered lessors that have sufficient nexus with Michigan have a legal obligation to collect and remit use tax to the Department. A seller that collects use tax from the consumer of tangible personal property or services must include in its gross receipts the "entire amount received" from "any activity" unless the amount received is statutorily exempted under MCL 208.1111. The statute provides no exemption for the collection of use tax. Therefore, a taxpayer that receives use tax from a consumer as part of a transaction not otherwise exempt under the Michigan Business Tax

must include in gross receipts the amount received from the sale of tangible personal property and certain services as well as the use tax received.

M20. Do construction subcontractors have to be licensed in order for payments made to such subcontractors to be considered "purchases from other firms" under section 113(6)(e) of the Michigan Business Tax Act ("MBTA")?

No. Included within the meaning of "purchases from other firms" under MCL 208.1113(6), are:

(e) For a person included in major groups 15, 16, and 17 under the standard industrial classification [SIC] code as compiled by the United States department of labor that does not qualify for a credit under section 417 [Small Business Alternative Credit], payments to subcontractors for a construction project under a contract specific to that project. MCL 208.1113(6)(e).

Thus, the statute limits the treatment of payments to subcontractors as "purchases from other firms" only to taxpayers that fall under SIC major groups 15 (Building Construction General Contractors and Operative Builders), 16 (Heavy Construction Other Than Building Construction Contractors) and 17 (Construction Special Trade Contractors) who do not qualify for the Small Business Alternative Credit under MCL 208.1417, and only for those payments made for a construction project under a contract specific to that project. There is no limitation or condition that the subcontractors to whom such payments are made be licensed.

M21. Can credit card processing fees be deducted from gross receipts when determining the modified gross receipts tax base under the Michigan Business Tax Act ("MBTA")?

No, credit card processing fees may not be deducted from gross receipts when determining the modified gross receipts tax base under the MBTA. A modified gross receipts tax is imposed on every taxpayer with nexus in Michigan (except for insurance companies under chapter 2A and financial institutions under chapter 2B of the MBTA) as determined under MCL 208.1200. The modified gross receipts tax base is calculated as gross receipts less "purchases from other firms," as defined in MCL 208.1113(6), before apportionment. "Purchases from other firms" are deducted from gross receipts to derive a taxpayer's modified gross receipts tax base under the MBTA. MCL 208.1203(3). "Purchases from other firms" is specifically defined in MCL 208.1113(6) to generally include:

(a) inventory, as defined in MCL 208.1111(4), acquired during the tax year, including freight, shipping, delivery, or engineering charges;

(b) assets, including fabrication and installation costs, acquired during the tax year of a type that are or will become eligible for depreciation, amortization, or accelerated capital cost recovery under the internal revenue code for federal income tax purposes; and

(c) to the extent not included in inventory or depreciable assets, materials and supplies, including repair parts and fuel.

A credit card processing fee is essentially a fee paid to a third-party processor who provides a retail merchant with access to networks of credit card companies. The third party processor processes the credit card transactions so that ultimately the retail merchant receives payment from the consumer's credit card company. As such, credit card processing fees do not fall within any of the prescribed categories of "purchases from other firms" under MCL 208.1113(6), and therefore are not deducted from gross receipts when determining the modified gross receipts tax base under the MBTA.

M22. To calculate the modified gross receipts tax base, may contractors deduct from gross receipts all amounts paid to subcontractors as purchases from other firms? Under the MBT, persons included in SIC codes 15, 16, and 17 that do not qualify for the alternate credit under MCL 208.1417 (known as the small business credit under the SBT) may deduct "payments to subcontractors for a construction project under a contract specific to that project." MCL 208.1113(6)(e). Persons included in SIC codes 15, 16, and 17 include general contractors (of residential buildings including single-family homes; industrial, commercial, and institutional buildings; bridges, roads, and infrastructure; etc.), operative builders, trade contractors (such as electricians, plumbers, painters, masons, etc.). See http://www.osha.gov/pls/imis/sic_manual.html for a more complete list.

In other words, purchases from other firms includes all payments to subcontractors for construction projects so long as such payments are made pursuant to a contract specific to that project. For example, payments made to an independent contractor to provide general labor services to the contractor not specific to a particular contract do not constitute purchases from other firms. However, payments made to a subcontractor for services and materials provided under a contract specific to a particular construction project (such as the construction of commercial property at 111 Main Street) do constitute purchases from other firms.

M23. For purposes of MCL 208.1113(6)(e), how is subcontractor defined?
Under the MBT, persons included in SIC codes 15, 16, and 17, that do not qualify for the credit under MCL 208.1417 may deduct “payments to subcontractors for a construction project under a contract specific to that project” as purchases from other firms. MCL 208.1113(6)(e).

The term “subcontractor” is not defined by the statute. Accordingly, the Department will apply the common, ordinary meaning of “subcontractor” to the statute. A “subcontractor” is an individual or entity that enters into a contract and assumes some or all of the obligations of a person included in SIC codes 15, 16, and 17 as set forth in the primary contract specific to a project.

M24. Must a contractor enter into a written contract with subcontractors in order to reduce gross receipts by the amount of payments made to subcontractors for a construction project?
Under the MBT, the modified gross receipts tax base is a taxpayer’s gross receipts less purchases from other firms before apportionment. MCL 208.1203(3). Contractors, defined as persons included in SIC codes 15, 16, and 17, that do not qualify for the credit under MCL 208.1417 may deduct “payments to subcontractors for a construction project under a contract specific to that project” as purchases from other firms. MCL 208.1113(6)(e).

While the statute is silent as to whether a contractor must enter into a written contract with a subcontractor for labor costs specific to a project, a taxpayer bears the burden to prove it is entitled to a deduction in computing its tax liability. It is contemplated that good business practice would include documentation such as a written contract that would support a deduction from gross receipts for payments to subcontractors as “purchases from other firms.”

The supporting information for payments to a subcontractor could be incorporated into the contract for the specific project or memorialized in a separate contract with a subcontractor specifying the project the costs pertain to.

M25. Can modified gross receipts (MGR) tax separately collected from customers by new motor vehicle dealers and new or used watercraft dealers be remitted with monthly sales, use and withholding returns?
Yes. New motor vehicle dealers and new or used watercraft dealers who elect to separately collect the MGR tax, in addition to sales price, under MCL 208.1203(5) may file and remit the tax

as estimated payments with their quarterly or monthly Form 160, *Combined Return for Michigan Taxes*. Generally, for a calendar year taxpayer, MBT quarterly estimated returns are due the 15th day of April, July, October and January. For fiscal year filers, quarterly estimated returns are due the 15th day of the first month after each quarter. MBT estimated payments may be made with either of the following returns:

- Form 4548, *Michigan Business Tax Quarterly Return*, or
- Form 160, *Combined Return for Michigan Taxes*.

If filing monthly using Form 160, *Combined Return for Michigan Taxes*, and not making remittances by electronic funds transfer, monthly estimated payments may be filed on the 20th day of the month. For example, a calendar year taxpayer may file monthly MBT estimates using Form 160 on February 20th, March 20th and on April 20th rather than April 15 for the first quarter. However, for taxpayers required to make remittances by electronic funds transfer or otherwise not using Form 160, MBT estimates remain due on the 15th day of the month following the final month of the quarter. Regardless of the method chosen, the estimated MBT for the quarter must also reasonably approximate the liability for the quarter.

M26. (This FAQ has been amended due to 2011 PA 305.) Does the Modified Gross Receipts Tax component of the Michigan Business Tax Act tax capital gains of investors, including trusts, Family Limited Partnerships and individuals?

Generally, no. The modified gross receipts tax base is a taxpayer's gross receipts less purchases from other firms. "Gross receipts" is defined as the entire amount received by the taxpayer from any activity whether intrastate, interstate, or foreign commerce carried on for direct or indirect gain, benefit, or advantage to the taxpayer or to others. MCL 208.1111. Certain personal transactions and investment activity, however, are excluded from gross receipts. For an individual, estate, or person organized for estate or gift planning purposes, gross receipts does include only amounts received from transactions, activities, and sources in the regular course of the person's trade or business." MCL 208.1111(1)(w). Receipts derived from certain personal transactions specifically excluded from gross receipts include, but are not limited to: (A) those from investment activity, including interest, dividends, royalties and gains from an investment portfolio or retirement account, if the investment activity is not part of the person's trade or business; and (B) receipts derived from the disposition of tangible, intangible, or real property held for personal use and enjoyment, such as a personal residence or personal assets. MCL 208.1111(1)(w)(*ii).* Also excluded from gross receipts are receipts derived from investment activity other than those from transactions, activities and sources in the regular course of the person's trade or business by a person that is organized exclusively to conduct investment activity who does not conduct investment activity for any person other than an individual or persons related to that individual, or by a common trust fund established under the Collective Investment Funds Act, 1941, PA 174. MCL 208.1111(x).

M27. Under the MBT, will there be a depreciation deduction, or will Michigan conform to federal depreciation rules?

To the extent applicable, federal depreciation rules are utilized for the purpose of calculating MBT liability. Although there is no specific deduction or credit for depreciation expenses under the MBT, a taxpayer receives the benefit of any depreciation deduction taken on its federal income tax return due to the inherent structure of the business income tax base. An MBT taxpayer's business income tax base is composed of the taxpayer's "business income," with certain adjustments. MCL 208.1201(2). "Business income" is defined under the statute as "that part of *federal taxable income* derived from business activity." MCL 208.1105(2) (emphasis added). Thus, calculation of the business income tax base begins with the taxpayer's federal taxable income, a figure that already includes any deductions taken by the taxpayer on account of depreciation expenses.

Under the former SBT, any amount taken for a depreciation deduction on the taxpayer's federal tax return was required to be added back into the taxpayer's tax base for purposes of calculating SBT liability. MCL 208.9(4)(c). There is no such add-back under the MBT. See MCL 208.1201(2). Because the business income tax base is based upon federal taxable income, and depreciation expenses are not added back in to that tax base, the MBT taxpayer effectively receives the benefit of its federal depreciation deduction.

With respect to the modified gross receipts tax component of the MBT, the entire cost of a depreciable asset may be subtracted from the taxpayer's modified gross receipts tax base in the year that the asset is acquired, since such an asset meets the definition of "purchases from other firms." MCL 208.1203(3); 208.1113(6)(b).

M28. Do wholesale gasoline purchases and applicable excise taxes paid by a gasoline retailer qualify as "purchases from other firms" under Section 113(6) of the Michigan Business Tax Act ("MBTA")?

Yes. To the extent that the gasoline purchased by a gasoline retailer is held for resale such wholesale purchases of gasoline constitute inventory ("stock of goods held for resale in the regular course of trade of a retail … business") and qualifies as "purchases from other firms."

Further, to the extent that the gasoline retailer's purchase of wholesale gasoline constitutes inventory under MCL 208.1111(4) and thus "purchases from other firms" under MCL 208.1113(6), then the amount of excise taxes paid by the retailer for such inventory would also be included in the "purchases from other firm" amount deductible from gross receipts.

M29. (This FAQ has been amended due to 2011 PA 305.) Does partnership income constitute gross receipts of the partner for purposes of the modified gross receipts tax portion of the MBT?

It depends on the partner. The distributive income of a partnership is not considered gross receipts of a partner who is an individual. In that case, the gross receipts are not derived from the trade or business of the partner; rather, the trade or business is that of the partnership, a taxpayer (and not a mere flow-through) under the MBT. MCL 208.1111.

The distributive income of a partnership is considered gross receipts of a partner that is other than an individual, estate, or person organized for estate or gift planning purposes where the income is derived from transactions, activities, and sources other than in the regular course of the person's trade or business.

M30. Does the sale by an individual of a direct investment in a corporation, partnership or LLC that is not traded on a public exchange constitute "personal investment activity" such that the income and proceeds from such a sale are excluded from business income and gross receipts? Similarly, is the distributive share of a partnership to a partner that is an individual business income or gross receipts to that individual?

For an individual, the sale of an ownership interest in a corporation, partnership, or limited liability company will generally not constitute business income or gross receipts to that individual so long as such investment does not constitute the trade or business of the individual. This is true even if the shareholder, partner, or member is an active rather than passive investor. The distributive share of a partnership to a partner that is an individual does not constitute business income or gross receipts to that individual.

M31. (This FAQ has been amended due to 2011 PA 305.) The MBT has been amended to exclude from business income and gross receipts certain personal investment activities. Which taxpayers may exclude personal investment activity from business income and gross

receipts? What about family limited partnerships that demonstrate a business purpose for federal purposes yet are intended to generate valuation discounts for gift and estate tax purposes? What about an investment club organized as a partnership?
MCL 208.1105(2) and 208.1111(1)(w) and (x) exclude from business income and gross receipts income and receipts other than those received from transactions, activities, and sources in the regular course of the taxpayer's trade or business. This exclusion only applies to the following persons:

1. an individual;
2. an estate;
3. a person organized exclusively for estate or gift planning purposes;
4. a person organized exclusively to conduct investment activity solely for an individual or persons related to that individual; and
5. a common trust established under the Collective Investment Funds Act, 1941 PA 174.

Partnerships that demonstrate a business purpose may or may not be "organized for estate or gift planning purposes." To the extent that the partnership, being an investment club or otherwise, was not organized for estate or gift planning purpose or where the income and receipts of such a partnership are derived from sources, transactions or activities of the partnership's regular course of business, such amounts are not excluded from business income and gross receipts under MCL 208.1105(2) or 208.1111(1)(w) and (x).

M32. A unitary business group under the MBTA is required to file a combined return. For purposes of calculating the unitary business group's modified gross receipts tax base, does the group eliminate all inter-company transactions between members of the group, including "purchases from other firms"?
Yes. Section 203 of the MBTA provides in part that:

> The modified gross receipts of a unitary business group is the sum of modified gross receipts of each person, other than a foreign operating entity or [an insurance company or financial institution], included in the unitary business group less any modified gross receipts arising from transactions between persons included in the unitary business group.

MCL 208.1203(3). A taxpayer calculates its modified gross receipts tax base by determining its gross receipts and then subtracting "purchases from other firms," a term that is defined at MCL 208.1113(6). Therefore, each member of a unitary business group must subtract any "purchases from other firms" in order to arrive at its individual modified gross receipts, whether those qualifying purchases were made from fellow group members or from outside companies. In addition, section 511 of the MBTA specifically provides that, in filing the required combined return, all transactions between members of a unitary business group are to be eliminated from the business income tax base, the modified gross receipts tax base, and the apportionment formula. MCL 208.1511. "All transactions" includes those transactions meeting the definition of "purchases from other firms," as well as other kinds of transactions between group members.

M33. How is the "purchases from other firms" subtraction determined? The statute uses the term "purchased" and "acquired"; neither of which are defined in the law. What method of accounting will be used for "purchases from other firms"?
A taxpayer should compute its modified gross receipts tax base using the accounting method that it used in calculating its federal taxable income. Whether a taxpayer uses the "cash basis" or "accrual basis", each method has recognized principles as to when a "purchase" is recognized and recorded. The property is "acquired" in the year the purchase is recorded under the

taxpayer's accounting method. Therefore, gross receipts and "purchases from other firms" should be computed using the method that the taxpayer used in computing its federal taxable income. Further, using the accounting method used to calculate federal taxable income will maintain consistency between the business income tax base that starts with federal taxable income and the modified gross receipts tax base.

M34. Is an SBT business loss related to a final short period SBT return that will be applied to the MBT based on a full twelve-month year or on the short period year? If the taxpayer uses the proration method to calculate its final SBT tax liability and first year MBT tax liability, is the SBT business loss also prorated?

As an initial matter, under the MBT Act, a SBT business loss carryforward is applied only to a taxpayer's modified gross receipts tax base, not to the taxpayer's total MBT tax liability. MCL 208.1203(4). The amount of the SBT business loss that may be deducted against the modified gross receipts tax base is based on the SBT business loss that was actually incurred in the 2006 or 2007 tax year, regardless of the method the taxpayer chooses to calculate its final SBT tax year liability and first MBT tax year liability. The method used for calculating final year SBT tax liability must be the same as that used for calculating first year MBT tax liability.

The answer is governed by MCL 208.1203(4), which provides that the SBT business loss relates to whatever is the taxpayer's final SBT tax year. The amount of the SBT business loss that may be carried forward to the MBT is limited to "65% of any remaining business loss carryforward calculated under section 23b (h) of the former 1975 PA 228 [SBT Act] that was actually incurred in the 2006 or 2007 tax year to the extent not deducted in tax years beginning before January 1, 2008." MCL 208.1203(4). Therefore, the amount of the SBT business loss that may be deducted against the modified gross receipts tax base is based on the SBT business loss that was actually incurred in [attributed to] the 2006 or 2007 tax year, regardless of the method the taxpayer chooses to calculate its final SBT tax year liability and first MBT tax year liability.

M35. Is a fiscal year taxpayer required to apply its final year SBT business loss against its first short period MBT return?

Yes, the deduction of any SBT business loss carryforward is limited to the taxpayer's "2008 tax year." MCL 208.1203(4). The taxpayer must apply its SBT business loss carryforward to that 2008 tax year, whether that tax year is a full calendar year or a short period for a fiscal year filer. Furthermore, the deduction is to be applied only to the taxpayer's 2008 tax year modified gross receipts tax base after apportionment, not to the taxpayer's total MBT tax liability. MCL 208.1203(4). If the modified gross receipts tax base after apportionment for the 2008 tax year is less than 65% of the amount of the SBT business loss carryforward, then the remaining SBT business loss amount is extinguished. In addition, with regard to a unitary business group taxpayer, the business loss carryforward may be deducted only against the modified gross receipts tax base of the unitary group member that generated the loss. MCL 208.1203(4).

M36. The definition of "modified gross receipts tax base" makes no provision for a negative modified gross receipts tax base. Will Treasury administratively allow a carryforward of a negative modified gross receipts tax base?

No. A modified gross receipts tax calculated as a negative is zeroed out for purposes of determining MBT tax liability for a tax year. The MBTA does not permit a carryforward of a negative modified gross receipts tax into subsequent tax years, nor does it permit a calculated negative modified gross receipts tax to offset a positive business income tax base for a tax year (see FAQ M15).

While the MBTA imposes tax computed on a modified gross receipts tax base (MCL 208.1203) and on a separate business income tax base (MCL 208.1201), the tax calculated from the two tax bases is combined to determine a single MBT tax liability for a given tax year. An arithmetically

derived negative modified gross receipts tax amount for a taxpayer in a given tax year would be deemed a modified gross receipts tax of zero for the tax year. The modified gross receipts tax of zero would be added to the taxpayer's calculated business income tax for the tax year to determine the taxpayer's MBT tax liability for the tax year, after allocation and apportionment and before surcharge and calculation of credits. Therefore, the MBTA neither contemplates nor permits a carryforward of a negative modified gross receipts tax. Likewise, the MBTA does not permit an arithmetically derived negative modified gross receipts tax to offset a positive business income tax when calculating MBT tax liability for a given tax year.

Although a negative modified gross receipts tax base may not be carried forward to later tax years, the MBTA does permit business income losses to be carried forward. MCL 208.1201(4)) expressly permits a taxpayer to carry forward a negative business loss after allocation or apportionment into the tax year immediately following the loss year as an offset to the allocated or apportioned business income tax base for the immediately succeeding tax year. Such losses may be carried forward up to 10 years following the loss year or until the loss is used up, whichever comes first. Any loss remaining after the 10 year carryforward period will expire unused.

M37. To qualify as "materials and supplies" or "purchases from other firms" deductible from gross receipts under MCL 208.1113(6), must assets be directly related to inventory or vice versa?

No. "Materials and supplies" under MCL 208.1113(6)(c) means tangible personal property acquired during the tax year to be used or consumed in – and directly connected to – the production or management of inventory under MCL 208.1113(6)(a) ***or*** the operation or maintenance of assets under MCL 208.1113(6)(b).

"Assets" as defined under MCL 208.1113(6)(b) mean those "acquired during the tax year of a type that are, or under the internal revenue code will become, eligible for depreciation, amortization, or accelerated capital cost recovery for federal income tax purposes."

There is no requirement that assets need to be related to inventory to qualify as a purchase from another firm. Moreover, there is no requirement that materials and supplies used or consumed in the operation or maintenance of assets are only deductible to the extent that such materials and supplies are used or consumed in the operation or maintenance of assets used to produce or manage inventory.

M38. (Answer rescinded, replacement located at M68) May taxpayers, including corporations and partnerships, take the IRC 199 deduction for MBT purposes?

M39. May any taxpayer separately itemize and collect the tax imposed under the Michigan Business Tax Act ("MBTA") from its customers in addition to sales price?

No, only new motor vehicle dealers and dealers of new or used personal watercraft are permitted to separately itemize and collect a tax imposed under the MBTA from customers in addition to sales price, and that authority is limited to only the modified gross receipts (MGR) tax imposed and levied under section 203. Section 203(5) of the MBTA states:

Nothing in this act shall prohibit *a taxpayer who qualifies for the credit under section 445* [a new motor vehicle dealer licensed under the Michigan vehicle code (1949 PA 300, MCL 257.1 to 257.923)] *or a taxpayer who is a dealer of new or used personal watercraft* from collecting the tax imposed under this section in addition to the sales price. The amount remitted to the department for the tax under this section shall not be less than the stated and collected amount. MCL 208.1203(5); emphasis added.

The statute's explicit mention of these two types of taxpayers having authority to state and collect the MGR tax in addition to sales price demonstrates intent to exclude all other taxpayers. Thus, the MBTA expressly limits the authority to separately itemize and collect the modified gross receipts tax in addition to sales price to only two types of taxpayers: new motor vehicle dealers and dealers of new or used personal watercraft.

M40. Our company adds a handling charge to all customer invoices. Is this handling charge taxable under the MBT?

Yes. Under the MBTA, a taxpayer (other than a financial institution or an insurance company) is subject to both a business income tax and a modified gross receipts tax, which together comprise the taxpayer's MBT liability. Handling charges added to customer invoices must be included when determining the taxpayer's business income tax base as well as its modified gross receipts tax base. There is no language in the MBTA which would exclude such handling charges from the calculation of either of these taxes.

For purposes of calculating the business income tax, "business income" is defined generally as "that part of federal taxable income derived from business activity." MCL 208.1105(2). "Business activity" means "a transfer of legal or equitable title to or rental of property, whether real, personal, or mixed, tangible or intangible, or the performance of services, or a combination thereof, made or engaged in, or caused to be made or engaged in, whether in intrastate, interstate, or foreign commerce, with the object of gain, benefit, or advantage, whether direct or indirect, to the taxpayer or to others …." MCL 208.1105(1). Selling property of any kind to and/or performing services for customers is clearly "business activity"; thus, all income received from such endeavors, to the extent that it is part of a taxpayer's federal taxable income, constitutes taxable "business income" under the MBTA. There is no language in the MBTA that would exclude handling charges added to customer invoices from business income.

Similarly, a taxpayer calculates its modified gross receipts tax base by determining its gross receipts less "purchases from other firms," as defined in MCL 208.1113(6), before apportionment. MCL 208.1203(3). "Purchases from other firms" generally includes purchases of inventory, depreciable assets, and materials and supplies used in the taxpayer's business. MCL 208.1113(6). A handling charge is a fee charged to a customer that is typically intended to cover the company's cost of packaging and mailing an order. Handling charges, even if they reflect amounts paid to a third-party that are simply passed through to customers, do not fall within the statutory definition of "purchases from other firms." Therefore, handling charges added to customer invoices are not deducted from gross receipts when determining the modified gross receipts tax base under the MBTA.

M41. My company intends to purchase a significant piece of business equipment in the near future. This equipment is the type of property that is or will become eligible for depreciation for federal tax purposes. Under the MBT, can my company deduct the cost of this equipment in the year of purchase when calculating its modified gross receipts tax base, and also qualify for the investment tax credit, which is applied against final MBT liability?

Yes. In calculating its modified gross receipts tax base, a taxpayer determines the amount of its gross receipts for the tax year and then subtracts any "purchases from other firms" before apportioning the result. MCL 208.1203(3). Pursuant to MCL 208.1113(6), "purchases from other firms" includes "[a]ssets, including the cost of fabrication and installation, acquired during the tax year of a type that are, or under the internal revenue code will become, eligible for depreciation, amortization, or accelerated capital cost recovery for federal income tax purposes." A purchase of depreciable business equipment as described above meets this definition and the total cost of the equipment, including the cost of fabrication and installation, would therefore be subtracted from the taxpayer's gross receipts as a "purchase from other firms."

The investment tax credit (ITC) set forth in MCL 208.1403(3) is a separately calculated credit that incentivizes capital investment in property. Subject to the combined credit limitation in MCL 208.1403(1), for the 2008 tax year, the ITC is equal to 2.32% of the net calculation of the cost, including fabrication and installation, paid or accrued in the taxable year of depreciable tangible assets that are physically located in Michigan, less any recapture of ITC on assets that have been disposed of. The credit rate increases to 2.9% of the net calculation for tax years 2009 and after. MCL 208.1403(3). The ITC is applied against a taxpayer's total MBT liability (which includes the modified gross receipts tax, the business income tax, and the surcharge), subject to the combined credit limitation in MCL 208.1403(1). Nothing in the MBTA prohibits a taxpayer from deducting the cost, in the year of purchase, of an asset that qualifies as a "purchase from other firms" when calculating its modified gross receipts tax base, and then subsequently utilizing the same asset purchase to qualify for the ITC, a credit that is applied against total MBT liability. However, taxpayers should be aware that the MBT requires recapture of ITC when a sale, exchange, or other disposition of a qualifying asset, including the removal of the asset from the state, occurs.

M42. A real estate limited partnership owns an apartment project in Michigan. The partnership is in the process of selling the apartment project to avoid foreclosure. The apartment project is the partnership's only asset and the partnership will be dissolved shortly after the sale.

As a result of the sale, the partnership will have a capital gain of approximately $6.3 million, and, in addition, will have debt forgiven of approximately $2.6 million. The debt being forgiven is a seller note and accrued interest that was executed in favor of the previous owner of the project. The potential buyer has agreed to pay a portion of the seller note and interest, and the former owner has agreed to forgive the balance of the debt. For federal tax purposes, their cancellation of debt ("COD") income is a pass through item and the ultimate taxability is determined at the partner level instead of the partnership level.

The partnership will be liable for both the modified gross receipts (MGR) and business income tax portions of the MBT on the rental income of the partnership. Will the partnership COD income and capital gain that are passed through to the partners be subject to MBT?
Yes. The partnership in this example would be subject to both components of the MBT on the rental income, the capital gain, and the COD income.

A taxpayer who meets the nexus standards and gross receipts thresholds of the MBT act is subject to a business income tax imposed on the business income base of the taxpayer and a modified gross receipts tax imposed on the modified gross receipts tax base of the taxpayer. MCL 208.1201 and 1203. The business income tax base of a taxpayer means the business income of the taxpayer subject to a series of specific adjustments listed in section 201. MCL 208.1105(2) defines business income, in part, to mean "that part of federal taxable income derived from business activity. For a partnership or S corporation, business income includes payments *and items of income and expense that are attributable to the business activity of the partnership or S corporation and separately reported to the partners or shareholders*. . .". (Emphasis added).

Here, the partnership has both COD income that is attributed to the business activity of the partnership (*i.e.* forgiveness of a debt secured by a partnership asset used in the business) and capital gain attributed to the business activity of the partnership (*i.e.* sale of the same partnership asset) that are separately reported to the partners on the federal K-1 form. While both capital gain and COD income are excluded from the calculation of partnership taxable income on the

federal 1065 form, they are both income of the partnership separately reported to the partners on the K-1 forms, and fall within the plain meaning of business income of a partnership as defined in MCL 208.1105(2), regardless of the ultimate taxability of the COD at the partner's level.

For the calculation of the modified gross receipts tax base under section 203 (MCL 208.1203), gross receipts is defined under section 111 (MCL 208.1111) to mean "the entire amount received from any activity whether in intrastate, interstate, or foreign commerce carried on for direct or indirect gain, benefit, or advantage to the taxpayer or to others," subject to specifically enumerated exceptions. COD income and capital gain of a partnership that are separately reported to the partners are not one of the specifically enumerated exceptions, and are therefore subject to the modified gross receipts tax imposed under section 203 of the MBT.

M43. How is a like-kind exchange treated under the MBT?
Generally, for federal income tax purposes, business or investment property exchanged solely for business or investment property of a like-kind, no gain or loss is recognized under Internal Revenue Code Section 1031. If, as part of the exchange other (not like-kind) property or money is received, gain is recognized to the extent of the other property and money received, but a loss is not recognized. Properties are of like-kind, if they are of the same nature or character, even if they differ in grade or quality.

Section 1031 does not apply to exchanges of inventory, stocks, bonds, notes, other securities or evidence of indebtedness, or certain other assets.

To the extent the like-kind exchange is or is not recognized for federal income tax purposes, the MBT Business Income tax base will recognize a similar amount. MBT Business Income means that part of federal taxable income derived from business activity. MCL 208.1105(2).

Like the SBT, the value of property received in a like-kind exchange will be excluded from gross receipts. If, as part of the exchange other (not like-kind) property or money is received and gain is recognized for federal income tax purposes, the gain will be included in gross receipts. Losses that are not recognized for federal income tax purposes similarly are not recognized for MBT and do not reduce gross receipts for the MBT.

Transfers of property in a like-kind exchange are not dispositions and do not cause the recapture of ITC. The transferor is not required to recapture ITC on the transferred property and the transferee is not entitled to ITC on the property received. However, when property that was exchanged in a like-kind exchange is disposed of, the acquisition date of the disposed property will be considered the date the original property was acquired to determine if the disposition causes recapture of ITC.

M44. (This FAQ has been amended due to 2011 PA 305.) Is an individual person who earns more than $350,000 in interest and dividends for the tax year subject to the MBT? Are the person's capital gains from sales of stock subject to the MBT?
Generally, no. Although the MBT filing threshold is $350,000 in apportioned or allocated gross receipts, MCL 208.1505(1), the definitions of "business income" and "gross receipts" as used in the MBT Act exclude investment income, gains from the sale of personal assets, and other income received by an individual that are not derived from the person's trade or business. Consequently, such amounts are not included in the determination of such person's MBT business income and gross receipts tax bases or in calculating the MBT filing threshold or the gross receipts filing threshold credit. MCL 208.1505(1); 208.1411. The interest, dividend, and capital gain income of the individual in the example, even if such income totaled more than $350,000 for a single tax year, would not be subject to the MBT, unless the trade or business of that individual includes making investments and engaging in investment activity.

M45. (Answer rescinded, replacement located at M80) How is "fuel" defined for purposes of the "purchases from other firms" deduction under MCL 208.1113(6)? Does it include the cost of gas for all of a business' automobiles currently in use, including owned and leased vehicles? Does it include propane to run equipment? Does it include natural gas to run furnaces?

M46. (Answer rescinded, replacement located at M70) Is the sale of stock by a stockholder in a closely held corporation back to the corporation or another stockholder subject to MBT?

M47. (Answer rescinded, replacement located at M71) Are dividends from subsidiaries and interest income from unrelated parties included in the modified gross receipts tax base in the MBT?

M48. I am a 100% shareholder of a corporation that does business in Michigan. I am a nonresident of Michigan. The corporation is organized as a C corporation. I sell 100% of the stock of the corporation which results in a capital gain. Is the capital gain from the sale of the stock subject to the new MBT?
Generally, no. The MBT act was amended on December 1, 2007 by Public Act 145 of 2007 to exclude personal investment activity from both the business income and gross receipts tax components of the MBT. MCL 208.1105(2) and MCL 208.111(1) respectively. For an individual, the sale of an ownership interest in a corporation, partnership, or limited liability company will generally not constitute business income or gross receipts to that individual unless he or she is in the business of buying and selling ownership interests in these types of business entities. This answer does not change if the individual shareholder, partner, or member is an active rather than passive investor or is a resident rather than a nonresident of Michigan.

In this case, the C corporation is the taxpayer and would be subject to MBT if the nexus standards and gross receipts thresholds are met. A 100% individual shareholder who sells all of some of the ownership interest in the C corporation will not be subject to MBT on any gain recognized from the sale of the stock except as otherwise provided above.

M49. Is the gain recognized on the one time sale of business assets and goodwill by an entity to another entity taxed under the Michigan Business Tax (MBT)?
Yes, the gain is taxed under the MBT. [The MBT does not provide an exception for noncorporate taxpayers for a casual transaction that was provided for under the SBTA.] To the extent the capital gain is derived from the business activity of the taxpayer and included in federal taxable income it must also be included in the business income tax base. The gain included in federal taxable income is also included in the modified gross receipts tax base. There are no statutory exceptions or exclusions that are applicable to capital gains recognized by a business from the sale of capital assets. As a result, these gains are included in gross receipts and the modified gross receipts tax base. Also see FAQs B4 and M10.

M50. Does the deduction for net earnings from self employment exempt self-employed individuals from taxation under the MBT?
No. The MBT is comprised of the business income tax and the modified gross receipts tax. MCL 208.1201; MCL 208.1203. The business income tax taxes "that part of federal taxable income derived from business activity." MCL 208.1105(2). The modified gross receipts tax is levied on a taxpayer's gross receipts less purchases from other firms, a defined term. MCL 208.1203(3). The deduction for net earnings from self employment is taken from the business income tax base and does not affect the modified gross receipts tax base. Further, the deduction is not an exemption from the business income tax base. MCL 208.1201(2)(h) permits a deduction, to the

extent included in federal taxable income, for net earnings from self-employment as defined under section 1402 of the internal revenue code of the taxpayer or a partner or limited liability company member of the taxpayer except to the extent that those net earnings represent a reasonable return on capital. [Emphasis added].

IRC 1402 defines net earnings from self employment to generally mean the net income and distributive share of an individual or a member of a partnership. This definition excludes several items of gross income. IRC 1402(a). For example, dividends on stock, interest on bonds, and gain on the sale of a capital asset or sale of property are all excluded from the definition of net earnings from self employment. IRC 1402(a). Each of these items, excluded by definition, will not be part of the net earnings from self employment deduction and will, thus, remain taxable in the business income tax base to the extent included in federal taxable income from business activity.

Finally, the net earnings from self employment deduction does not allow an individual, partner or limited liability company member to deduct amounts that represent a return of capital. These amounts remain taxable in the business income tax base.

M51. Are vehicles taken as trade-ins and later sold by an auto dealer considered "purchases from other firms" under the MBT, and thus deductible from gross receipts in determining the modified gross receipts tax base?

Yes. Vehicles an auto dealer acquires as trade-ins and which are later resold by the auto dealer are considered "purchases from other firms", and deductible for gross receipts to arrive at modified gross receipts. MCL 208.1113(6). "Purchases from other firms" includes inventory which is defined as "[t]he stock of goods held for resale in the regular course of trade of a retail … business." MCL 208.1111(4). An auto-dealer that accepts a trade-in as part of the purchase price of a replacement vehicle and holds the trade-in for resale in the regular course of its retail business is holding the trade-in as inventory. The auto dealer's gross receipts is reduced by the amount that the auto dealer credited against the purchase price of the replacement vehicle it sold when acquiring the trade-in.

M52. We manufacture customized tooling systems, which we then sell to our customer. After the sale, although the customer owns the tooling, it physically remains at our plant, and we use the tooling to manufacture the customer's product. Are these sales of tooling taxable under the Michigan Business Tax Act (MBTA)?

Yes. Under the MBTA, a taxpayer (other than a financial institution or an insurance company) is subject to both a business income tax and a modified gross receipts tax, which together comprise the taxpayer's MBT liability. Proceeds from the sale of custom tooling must be included when determining a taxpayer's business income tax base as well as its modified gross receipts tax base. There is no language in the MBTA which would exclude such sales from the calculation of either of these taxes.

For purposes of calculating the business income tax component of the MBT, "business income" means "that part of federal taxable income derived from business activity." MCL 208.1105(2). "Business activity" is broadly defined as "a transfer of legal or equitable title to or rental of property, whether real, personal, or mixed, tangible or intangible, or the performance of services, or a combination thereof, made or engaged in, or caused to be made or engaged in, whether in intrastate, interstate, or foreign commerce, with the object of gain, benefit, or advantage, whether direct or indirect, to the taxpayer or to others …." MCL 208.1105(1). Selling property of any kind (such as the tooling) to customers and performing services (such as the design and manufacture of the tooling) for customers both clearly constitute "business activity"; thus, all income received from such endeavors, to the extent that it is part of a taxpayer's federal taxable income, constitutes taxable "business income" under the MBTA. There is no language in the MBTA that

would exclude sales of custom-made tooling from business income, and the fact that the tooling remains at the manufacturer's plant does not alter that conclusion.

Similarly, a taxpayer calculates its modified gross receipts tax base by determining its gross receipts less "purchases from other firms," as defined in MCL 208.1113(6), before apportionment. MCL 208.1203(3). "Purchases from other firms" generally includes purchases of inventory, depreciable assets, and materials and supplies used in the taxpayer's business. MCL 208.1113(6). While the customized tooling might otherwise satisfy the definition of a depreciable asset or a material or supply used in the taxpayer's business, the tooling is made and sold, rather than purchased, by the taxpayer. Accordingly, the receipts from the customized tooling cannot be excluded as "purchases from other firms," and sales of such tooling are not deducted from gross receipts when determining the modified gross receipts tax base under the MBTA.

M53. Are Michigan lottery dealers required to include the proceeds from retail lottery ticket sales when calculating gross receipts, or are they only required to include the amount of the commission that they receive on such sales?

Under the MBT, proceeds from the licensed sale of lottery tickets are excluded from the definition of "gross receipts;" thus, only the commission paid on those sales would be included in a taxpayer's gross receipts. The MBT Act defines "gross receipts" as "[t]he entire amount received by the taxpayer from any activity whether in intrastate, interstate, or foreign commerce carried on for direct or indirect gain, benefit, or advantage to the taxpayer or to others." MCL 208.1111(1). Section 111(1) also contains a list of items that are specifically excluded from the definition of "gross receipts." One such exclusion is the "[p]roceeds from sales by a principal that the taxpayer collects in an agency capacity solely on behalf of the principal and delivers to the principal." MCL 208.1111(1)(a).

Michigan's Lottery Act mandates that the Commissioner of the Bureau of State Lottery "license as agents to sell lottery tickets such persons whom he deems will best serve the public convenience and promote the sale of tickets or shares." MCL 432.17(b). Lottery licensees are similarly referred to in another section of the statute as both "lottery sales agents" and "licensed agents." MCL 432.23. In addition, the administrative rules implementing the Lottery Act state that a lottery sales license "is evidence of an agency that is revocable at will by either the bureau or the retailer." Mich. Admin. Code Rule 432.4. Pursuant to section 35 of the Lottery Act, lottery licensees are required to deposit all monies collected from the sale of lottery tickets in a financial institution designated by the Department of Treasury to the credit of the State of Michigan. MCL 432.35(1). Accordingly, because lottery dealers are statutorily defined as "agents" of the Bureau of State Lottery (and, therefore, the State of Michigan) for the purpose of selling lottery tickets, and the dealers are required to remit back to the State of Michigan all proceeds received from the sales of lottery tickets, such sales proceeds meet the requirements for the exclusion from gross receipts set forth in section 111(1)(a). When calculating gross receipts, MBT taxpayers that are licensed lottery sales agents should not include the proceeds from their sales of lottery tickets on behalf of the State of Michigan.

The contractual agreement entered into between a licensee and the Bureau of State Lottery may provide that the licensee be paid a commission or other remuneration for all valid sales and valid prize payments made by the licensee. Because no exclusion from gross receipts applies to the commissions or other remuneration paid to lottery agents by the Bureau of State Lottery, all such payments are includable in the taxpayer's gross receipts.

M54. How are accounts receivable factoring companies treated for purposes of the Michigan Business Tax Act (MBTA)?

Factoring is a financial transaction whereby a business sells some or all of its accounts receivable (i.e., its collectible invoices) to a factoring company at a discount. Factoring is to be

distinguished from a lending transaction in that the emphasis is on the value of the receivables being sold, not the business's credit worthiness, and the receivables are actually sold to the factoring company, not simply used as collateral. The factoring company assumes all risk on the receivables, and the amount of value assigned to each account typically depends on its age. Factoring can be a one-time transaction, or there can be an on-going relationship between the invoice seller and the factoring company.

Under the MBTA, a taxpayer (other than a financial institution or an insurance company) is subject to both a business income tax and a modified gross receipts tax, which together comprise the taxpayer's MBT liability. Proceeds collected by a factoring company from accounts receivable purchased from other businesses must be included when determining the factoring company's business income tax base and its modified gross receipts tax base. There is no language in the MBTA which would exclude such proceeds from the calculation of either of these taxes.

For purposes of calculating the business income tax component of the MBT, "business income" means "that part of federal taxable income derived from business activity." MCL 208.1105(2). "Business activity" is broadly defined as "a transfer of legal or equitable title to or rental of property, whether real, personal, or mixed, tangible or intangible, or the performance of services, or a combination thereof, made or engaged in, or caused to be made or engaged in, whether in intrastate, interstate, or foreign commerce, with the object of gain, benefit, or advantage, whether direct or indirect, to the taxpayer or to others …." MCL 208.1105(1). The services provided by a factoring company, including purchasing receivables in exchange for cash and then collecting from the underlying account debtors, clearly constitute "business activity"; thus, all income received from such endeavors, to the extent that it is part of the factoring company's federal taxable income, constitutes taxable "business income" under the MBTA. There is no language in the MBTA that would exclude from the calculation of the business income tax base the proceeds collected by a factoring company from accounts receivable purchased from other businesses.

Similarly, a taxpayer calculates its modified gross receipts tax base by determining its gross receipts less "purchases from other firms," as defined in MCL 208.1113(6), before apportionment. MCL 208.1203(3). Section 111(1) specifies certain items that are excluded from the definition of "gross receipts." One such exclusion is "[p]roceeds from the taxpayer's transfer of an account receivable if the sale that generated the account receivable was included in gross receipts for federal income tax purposes." The exclusion does not apply to a taxpayer that both buys and sells receivables during the tax year. MCL 208.1111(1)(f). While this exclusion will generally apply to the invoice seller (the factoring company's customer), it does not apply to the factoring company itself, since the factoring company had nothing to do with the sale that generated the transferred account receivable and it therefore will not have included that sale in gross receipts for federal income tax purposes.

"Purchases from other firms" generally includes purchases of inventory, depreciable assets, and materials and supplies used in the taxpayer's business. MCL 208.1113(6). Such "purchases from other firms" are subtracted from the taxpayer's gross receipts when determining its modified gross receipts tax base. A factoring company's purchase from another business of intangibles such as accounts receivable does not fall within the statutory definition of "purchases from other firms." Accordingly, amounts paid by a factoring company to invoice sellers for accounts receivable are not deducted from the factoring company's gross receipts when determining its modified gross receipts tax base under the MBTA.

M55. How are gross receipts computed on an installment sale of a capital asset? Is the realized installment sale gain included in the two tax bases? How is the investment tax credit (ITC) affected?

Michigan Business Tax Frequently Asked Questions

When calculating gross receipts and the tax bases under the MBT, taxpayers should consistently use the accounting method used in computing federal income taxes. Annual federal installment sale gain is realized by computing a gross profit rate on the sale and then applying that rate to the payments received in the year. The annual installment payments received on the sale of the capital asset and the gain realized for federal income taxes should be used in calculating the MBT gross receipts for that year.

Under the MBT, "gross receipts" are defined as the entire amount received by the taxpayer from any activity whether in intrastate, interstate, or foreign commerce carried on for direct or indirect gain, benefit, or advantage to the taxpayer or to others. MCL 208.1111(1) Excepted from the definition of gross receipts are the proceeds less any gain related to the disposition of a trade or business capital asset. Subsection (o) provides:

Proceeds from a sale, transaction, exchange, involuntary conversion, or other disposition of tangible, intangible, or real property that is a capital asset as defined in section 1221(a) of the internal revenue code or land that qualifies as property used in the trade or business as defined in section 1231(b) of the internal revenue code, less any gain from the disposition to the extent that gain is included in federal taxable income. MCL 208.111(1)(o).

The installment sale method prorates gain and recognizes it over the years in which payments are received. For federal income tax purposes, the installment method may only be used for nondealer sales of property other than inventory. Generally, dealers in real or personal property may not use the installment method to report gain. A "dealer disposition" includes, with some exceptions, any disposition of personal property by a person who regularly sells or otherwise disposes of such property on an installment plan and any disposition of real property which is held for sale to customers in the ordinary course of the taxpayer's business.

There are no other gross receipts exceptions under the MBT for gains received on sales of property other than capital assets. Nor are there any other exceptions that are computed using gains realized from transactions that are not from the sale of capital assets. Therefore, any amount received that is attributed to installment sales and the gains that are realized in subsequent years are included in MBT gross receipts.

To the extent the installment sale gain is derived from the business activity of the taxpayer and included in federal taxable income it must also be included in the business income tax base. The gain realized in any tax year from the installment sale is included in both the business income and modified gross receipts tax base.

The MBT requires recapture of ITC when a sale, exchange, or other disposition of a qualifying asset, including the removal of the asset from the state, occurs. Similar to the SBT, a sale of qualifying property reported on the installment method for federal income tax purposes causes the recapture of the entire gross proceeds in the year of the sale, less any gain reported in federal taxable income in that year. Gain attributed to the installment sale that is realized in the seller's federal taxable income in subsequent years is subtracted in computing any ITC claimed against the MBT in those subsequent years.

The purchaser of a qualifying asset on an installment sale may claim ITC against total MBT liability using the entire amount paid or accrued in the taxable year pursuant to MCL 208.1403(3). Nothing in the MBTA prohibits a taxpayer from deducting the cost, in the year of purchase, of an asset that qualifies as a "purchase from other firms" when calculating its modified gross receipts tax base, and then subsequently utilizing the same asset purchase to qualify for the ITC.

M56. Are retailers who drop ship products from suppliers to customers within and outside of Michigan entitled to deduct the cost of these items from gross receipts as purchases from other firms?

A drop shipment (or third party sale) is a transaction where a seller (taxpayer) accepts an order from an end user purchaser. The seller places this order with a third party supplier and directs the third party to ship the property directly to the end user. In such an arrangement the seller generally does not hold an inventory of the goods for resale.

"Purchases from other firms are deducted from a taxpayer's gross receipts to calculate the modified gross receipts tax base. 208.1203(3) Purchases from other firms includes inventory purchased for resale. 208.1113(6) For retailers and wholesalers, inventory generally is defined by statute as, "the stock of goods held for resale in the regular course of trade of a retail or wholesale business, including electricity or natural gas purchased for resale." MCL 208.1111(4)(a) Inventory excludes personal property under lease or principally intended for lease rather than sale and property allowed a deduction or allowance for depreciation or depletion under the internal revenue code. 208.1111(4)(e)

If the facts and circumstances indicated that the property drop shipped constitutes the taxpayer's inventory as defined by statute, the cost of those items may be deducted as "purchases from other firms." Relevant facts for this inquiry include whether the drop shipped property appears on the taxpayer's books and records as inventory.

M57. Are royalties received from a foreign entity included in the tax base of the MBT?

Yes, but generally only as part of the modified gross receipts tax component of the MBT.

Royalties – including those received from foreign persons – are included in gross receipts and the gross receipts tax base for purposes of the modified gross receipts tax. MCL 208.1111(1), 208.1203.

However, for business income tax purposes, royalties received "from persons other than United States persons and foreign operating entities, including, but not limited to, amounts determined under section 78 of the [IRC] or sections 951 to 964 of the [IRC]" are subtracted from business income "to the extent included in federal taxable income." MCL 208.1201.

Foreign entities – and foreign operating entities as defined by MCL 208.1109 – cannot be included in a unitary business group. Therefore, intercompany eliminations that would otherwise remove intra-unitary business group transactions from the tax bases under are not available to royalties paid to or received by a foreign entity.

M58. How should inter-company transactions between members of a unitary business group be eliminated when the members have different year ends?

MCL 208.1511 requires the elimination of all transactions between members of the unitary business group that affect the business income tax base, modified gross receipts tax base and the apportionment formula. When members of a unitary business group have different year ends, the combined return of the unitary business group must include each tax year of each member whose tax year ends with or within the tax year of the designated member. Each member should eliminate the inter-company items of income and expense recorded on its books for the tax period of the member that is included in the combined return of the unitary business group. In other words, inter-company eliminations are made on an entity basis in computing the members' tax bases that are summed together for the combined return.

For example, a unitary business group consists of company A, the designated member that reports on a calendar year, company B that reports on a calendar year and company C that has a

fiscal year ending March 31. In 2008, companies A and B will eliminate all inter-company transactions between each other since they both report on a calendar year end. In computing their 2008 tax bases, companies A and B will also eliminate all inter-company transactions they had recorded on their books during the calendar year with company C.

Company C will report the months April 1, 2007 through December 31, 2007 on a final SBT return. Only January 1, 2008 through March 31, 2008 will be reported on the unitary group's 2008 MBT return. When computing its 2008 Business Income and Modified Gross Receipts tax bases, Company C will eliminate all inter-company transactions it has recorded on its books for the period January 1, 2008 through March 31, 2008. On the unitary group's 2009 MBT return, Company C will eliminate all inter-company transactions it has recorded on its books for the periods April 1, 2008 through March 31, 2009. Companies A and B will eliminate all intercompany transactions recorded in 2009 between each other and with company C since both A & B report on a calendar year end. While timing differences will occur due to differences in each members year end, eliminating each member's inter-company transactions that were recorded on that member's books during the periods included in the combined return will eliminate intercompany transactions from the unitary business group's tax base.

M59. What qualifies as purchases from other firms for mortgage companies?

Generally, "purchases from other firms" means:

a. Inventory acquired during the tax year, including freight, shipping, delivery, or engineering charges included in the original contract price for that inventory.
b. Assets, including the costs of fabrication and installation, acquired during the tax year of a type that are, or under the internal revenue code will become, eligible for depreciation, amortization, or accelerated capital cost recovery for federal income tax purposes.
c. To the extent not included in inventory or depreciable property, materials and supplies, including repair parts and fuel.

MCL 208.1113(6).

Potential purchases from other firms include depreciable assets acquired by a mortgage company and the materials and supplies used to maintain or operate depreciable assets.

Additionally, mortgage companies may exclude from gross receipts proceeds representing the principal balance of loans transferred or sold in the tax year. MCL 208.1111(s). To qualify for this exclusion, a mortgage company must be licensed under the mortgage brokers, lenders, and servicers licensing act, 1987 PA 173, MCL 445.1651 to 445.1684, or the secondary mortgage loan act, 1981 PA 125, MCL 493.51 to 493.81, and [have] greater than 90% of its revenues, in the ordinary course of business, from the origination, sale, or servicing of residential mortgage loans.

M60. Are returns and allowances included or excluded when calculating the modified gross receipts figure?

Returns and allowances are subtracted from total sales revenue in computing the seller's initial "gross receipts" figure. The MBT Act defines "gross receipts" as "[t]he entire amount received by the taxpayer from any activity whether in intrastate, interstate, or foreign commerce carried on for direct or indirect gain, benefit, or advantage to the taxpayer or to others." MCL 208.1111(1). Section 111(1) also contains a list of items that are specifically excluded from the definition of "gross receipts." One such exclusion specified in the list is "[r]efunds from returned merchandise." MCL 208.1111(1)(h). Sales returns and allowances are simply post-transaction adjustments in the purchase price of merchandise.

M61. Do food items purchased by a restaurant that are ingredients in menu items for sale to customers constitute "purchases from other firms?"

Yes. Under MCL 208.1113(6), "purchases from other firms" includes:

(a) Inventory acquired during the tax year, including freight, shipping, delivery, or engineering charges included in the original contract price for that inventory.
* * *
(c) To the extent not included in inventory or depreciable property, materials and supplies, including repair parts and fuel.

Under MCL 208.1111(4), "inventory" means:

(a) The stock of goods held for resale in the regular course of trade of a retail or wholesale business, including electricity or natural gas purchased for resale.

(b) Finished goods, goods in process, and raw materials of a manufacturing business purchased from another person.

While a restaurant is not a manufacturing business or a wholesaler, it is a retailer. That is, a restaurant sells tangible personal property to others for use or consumption in the ordinary course of business. Furthermore, the food items purchased by a restaurant that are menu items – or are ingredients in menu items – sold to customers constitute a stock of goods held for resale in the ordinary course of the restaurant's trade.

M62. Are parts used by an outside repair person to repair taxpayer's fixed assets a "purchase from another firm" under MCL 208.1113(6)?

The answer depends upon whether the taxpayer purchased or acquired the repair part itself or whether the repair part was provided by the repair person in conjunction with and incidental to the repair person's provision of service. "Purchases from other firms" is defined in part at MCL 208.1113(6) as:

(a) Inventory acquired during the tax year, including freight, shipping, delivery, or engineering charges included in the original contract price for that inventory.

(b) Assets, including the costs of fabrication and installation, acquired during the tax year of a type that are, or under the internal revenue code will become, eligible for depreciation, amortization, or accelerated capital cost recovery for federal income tax purposes.

(c) To the extent not included in inventory or depreciable property, materials and supplies, including repair parts and fuel.

If the taxpayer acquired (i.e. purchased) the repair part during the tax year for use in operating or maintaining the taxpayer's assets under MCL 208.1113(6)(b), and hired a repair person who then used the repair part to repair taxpayer's fixed assets under MCL 208.1113(6)(b), the repair part would be considered "materials and supplies" under MCL 208.1113(6)(c) and thus a "purchase from other firms" under MCL 208.1113.

To the contrary, where the taxpayer retained the services of the repair person, pursuant to which the repair person used the repair part incidental to the provision of services to the taxpayer, then the repair part would not be "materials and supplies" under MCL 208.1113(6)(c) and, thus, would not be a "purchase from other firms" under MCL 208.1113(6). In this situation, the taxpayer did not "acquire" the repair part; rather, the repair part was merely tangible property provided in connection with and incidental to the provision of repair services to taxpayer, the cost of which is not a "purchase from other firms." However, if the repair person were to separately itemize and charge the taxpayer for the repair part used in conjunction with the repair service, the repair part

would then be considered as having been acquired by taxpayer as a repair part for use in operating or maintaining the taxpayer's assets under MCL 208.1113(6)(b), and thus constitute a "purchase from other firm" under MCL 208.1113(6).

M63. When determining the modified gross receipts portion of MBT tax liability, do you include and report receipts from out-of-state companies or just Michigan-based receipts?
A taxpayer must report all gross receipts, whether from Michigan or out-of-state sources. For MBT purposes a "taxpayer" includes a unitary business group. For a taxpayer that is a unitary business group, all gross receipts must be reported, but gross receipts attributable to transactions between members of the unitary business are deducted from the determination of the modified gross receipts tax base. MCL 208.1203(3).

The modified gross receipts tax is imposed on the modified gross receipts tax base of the taxpayer, after allocation or apportionment to Michigan, at a rate of 0.80%. MCL 208.1203(1). The modified gross receipts tax base is calculated as gross receipts less "purchases from other firms," as defined in MCL 208.1113(6), before apportionment. The modified gross receipts tax base is apportioned based upon a sales factor. 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. MCL 208.1301(2) and 208.1303(1). Therefore, the determination of the taxpayer's modified gross receipt tax liability will depend upon sales that are sourced to Michigan relative to sales everywhere. For a taxpayer that is a unitary business group, sales include Michigan sales of every person included in the unitary business group whether or not the unitary member has nexus in Michigan. Sales between unitary members are eliminated when calculating the sales factor for apportionment. MCL 208.1303(2).

M64. I am a broker/dealer in securities without any W-2 payroll. My major expense is 1099 commissions paid to sales representatives. Are these commission expenses deductible on my MBT return?
Business income is generally defined as "that part of federal taxable income derived from business activity." MCL 208.1105(2). To the extent that federal taxable income derived from business activity is reduced by these expenses, a taxpayer's Business Income tax base will be reduced.

The Modified Gross Receipts tax base is a taxpayer's gross receipts less purchases from other firms before apportionment. MCL 208.1203(3). "Gross receipts" are defined as the entire amount received by the taxpayer from any activity whether in intrastate, interstate, or foreign commerce carried on for direct or indirect gain, benefit, or advantage to the taxpayer or to others with certain exceptions. MCL 208.1111(1). Section 111 provides no exception for or deduction of 1099 commission expense from gross receipts of broker/dealers. Therefore, the 1099 commission expense will not reduce the gross receipts or Modified Gross Receipts tax base.

Further, commissions paid to non-employees are not compensation as defined in MCL 208.1107(2). Only commissions, wages, salaries, fees, bonuses, and other payments made in the tax year on behalf of or for the benefit of employees, officers, or directors of the taxpayer would meet the statutory definition of compensation and qualify for the compensation credit provided under MCL 208.1403. The non-employee 1099 commissions in this example do not qualify for the compensation credit.

M65. What impact would a merger in 2008 have on the ability of the surviving entity to utilize SBT business loss carryforwards? How will losses incurred after December 31, 2007 be impacted by the merger?
The MBT provides for a limited deduction of SBT business loss carry forward in the 2008 MBT tax year in calculating the Modified Gross Receipts tax base only. MCL 208.1203(4) provides

that 65% of any SBT business loss carry forward that was actually incurred in the 2006 or 2007 SBT tax years and that was not previously deducted in tax years beginning before January 1, 2008 may be deducted against the Modified Gross Receipts tax base. Any business loss carry forward incurred before January 1, 2006 is not eligible for the deduction.

In a merger two or more entities combine into one, through a purchase acquisition or a pooling of interests. A merger differs from a consolidation in that no new entity is created. The surviving entity may utilize what would have been the business loss of each of the separate entities had each entity filed a separate return. Any SBT business loss carryforward that is not deducted against the 2008 Modified Gross Receipts tax base of the surviving entity is lost.

A taxpayer's Business Income tax base is its business income subject to certain statutory adjustments before allocation or apportionment. MCL 208.1201(2). Business income is generally defined as "that part of federal taxable income derived from business activity." MCL 208.1105(2). To this extent, the calculation of the MBT business income tax base of the surviving entity will follow federal regulations.

The MBT provides for the deduction of a business loss incurred after December 31, 2007. This deduction may only be taken against the Business Income tax base of an entity. Losses incurred after December 31, 2007 may not be deducted against the Modified Gross Receipts tax base. "Business loss" is defined as a negative business income taxable amount after allocation or apportionment. Any unused business loss may be carried forward to the year following the loss year and the next 9 successive tax years or until the loss is used up, whichever occurs first, but for not more than 10 taxable years after the loss year. MCL 208.1201(5). The surviving entity of a merger that files a 2008 MBT return will be able to begin deducting any resulting 2008 business loss against its 2009 Business Income tax base as permitted by statute.

M66. (Answer rescinded, replacement located at M72) Can a taxpayer net the cost of purchased securities with the proceeds from those securities? For purposes of taxing the gain, is the cost the actual cost of the securities or the fair market value on January 1, 2008?

M67. What are purchases from other firms?

"Purchases from other firms" are deducted from a taxpayer's gross receipts to calculate the modified gross receipts tax base. In general, purchases from other firms means:

- **Inventory acquired during the tax year.** Inventory – defined at MCL 208.1111 – means the stock of goods, including electricity and natural gas, held for resale in the ordinary course of a retail or wholesale business, and finished goods and good in process of a manufacturer, including raw materials purchased from another person. Inventory also includes floor plan interest for licensed new car dealers and shipping and engineering charges so long as such charges are included in the original contract price for the associated inventory. Finally, inventory includes the cost of certain securities and commodities for securities traders, brokers, and dealers as defined under the MBT.

- **Depreciable assets acquired during the tax year.** Deductible depreciable assets are those that are or will become eligible for depreciation, amortization, or accelerated capital cost recovery under the IRC. The cost of depreciable assets includes costs of fabrication and installation.

- **Materials and supplies.** Materials and supplies means tangible personal property acquired during the tax year to be used or consumed in – and directly connected to – the

production or management of inventory or the operation or maintenance of depreciable assets as described above. "Materials and supplies" includes repair parts and fuel.

- **Staffing company compensation.** Wages, benefits, and certain payroll taxes paid to personnel provided to the clients of staffing companies as defined under the MBT.

- **Payments to subcontractors and purchases by contractors.** For persons included in SIC codes 15, 16, and 17 – such as general contractors, operative builders, and trade contractors – that fail to qualify for the Small Business Alternative Credit: (i) payments to subcontractors for construction projects so long as such payments are made pursuant to a contract specific to that project, and (ii) to the extent not deducted as inventory or materials and supplies, materials deducted as purchases in determining the cost of goods sold on the taxpayer's federal return. For a more complete list of those persons within SIC codes 15, 16, and 17, see http://www.osha.gov/pls/imis/sic_manual.html.

- **Select payments by theater owners.** Film rental or royalty payments paid by a theater owner to a film distributor, film producer, or a film distributor and producer.

- **Select payments by real estate brokers and appraisers.** For persons licensed under articles 25 or 26 of the Occupational Code (real estate brokers, salespersons, and appraisers), payments to independent contractors licensed under those same articles. For a more complete list of those persons licensed under articles 25 and 26 of the Occupational Code, see MCL 339.2501 - .2518, 339.2601 - .2637.

The more specific statutory definition of "purchases from other firms" is found at MCL 208.1113(6).

M68. May taxpayers take the IRC 199 deduction for MBT purposes?
No. For federal tax purposes, the domestic production activities deduction under IRC 199 provides a tax benefit for certain domestic production activities. In particular, IRC 199 allows a deduction equal to a specified percentage of the taxpayer's qualified production activities income for the tax year.

This federal deduction, however, does not flow through to the MBT. The MBT defines "federal taxable income" to mean "taxable income as defined in section 63 of the internal revenue code, *except that federal taxable income shall be calculated as if . . . section 199 of the [IRC was] not in effect*." MCL 208.1109 (emphasis added). Thus, to the extent that the IRC 199 deduction is included in federal taxable income for federal tax purposes, that deduction must be added back in calculating federal taxable income for MBT purposes.

M69. (This FAQ has been amended due to 2011 PA 305.) Can a taxpayer net the cost of purchased securities with the proceeds from those securities? For purposes of taxing the gain, is the cost the actual cost of the securities or the fair market value?
Generally, securities, such as stocks, bonds and similar intangibles, will be capital assets under section 1221 of the IRC unless the securities are inventory to the taxpayer. Receipts from the sale of capital assets could be taxable in both the business income and modified gross receipts tax bases of the MBT.

Business income is generally defined as "that part of federal taxable income derived from business activity." MCL 208.1105(2). To the extent the capital gain from the sale of the securities is derived from the business activity of the taxpayer, the gain must be included in the business income tax base of the MBT. For this purpose, the capital gain will be computed the same as it is

federally, which is amount realized minus basis. The result will flow to the MBT return if the gain is derived from the business activity of the taxpayer. The "cost" or basis is the acquisition cost of the asset just as it is for federal purposes and is not the fair market value as of January 1, 2008, the date that the MBT went into effect.

For purposes of the modified gross receipts tax base, if the securities are sold at a gain then the proceeds of the sale of the securities minus any gain from the sale, to the extent that the gain was included in federal taxable income, will be excluded from the tax base. MCL 208.1111(1)(p).

If the securities were held for investment purposes by an individual, estate or person organized for gift or estate planning purposes and the investment activity is not part of the individual's, estate's or person's trade or business, the gain is not included in the business income tax base. MCL 208.1105(2)(f). There is a similar exclusion under the gross receipts tax base. MCL 208.1111(1)(w). Additionally, the receipts may also be excluded from both the business income tax base and the modified gross receipts tax base if the securities were held for investment purposes and sold by a person organized exclusively to conduct such investment activity who does not conduct investment activity for any person other than an individual and/or persons related to that individual. MCL 208.1105(2) and 208.1111(1)(x).

M70. (This FAQ has been amended due to 2011 PA 305.) Is the sale of stock by a stockholder in a closely held corporation back to the corporation or to another stockholder subject to MBT?

For an individual, the sale of stock in a corporation will generally not constitute business income or gross receipts to that individual so long as the investment does not constitute nor is part of the individual's trade or business. The sale of stock would generally be included in a taxpayer's business income and modified gross receipts tax bases; however, there are specific exceptions. MCL 208.1105(2)(f)(i) provides that for an individual, an estate, or a person organized for estate or gift planning purposes, income from investment activity is not included in business income if the investment activity is not part of the person's trade or business. Therefore, to the extent that the stockholder is an individual and the sale of the stock is investment activity that does not constitute part of the individual's trade or business, the sale of the stock is not included as business income subject to MBT. Similar treatment is accorded with regard to modified gross receipts.

M71. Are dividends from subsidiaries and interest income from unrelated parties included in the modified gross receipts tax base in the MBT?

Generally, interest income from unrelated parties is included in a taxpayer's modified gross receipts (MGR) tax base, with the exception of the following: (1) interest income received by a taxpayer that is an individual, estate or other person organized for estate or gift planning purposes from the taxpayer's personal investment portfolio or retirement account, or from transactions, activities and sources other than in the regular course of the taxpayer's trade or business, is excluded from gross receipts (MCL 208.1111(1)(w)); (2) interest income receipts derived from investment activity by a person that is organized exclusively to conduct investment activity solely for an individual or person related to that individual (e.g., spouse, sibling, ancestor or lineal descendent) or by a common trust fund established under the Collective Investment Funds Act, 1941 PA 174 (MCL 208.1111(1)(x)); and (3) interest income receipts derived from obligations or securities of the U.S. government, the State of Michigan, or any governmental unit of the State of Michigan are excluded from gross receipts (MCL 208.1111(1)(y)).

The inclusion of dividends a taxpayer receives from a subsidiary into the taxpayer's MGR tax base depends on whether the taxpayer is a unitary business group and whether the subsidiary is a member of the unitary business group. Dividends received from a subsidiary that is not a member of the taxpayer's unitary business group are included in a taxpayer's MGR tax base.

Dividends from a subsidiary that is a member of a unitary business group taxpayer, however, are not included in the taxpayer's MGR tax base as the inter-company dividends are eliminated under MCL 208.1203(3) and MCL 208.1511.

Furthermore, dividends received or deemed received by the taxpayer from a foreign operating entity or a non-U.S. person, are excluded from gross receipts pursuant to a five year phase-in period. For tax year 2008, 50% of the amount of such dividends is excluded from gross receipts. For tax years 2009 and 2010 60% of the amount of such dividends is excluded from gross receipts. For tax year 2011, 75% of the amount of such dividends is excluded from gross receipts and for tax year 2012 and each year thereafter, 100% of such dividend receipts is excluded from gross receipts. MCL 208.1111(z).

M72. (This FAQ has been amended due to 2011 PA 305.) An investment partnership has sales of capital asset securities consisting of both gains and losses that result in an overall gain. In determining the business income and modified gross receipts tax bases, is only the net gain included in the tax bases?

Generally, for federal reporting, gains and losses are classified as either ordinary or capital. Capital gains or losses are either short term or long term and netted on federal Schedule D. Investment property such as stocks and bonds are capital assets and the gain or loss generated is a capital gain or loss. Federally, for a partnership or an S corporation, these gains and losses are separately reported to the partners or shareholders.

The MBT imposes tax on the business income tax base of every taxpayer with business activity within this state. The business income tax base means a taxpayer's business income subject to certain adjustments. "Business income" means that part of federal taxable income derived from business activity. For a partnership or an S corporation, business income includes payments and items of income and expense that are attributable to business activity of the partnership or S corporation and separately reported to the partners or shareholders. MCL 208.1105. There are no statutory adjustments to the business income tax base for the disposition of capital assets. MCL 208.1201. Therefore, any net capital gain attributable to business activity of the investment partnership that is separately reported to the partners is also included in the MBT business income tax base of the partnership.

The MBT also imposes tax on the modified gross receipts tax base of each taxpayer with nexus. MCL 208.1203. "Gross receipts" means the entire amount received by the taxpayer as determined by using the taxpayer's method of accounting used for federal income tax purposes, from any activity whether in intrastate, interstate, or foreign commerce carried on for direct or indirect gain, benefit, or advantage to the taxpayer or to others with certain exceptions.

Subsection (p) provides an exception for each capital asset sold. MCL 208.1111(1)(p). When a capital asset is sold or disposed of at a gain, only the gain is effectively included in gross receipts. This exception does not make a similar provision for capital assets sold at a loss. In such cases, the exception only excludes the proceeds from gross receipts. There is no adjustment or deduction of losses from the gross receipts. Therefore, a taxpayer may not net capital gains and losses when calculating the modified gross receipts tax base.

Finally, there is an exception to the inclusion of gains into the business income tax base or the modified gross receipts tax base of an investment partnership if the investment partnership was organized for gift or estate planning purposes or was organized exclusively to conduct investment activity and does not conduct investment activity for any person other than an individual or persons related to that individual, and the gains were derived from activities that were not in regular course of the investment partnership's trade or business. MCL 208.1105(2). Unless the facts and circumstances surrounding the investment partnership meet this exemption, gains from

the sale of capital assets must be included in business income and gross receipts as described above.

M73. Can modified gross receipts (MGR) tax separately collected from customers by new motor vehicle dealers and new or used watercraft dealers be remitted with monthly sales, use and withholding returns?

Yes. New motor vehicle dealers and new or used watercraft dealers who elect to separately collect the MGR tax, in addition to sales price, under MCL 208.1203(5) may file and remit the tax as estimated payments with their quarterly or monthly Form 160, *Combined Return for Michigan Taxes*. Generally, for a calendar year taxpayer, MBT quarterly returns are due the 15th day of April, July, October and January. For fiscal year filers, quarterly returns are due the 15th day of the first month after each quarter. MBT payments may be made with either of the following returns:

- Form 4548, *Michigan Business Tax Quarterly Return*, or
- Form 160, *Combined Return for Michigan Taxes*.

If filing monthly using Form 160, *Combined Return for Michigan Taxes*, and not making remittances by electronic funds transfer, monthly payments may be filed on the 20th day of the month. For example, a calendar year taxpayer may file monthly MBT estimates using Form 160 on February 20th, March 20th and on April 20th rather than April 15 for the first quarter. However, for taxpayers required to make remittances by electronic funds transfer or otherwise not using Form 160, MBT estimates remain due on the 15th day of the month following the final month of the quarter. Regardless of the method chosen, the estimated MBT for the quarter must also reasonably approximate the liability for the quarter.

M74. For purposes of MCL 208.1113(6)(e), how is subcontractor defined?

Under the MBT, persons included in SIC codes 15, 16, and 17, that do not qualify for the credit under MCL 208.1417 may deduct “payments to subcontractors for a construction project under a contract specific to that project” as purchases from other firms. MCL 208.1113(6)(e).

The term “subcontractor” is not defined by the statute. Accordingly, the Department will apply the common, ordinary meaning of “subcontractor” to the statute. A “subcontractor” is an individual or entity that enters into a contract and assumes some or all of the obligations of a person included in SIC codes 15, 16, and 17 as set forth in the primary contract specific to a project.

M75. Must a contractor enter into a written contract with subcontractors in order to reduce gross receipts by the amount of payments made to subcontractors for a construction project?

Under the MBT, the modified gross receipts tax base is a taxpayer’s gross receipts less purchases from other firms before apportionment. MCL 208.1203(3). Contractors, defined as persons included in SIC codes 15, 16, and 17, that do not qualify for the credit under MCL 208.1417 may deduct “payments to subcontractors for a construction project under a contract specific to that project” as purchases from other firms. MCL 208.1113(6)(e).

While the statute does not require a contractor execute a written contract with a subcontractor for labor costs specific to a project, a taxpayer bears the burden to prove it is entitled to a deduction in computing its tax liability. It is contemplated that good business practice would include documentation, such as a written contract, to support a deduction from gross receipts for payments to subcontractors as “purchases from other firms.”

The supporting information for payments to a subcontractor could be incorporated into the contract for the specific project or memorialized in a separate contract with a subcontractor specifying the project the costs pertain to.

M76. To calculate the modified gross receipts tax base, may contractors deduct from gross receipts all amounts paid to subcontractors as purchases from other firms? Under the MBT, persons included in SIC codes 15, 16, and 17 that do not qualify for the small business alternate credit under MCL 208.1417 may deduct "payments to subcontractors for a construction project under a contract specific to that project." MCL 208.1113(6)(e). Persons included in SIC codes 15, 16, and 17 include general contractors (of residential buildings including single-family homes; industrial, commercial, and institutional buildings; bridges, roads, and infrastructure; etc.), operative builders, trade contractors (such as electricians, plumbers, painters, masons, etc.). See http://www.osha.gov/pls/imis/sic_manual.html for a more complete list.

In other words, purchases from other firms includes all payments to subcontractors for construction projects so long as such payments are made pursuant to a contract specific to that project. For example, payments made to an independent contractor to provide general labor services to the contractor not specific to a particular contract do not constitute purchases from other firms. However, payments made to a subcontractor for services and materials provided under a contract specific to a particular construction project (such as the construction of commercial property at 111 Main Street) do constitute purchases from other firms.

M77. Taxpayer is a commercial printing and mailing company. Taxpayer provides printing and mailing services to clients throughout the U.S. Postage is billed to the client. Is the postage included in the gross receipts of the taxpayer?
Yes. Gross receipts are the "entire amount received" from "any activity" unless the amount received is expressly excluded under MCL 208.1111 or deductible as "purchases from other firms" under MCL 208.1113. Postage is neither an excluded receipt nor is it a purchase from another firm. Furthermore, the taxpayer in question – absent a contract demonstrating otherwise – is not a legal agent of its customers. Thus, the agency exemption under MCL 208.1111 does not apply.

M78. Are commissions that real estate brokers collect and pay to their real estate agents who actually sold the property include in gross receipts? If not, may they be deducted from gross receipts as a "Purchase From Another firm"?
Commissions are included in gross receipts. Gross receipts are the "entire amount received" from "any activity" unless the amount received is statutorily exempted under MCL 208.1111. The statute provides no exemption from the definition of gross receipts for real estate commissions collected. Therefore, a real estate broker that receives commissions must include those commissions in its gross receipts even if all, or a portion of the commissions will later be paid out to real estate agents or salespersons affiliated with the broker.

However, the modified gross receipts tax base is a taxpayer's gross receipts less purchases from other firms before apportionment. MCL 208.1203(3). Purchases from other firms include, in part, payments made by brokers licensed under article 25 or 26 of the Occupational Code, 1980 PA 299, to independent contractors also licensed under that Act. MCL 208.1113(6)(g). Therefore, while commissions received are not excluded from a broker's gross receipts, any commissions that are in turn paid out to real estate agents or salespersons that are independent contractors are deducted from gross receipts in calculating the modified gross receipts tax base.

Note however, if the relationship between the broker and the real estate agent or salesperson is one of an employer/employee, any payments made to the licensed employee are not deductible from gross receipts as the definition of purchases from other firms is limited to payments made to "independent contractors."

M79. Are the qualified affordable housing deductions from business income and gross receipts under MCL 208.1201(7) and 208.1203(6) limited to qualified affordable housing projects ("QuAHPs") that purchase residential rental units after the effective date of 168 PA 2008?

No. Under the MBT, QuAHPs are permitted a deduction from business income and gross receipts for income and receipts generally attributable to rent-restricted residential rental units in this state owned by the QuAHP. More specifically, the deduction from business income states:

[F]or a person that is a qualified affordable housing project, deduct an amount equal to the product of that person's taxable income that is attributable to residential rental units in this state owned by the qualified affordable housing project multiplied by a fraction, the numerator of which is the number of rent restricted units in this state owned by that qualified affordable housing project and the denominator of which is the number of all residential rental units in this state owned by the qualified affordable housing project. [MCL 208.1201(7).]

Similarly, the deduction from gross receipts states:

[F]or a person that is a qualified affordable housing project, deduct an amount equal to that person's total gross receipts attributable to residential rental units in this state owned by the qualified affordable housing project multiplied by a fraction, the numerator of which is the number of rent restricted units in this state owned by the qualified affordable housing project and the denominator of which is the number of all rental units in this state owned by the qualified affordable housing project. [MCL 208.1203(6).]

There is no requirement under MCL 208.1201(7) and 208.1203(6) that the deductions are limited to QuAHPs that purchase rental units after the effective date of 168 PA 2008 or rental units purchased after that date. That is, the deductions under MCL 208.1201(7) and 208.1203(6) are available to QuAHPs for all rental units that meet the requirements set forth under MCL 208.1201 and 208.1203, subject only to extinguishment under the following provision:

If a qualified affordable housing project no longer meets the requirements of subsection (9)(b) or fails to operate those residential rental units as rent restricted units in accordance with the operation agreement and the requirements of subsection (9)(c), the taxpayer is entitled to the deductions under subsections (6) and (7) as long as the qualified affordable housing project continues to offer some of the residential rental units purchased as rent restricted units in accordance with the operation agreement. [MCL 208.1201(8). The disqualification provision for gross receipts purposes is substantially the same and found at MCL 208.1203(7).]

M80. How is “fuel” defined for purposes of the “purchases from other firms” deduction under MCL 208.1113(6)? Does it include the cost of gas for all of a business’ automobiles currently in use, including owned and leased vehicles? Does it include propane to run equipment? Does it include natural gas to run furnaces?

Note: This FAQ revises M45 by removing the phrase "purchased in the tax year" from the last sentence of the second paragraph.

Whether fuel is a “purchase from other firm” under MCL 108.1113(6) depends upon whether the taxpayer’s use of the fuel powers inventory or a depreciable asset acquired by the taxpayer during the tax year.

“Purchases from other firms” includes in pertinent part:

(a) inventory, as defined in MCL 208.1111(4), acquired during the tax year;

(b) assets acquired during the tax year of a type that are or will become eligible for depreciation, amortization, or accelerated capital cost recovery under the internal revenue code for federal income tax purposes; and

(c) to the extent not included in inventory (subparagraph (a)) or depreciable assets (subparagraph (b)), materials and supplies, including repair parts and fuel.

Materials and supplies in subparagraph (c) are those items taxpayer acquired during the tax year to be used or consumed in, and directly connected to, producing or managing inventory acquired (subparagraph (a)) or operating or maintaining depreciable assets acquired (subparagraph (b)) during the tax year. Therefore, fuel acquired in the tax year to be used in, and directly connected to, producing or managing inventory purchased in the tax year or operating and maintaining depreciable assets purchased would be a “purchase from other firms” and deducted from gross receipts when determining the modified gross receipts tax base.

“Fuel” is not expressly defined in the MBT, but the term commonly refers to material used to produce heat or power by burning. In the example posed, gasoline purchased to power automobiles the taxpayer uses is not a “purchase from other firms” because automobiles used by taxpayer are not taxpayer’s inventory. Gasoline purchased to power taxpayer’s automobiles might be a “purchase from other firms” to the extent that such automobiles acquired during the tax year are depreciable assets for federal income tax purposes. Passenger automobiles, both owned and leased, are included as “listed property” under section 280F of the internal revenue code and may be eligible for depreciation deductions for federal income tax purposes, subject to specific rules and limitations. 26 USC § 280F; Treas. Reg § 1.280F-1T *et seq*.

Equipment and furnaces are generally depreciable assets for federal income tax purposes. Consequently, propane or natural gas purchased to run the equipment or furnace might be “purchases from other firms” if the equipment or furnace powered by the fuel was purchased during the tax year. Natural gas consumed for general space heating of a commercial office building would not be a “purchase from other firms;” however, natural gas purchased to run equipment or furnace designed to maintain temperature or dryness specifications necessary to preserve the quality and integrity of inventory purchased during the tax year might be a “purchase from other firm.” Therefore, whether a certain fuel purchased constitutes a “purchase from other firms” will depend upon the facts and circumstances of its use.

M81. Does the step up in basis under Internal Revenue Code (IRC) section 754 election and 743 application qualify as "purchases from other firms" when calculating the modified gross receipts tax base? Does the step up in basis qualify for investment tax credit (ITC)?
No, a taxpayer may not subtract a step up in basis under IRC section 754 election and 743 application as "purchases from other firms" when calculating the modified gross receipts tax base. The step up in basis does not qualify for ITC.

"Purchases from other firms" are deducted from a taxpayer's gross receipts to calculate the modified gross receipts tax base. Purchases from other firms includes in relevant part:

(b) Assets, including the costs of fabrication and installation, acquired during the tax year of a type that are, or under the internal revenue code will become, eligible for depreciation, amortization, or accelerated capital cost recovery for federal income tax purposes. MCL 208.1113(6)(b).

The statute emphasizes that to qualify for this deduction, a taxpayer's purchase must be acquired during the tax year and be an asset of the type that is or will become eligible for depreciation, amortization, or accelerated capital cost recovery for federal income tax purposes.

An election by a partnership under IRC section 754 to apply section 743 (b) allows for the step up in the basis of partnership property for transfers of partnership interests. Section 743(b) requires the incoming partner increase his or her share of the partnership's basis in its assets by the excess of the investing partner's outside basis (i.e. what was paid for the partnership interest) over their proportionate share of the adjusted basis of the partnership property. This optional basis adjustment directly affects only the incoming investor partner. An election under IRC Section 754 permits an investor to claim depreciation deductions to the extent that any basis adjustment is allocated to depreciable property.

Under this election, the taxpayer/partnership has not acquired any assets in the year of the election nor has it acquired any assets from another firm. Rather, the assets of the partnership were continually maintained except that they have been revalued for the investing partner due to the change in ownership. Thus, the taxpayer/partnership does not qualify for and may not take a "purchases from other firms" deduction when computing the modified gross receipts tax base.

A taxpayer may claim an ITC against the MBT tax liability for a percentage of the net capital investment paid or accrued for qualifying assets physically located in Michigan for use in a business activity. MCL 208.1403(3). Because the taxpayer/partnership has not made any additional investment in qualifying assets, no ITC may be claimed on the incoming partner's increase to his or her share of the partnership's asset basis.

Nexus

N1. How does a unitary business group apportion its tax bases when some members of the group do not have nexus with Michigan?

For a unitary group with business activities within and without Michigan, as defined in MCL 208.1301(3), the tax bases are apportioned to this state by multiplying them by the sales factor. The tax bases of a unitary group are calculated according to MCL 208.1201 and 208.1203. The sales factor is Michigan sales divided by everywhere sales. The sales of all members of the unitary group are included in both the numerator and the denominator.

N2. What are the nexus standards under the MBT?

A taxpayer, other than an insurance company, has nexus with Michigan and is subject to the tax imposed under the MBT if (a) the taxpayer has a physical presence in this state for more than one day in a tax year, or (b) the taxpayer actively solicits sales in this state and has unapportioned gross receipts of $350,000 or more sourced to this state. MCL 208.1200(1).

However, the business income tax is limited by federal statutory provisions commonly referred to as PL 86-272, which prohibits Michigan from imposing the tax if the only in-state business activity of the out-of-state person is the solicitation of orders for sales of tangible personal property where the orders are sent outside the state for approval or rejection and are filled by shipment or delivery from a point outside the state. 15 USC 381 et seq. Once a taxpayer exceeds the safe harbor of PL 86-272, the taxpayer is then subject to the business income tax on its entire tax base, including that portion of income otherwise protected by PL 86 272.

Physical presence means "any activity conducted by the taxpayer or on behalf of the taxpayer by the taxpayer's employee, agent, or independent contractor acting in a representative capacity." MCL 208.1201(3). Physical presence does not include "the activities of professionals providing services in a professional capacity or other service providers if the activity is not significantly associated with the taxpayer's ability to establish and maintain a market in this state." MCL

208.1201(3). [Although RAB's issued under the SBT are limited to the SBT, future guidance regarding physical presence under the MBT will likely be similar to that found in RAB 1998-1.]

The "actively solicits" provision will be further defined by the Department prior to January 1, 2008.

Insurance companies are subject to the MBT on all property or risk located or residing in this state. MCL 208.1235.

N3. If a flow through entity establishes nexus for either or both the business income tax or modified gross receipts tax under the MBTA, do the individual partners or shareholders automatically acquire nexus for individual income tax purposes under the Michigan Income Tax Act (ITA).

If a flow through entity has business income tax nexus with Michigan for MBT, the individual partners or shareholders will be subject to apportionment under the ITA on their distributive or pro-rata share of the flow through entity's (partnership or S corporation) income.

If a flow through entity has nexus with Michigan under the MBT nexus standards, but the business activity of the flow through entity is afforded immunity under Public Law (P.L.) 86-272, 15 USC 381 – 384, the individual partners or shareholders will not be subject to apportionment on their share of profits from the flow through entity.

Conversely, if a Michigan flow through entity has nexus with another state or states as described above, and the activity of the flow through entity is not protected under PL 86-272, the individual partners or shareholders, whether residents or nonresidents of Michigan, would be able to apportion income from the flow through entity to other states under the apportionment provisions of the ITA.

Michigan's Income Tax Act does not apply to gross receipts.

N4. For purposes of apportionment under the MBT, what jurisdictional standard will be applied to determine whether a taxpayer is subject to tax in another state?

Section 301(3) of the MBT Act provides as follows:

(3) A taxpayer whose business activities are subject to tax both within and outside of this state is subject to tax in another state in either of the following circumstances:

(a) the taxpayer is subject 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 this act in that state.

(b) That state has jurisdiction to subject the taxpayer to 1 or more of the taxes listed in subdivision (a) regardless of whether that state does or does not subject the taxpayer to that tax.

Under the MBT Act, a taxpayer "has substantial nexus in this state and is subject to the tax imposed under this act if the taxpayer has a physical presence in this state for a period of more than 1 day during the tax year or if the taxpayer actively solicits sales in this state and has gross receipts of $350,000 or more sourced to this state." MCL 208.1200(1).

The same standard used to determine nexus for out-of-state taxpayers, as described in Section 200(1) above, will be applied to determine whether a taxpayer is subject to tax in another state for purposes of apportionment under the MBT.

N5. For purposes of apportionment, in determining whether a Michigan-based taxpayer has nexus with a state other than Michigan pursuant to section 301(3), must gross receipts in any "one" state or in all states equal or exceed $350,000 in order to satisfy the "actively solicits sales" nexus standard?

A taxpayer whose business activities are subject to tax both within and outside of Michigan is permitted to apportion its tax base to Michigan. MCL 208.1301(2). Section 301(3) describes the circumstances under which a taxpayer will be considered to be subject to tax in another state. MCL 208.1301(3). For purposes of apportionment, in determining whether a taxpayer is "subject to tax in another state" within the meaning of section 301(3), the Department will apply the same standard used to determine nexus for out-of-state taxpayers, which is set forth in section 200(1). That standard requires that the taxpayer have physical presence in this state, or that the taxpayer "actively solicits sales" in this state and have gross receipts of at least $350,000 sourced to Michigan. MCL 208.1200(1). Because the nexus standard references $350,000 in gross receipts sourced to a single state (Michigan), in applying that standard to determine whether a taxpayer is subject to tax in another state for purposes of apportionment, the Department will require that the taxpayer meet the $350,000 gross receipts threshold in a single non-Michigan state. Also, section 301(3) by its terms refers to "another state" (singular) having jurisdiction to subject the taxpayer to tax. MCL 208.1301(3). Accordingly, a Michigan-based taxpayer having gross receipts of $150,000 in one non-Michigan state and gross receipts of $200,000 in another non-Michigan state would not meet the section 301(3) standard and would not be able to apportion its tax base.

N6. Regarding the MBT nexus standard found in section 200(1), which is based upon the taxpayer actively soliciting sales in Michigan and having "gross receipts of $350,000.00 or more sourced to this state," will the $350,000.00 be calculated using "gross receipts" as defined in section 111, or will that sum be determined by using "sales" as defined in section 115?

As section 200(1) specifically directs that it is gross receipts of $350,000.00 or more sourced to Michigan [and active solicitation of sales in this state] that determine substantial nexus, the definition of gross receipts found in section 111 will be applied, not the definition of sales.

N7. Please provide examples of when and how an internet web site can be determined to be "purposeful" or "active solicitation".

"Active solicitation" is defined in RAB 2007-6. But in summary, "active solicitation" includes soliciting sales through an internet site available to everyone everywhere – even if the internet site in question is not limited to Michigan. When evaluating whether acts of solicitation are sufficient to establish active solicitation, the Department examines the activity on a facts and circumstances basis. To the extent that an internet site clearly excludes the Michigan market or refuses orders from persons within Michigan, then that person is not actively soliciting sales in Michigan through the internet site.

Example 1. A retailer located outside Michigan maintains an internet site over and through which customers may browse products and place orders. The internet site is generally available to all persons throughout the country. Through maintenance of the interactive site, the retailer intends to reach all persons and markets, including persons within Michigan and the Michigan market. The retailer is actively soliciting sales in Michigan.

Example 2. A retailer located outside Michigan maintains an internet site that advertises products and provides the terms under which such products may be purchased from the retailer. Although customers may not place orders directly through the internet site, the internet site provides a phone number and printable order form and invites customers to place orders through the phone or mail. Through this internet site, the retailer intends to reach all persons and

markets, including persons within Michigan and the Michigan market. The retailer is actively soliciting sales in Michigan.

Example 3. A retailer located outside Michigan maintains an internet site over and through which customers may browse products and place orders. The retailer does not accept orders from and does not ship to persons within Michigan. The retailer does not direct its activities at persons within Michigan or the Michigan market. The retailer is not actively soliciting sales in Michigan.

Example 4. A manufacturer located outside Michigan maintains an internet site over and through which persons may view the manufacturer's products and specifications. The manufacturer does not accept orders through the internet site, provide order forms, or invite persons to call the manufacturer with orders. Although the internet site is generally available to all persons throughout the country, the manufacturer is not actively soliciting sales in Michigan.

N8. An out-of-state company has a remote employee located in Michigan. The out-of-state company has no sales or business activities in Michigan. Does the out-of-state company have nexus with Michigan under the MBT?

Yes. Under the MBT, a taxpayer, other than an insurance company, has nexus with Michigan if
(a) the taxpayer has a physical presence in this state for more than one day in a tax year, or
(b) the taxpayer actively solicits sales in this state and has unapportioned gross receipts of $350,000 or more sourced to this state. MCL 208.1200(1). The presence of a permanent employee in Michigan constitutes physical presence in this state and creates nexus.

However, absent Michigan sales and business activities, that company is unlikely to meet or exceed the filing threshold of $350,000 in allocated or apportioned gross receipts. MCL 208.1505. In that case, the out-of-state company need not pay the MBT or file a return.

N9. Non-U.S. corporations qualify as taxpayers under the MBT. For purposes of the business income tax component of the MBT, will the Department recognize the protection of PL 86-272 for non-U.S. corporations?

Yes, the Department will recognize the protection of PL 86-272 for non-U.S. business entities.

Although PL 86-272, by its plain terms, applies only to interstate commerce and makes no mention of foreign commerce, the Department has determined that the protections afforded by this federal statute should also be extended to non-U.S. corporations and business entities.

N10. Does the protection of Public Law 86-272 apply to financial institutions?

No. Financial institutions are subject to a franchise tax under Chapter 2B of the MBT. The franchise tax is levied at a rate of .235% on a financial institution's net capital. This tax on net capital is not a net income tax. Thus, the protection of PL 86-272 does not apply to financial institutions taxed under Chapter 2B of the MBT.

Any taxpayer, other than an insurance company, has nexus with Michigan and is therefore subject to the taxes imposed by the MBT, if the taxpayer either (a) has physical presence in this state for more than one day during a tax year, or (b) the taxpayer actively solicits sales in this state and has $350,000 or more in gross receipts sourced to Michigan. MCL 208.1200. "Active Solicitation" is defined in Revenue Administrative Bulletin 2007-06.

Public Law 86-272 is a federal law that prohibits a state from imposing a net income tax on an out-of state taxpayer whose only business activity in Michigan is the solicitation of orders for sales of tangible personal property where the orders are sent outside the state for approval or rejection and are filled by shipment or delivery from a point outside the state. 15 USC 381 *et seq*. PL 86272 only applies to the business income tax of the MBT.

N11. Does a mail order company that does not have physical presence in Michigan and was not previously subject to the SBT, but mails catalogs to persons within Michigan and has $350,000 or more in Michigan sales have nexus for purposes of the MBT? If so, must that company register with the Department?

Yes. Under the MBT, a taxpayer, other than an insurance company, has nexus with Michigan and is subject to the MBT if "the taxpayer has a physical presence in this state for a period of more than 1 day during the tax year or if the taxpayer actively solicits sales in this state and has gross receipts of $350,000 or more sourced to this state." MCL 208.1200(1). In other words, there are two nexus standards under the MBT. A person may have nexus with the state if that person has physical presence in the state for more than one day during the tax year. Alternatively, a person may have nexus with the state if the person actively solicits sales in this state and has Michigan gross receipts of $350,000 or more.

RAB 2007-6 defines "actively solicits" to mean purposeful solicitation of persons within this state. Solicitation means (1) speech or conduct that explicitly or implicitly invites an order; and (2) activities that neither explicitly nor implicitly invite an order, but are entirely ancillary to requests for an order. Solicitation is purposeful when it is directed at or intended to reach persons within Michigan or the Michigan market.

Active solicitation includes, but is not limited to, solicitation through (1) the use of mail, telephone, and e-mail; (2) advertising, including print, radio, internet, television, and other media; and (3) maintenance of an internet site over or through which sales transactions occur with persons within Michigan. Sending mail orders catalogs to Michigan residents is a common example of active solicitation.

Active solicitation, coupled with $350,000 in Michigan gross receipts, constitutes nexus under the MBT. Thus, a mail order company without physical presence in Michigan that actively solicits sales in Michigan and has over $350,000 in Michigan gross receipts will have nexus under the MBT.

If the only in-state activity of the mail order company is the solicitation of orders for sales of tangible personal property through mail order catalogs where the orders are sent outside the state for approval or rejection and are filled by shipment or delivery from a point outside the state, then the mail order company falls within the protection of PL 86-272 and will not be subject to the business income tax component of the MBT. However, that taxpayer will still be subject to the modified gross receipts tax component of the MBT.

A taxpayer that was not subject to the SBT but is now subject to the MBT must register using Form 518. The taxpayer must also file an annual return and may be subject to quarterly estimated tax payments. See MBT FAQs A3, A4, and A6 for further information on annual returns and quarterly estimates.

N12. Under the MBT nexus standards for the modified gross receipts tax, is owning a partnership interest considered physical presence in Michigan? The partnership owns rental real property in Michigan.

No. If the person has no business activity or physical presence in Michigan outside of the partnership interest, the person would not have nexus with Michigan.

If the person is part of a unitary group that includes the partnership, the person’s business activity would be included in the unitary group’s combined MBT return.

Under section 200 of the MBT, MCL 208.1200, a taxpayer has nexus with Michigan if the taxpayer has a physical presence in Michigan for a period of more than 1 day during the tax year or actively solicits sales in Michigan and has Michigan sourced gross receipts of $350,000 or more. Section 117(5) defines "taxpayer" to mean "a person or a unitary business group liable for tax, interest of penalty under this act [MBT]." Person is defined at MCL 208.1113(3) to include individuals and various types of business entities, and a unitary business group is defined as a group of United States persons that meet certain control and relationship tests specified in MCL 208.1117.

A partnership that owns real property in Michigan for more than 1 day clearly has established physical presence in Michigan under section 200 of the MBT act. However, a person with *no* business activity or property in Michigan other than an ownership interest in this partnership will have no physical presence in Michigan. And if the person and partnership do not constitute a unitary group under MCL 208.1117 the person will *not* be subject to MBT.

N13. Does an out-of-state trucking company that drives into Michigan for pick up or delivery of product, but has no other physical presence (e.g. employees or real or personal property) in Michigan, create nexus with Michigan subjecting the company to the Michigan Business Tax ("MBT")? If nexus is created, how is apportionment calculated? The out-of-state trucking company would have nexus with Michigan for purposes of the MBT if the company either picked up or delivered product in Michigan during 2 or more days within the tax year. Furthermore, the company would have nexus with Michigan if the company merely drives through Michigan, i.e, travels through Michigan on a trip that originates and terminates outside of Michigan, with no pick up or delivery in Michigan and with no other business activity in Michigan, during 2 or more days within the tax year.

If nexus is established, the taxpayer's business income and modified gross receipts tax bases must be apportioned by multiplying each tax base by the sales factor. MCL 208.1301(1). Generally, for an out-of-state transportation company, receipts from transportation services provided by the transportation company are sourced according to MCL 208.1305(11), (12) based on the ratio of revenue miles in Michigan (numerator) to revenue miles everywhere (denominator). Revenue mile means the transportation for consideration of one net ton in weight or one passenger the distance of one mile. MCL 208.1113(7). Receipts from transportation services are combined with other receipts or sales of the taxpayer to compute the sales factor. Note that once nexus exists in a tax year, then all revenue miles driven in Michigan, including revenue miles associated with "drive through" trips made in Michigan, are included in the apportionment formula numerator. For an out-of-state transportation company that is a "foreign person" as defined in MCL 208.1207(8)(d) and is subject to MBT taxes, the sales factor is a fraction, the numerator of which is the taxpayer's total sales in Michigan where title passes inside the United States during the tax year and the denominator of which is the taxpayer's total sales in the United States where title passes inside the United States during the tax year. MCL 208.1207(7).

Under MCL 208.1207(1)(i), however, a foreign trucking company domiciled in a subnational jurisdiction would not be subject to MBT taxes, notwithstanding the fact that it has nexus with Michigan for MBT, where that subnational jurisdiction does not impose an income tax on a similarly situated person domiciled in Michigan whose presence in the foreign country is the same as the foreign trucking company's presence in the United States. Furthermore, if a subnational jurisdiction does not impose an income tax on businesses, but instead imposes some other type of subnational business tax, then the foreign trucking domiciled in that subnational jurisdiction is not subject to MBT taxes if that subnational jurisdiction's business tax is not imposed on a similarly situated person domiciled in Michigan whose presence in the foreign country is the same as the foreign person's presence in the United States. MCL 208.1207(1)(i).

Michigan Business Tax Frequently Asked Questions

Unitary

U1. How does a unitary business group apportion its tax bases when some members of the group do not have nexus with Michigan?
For a unitary group with business activities within and without Michigan, as defined in MCL 208.1301(3), the tax bases are apportioned to this state by multiplying them by the sales factor. The tax bases of a unitary group are calculated according to MCL 208.1201 and 208.1203. The sales factor is Michigan sales divided by everywhere sales. The sales of all members of the unitary group are included in both the numerator and the denominator.

U2. An out-of-state Real Estate Investment Trust (REIT) has a Michigan subsidiary. The Michigan subsidiary was previously required to file SBT returns. The REIT did not file SBT returns. A single federal return is filed for the REIT and its subsidiary. Under the MBT, can the subsidiary continue to file separately or will the REIT and subsidiary be required to file a consolidated return?
To the extent these entities meet the definition of a "unitary business group" the group is deemed the taxpayer and a combined tax return must be filed. MCL 208.117(5).

Under MCL 208.117(6), a "unitary business group" includes a group of businesses, 1 of which owns or controls more than 50% of the ownership interest, and that has business activities or operations which result in a flow of value between or among persons in the group or has business activities or operations that are integrated with, are dependent upon, or contribute to each other.

When at least one member of a unitary group has substantial nexus with Michigan, as defined by MCL 208.1200, all Michigan sales by members of the unitary group are included in the numerator of the apportionment factor.

U3. How does a unitary business group apportion its tax bases under the MBT? Is the apportioned tax base of a unitary group allocated back to the members of the unitary business group?
The business income tax base and modified gross receipts tax base of "a *taxpayer* whose business activities are subject to tax both within and outside of this state shall be apportioned to this state" by multiplying the business income tax base and modified gross receipts tax base by the sales factor. MCL 208.1301 (emphasis added). The sales factor is a fraction, "the numerator of which is the total sales of the taxpayer in this state during the tax year and the denominator of which is the total sales of the taxpayer everywhere during the tax year." MCL 208.1303(1). Sales are sourced to Michigan or elsewhere under MCL 208.1305.

"Taxpayer" means "a person *or a unitary business group* liable for a tax, interest, or under this act." MCL 208.1117 (emphasis added). In other words, apportionment is not calculated separately for each member of the unitary business group but on the combined tax bases as calculated under MCL 208.1201 and 208.1203. There is no need to allocate the apportioned tax base of the unitary business group back to the members of the unitary business group.

U4. Are special purpose entities taxpayers under the MBT?
Yes. Under the MBT, taxpayer means "a person or a unitary business group liable for a tax, interest, or penalty." MCL 208.1117(5). "Person" means "an individual, firm, bank, financial institution, insurance company, limited partnership, limited liability partnership, copartnership, partnership, joint venture, association, corporation, subchapter S corporation, limited liability

company, receiver, estate, trust, or any other group or combination of groups acting as a unit." MCL 208.1113(3).

According to Black's Law Dictionary, "special purpose entity" is defined as "a business established to perform no function other than to develop, own, and operate a large complex project . . . ." Black's Law Dictionary (7th ed). More generally, a special purpose entity can be defined as a business formed solely in order to fulfill narrow, specific or temporary objectives. Special purpose entities are often used to facilitate securitzation.

Thus, to the extent that it satisfies the filing threshold, a special purpose entity will be a taxpayer under the MBT. Alternatively, a special purpose entity may be a member of a unitary business group if the control test and one of the two relationship tests of MCL 208.1117(6) are satisfied. There are no exemptions under the MBT for special purpose entities.

U5. How are the business income and modified gross receipts tax bases apportioned for a unitary business group that includes both transportation companies and companies other than transportation companies?

The business income tax base and modified gross receipts tax base of a taxpayer whose business activities are subject to tax within and without Michigan must be apportioned by multiplying each tax base by the sales factor. MCL 208.1301(1). Taxpayer includes a unitary business group. MCL 208.1117(5).

The sales factor is a fraction of Michigan sales over sales everywhere. MCL 208.1303(1). For a unitary business group, the Michigan sales of each member – without regard to nexus – are combined in the numerator and all sales of each member are combined in the denominator. MCL 208.1303(2). Sales between members of a unitary group are eliminated when calculating the sales factor. MCL 208.1303(2), 208.1511.

Sales are sourced to Michigan and elsewhere under MCL 208.1305. Receipts from transportation services provided by a transportation company or any other company are sourced according to MCL 208.1305(11), (12). Receipts from transportation services are then combined with other receipts or sales of that member and those of other members of the unitary business group in the numerator and denominator to compute the sales factor. Although transportation services are subject to a specific sourcing rule, transportation companies do not – and receipts from transportation services are not – apportioned separately.

U6. (Answer rescinded, replacement located at U51) Would a group of companies who have a flow of value between them but are owned by two nonrelated persons, each owning 50%, be considered a unitary business group?

U7. Are unitary business groups under the MBT the same as controlled groups under the SBT?

No. Under the MBT, a unitary business group is:

> a group of United States persons, other than a foreign operating entity, 1 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 United States persons, and that has business activities or operations which result in a flow of value between or among persons included in the unitary business group or has business activities or operations that are integrated with, are dependent upon, or contribute to each other. For purposes of this subsection, flow of value is determined by reviewing the totality of facts and circumstances of business activities and operations. [MCL 208.1117(6).]

The Department will follow IRC § 318 pertaining to constructive ownership of corporate stock, or analogous authority to determine indirect, or constructive ownership and control. However, the Department will apply IRC § 318 principles to ownership interests for all types of entities subject to the MBT.

To qualify as a unitary business group under the MBT, a group must satisfy the *control test* and one of two *relationship tests*: business activities that (1) result in a *flow of value* between members; or that (2) are *integrated with, dependent upon, or contribute to* each other.

In contrast, "controlled groups" under the SBT are generally defined as:

[a]n affiliated group as defined in this act, a controlled group of corporations as defined in section 1563 of the internal revenue code and further described in 26 C.F.R. 1.414(b)-1 and 1.414(c)-1 to 1.414(c)-5, or an entity under common control as defined by the internal revenue code . . . . [See MCL 208.36.]

An "affiliated group" means "2 or more United States corporations, 1 of which owns or controls, directly or indirectly, 80% or more of the capital stock with voting rights of the other United States corporation or United States corporations." MCL 208.3. Under IRC 1563, control of a brother-sister controlled group is established if five or fewer persons combine to possess more than 50% of the stock of each corporation. RAB 1989-48 concludes – in part – that entities under common control exist when five or fewer persons combine to own a controlling interest in each entity.

In other words, the ownership tests for controlled groups under the SBT differ from that under the MBT. The MBT requires members of a unitary business group to meet a relationship test not found in the SBT. Therefore, while there might be some overlap between affiliated groups under the SBT and unitary business groups under the MBT, an affiliated group under the SBT will not necessarily be a unitary business group under the MBT. All facts and circumstances related to business activities and operations should be reviewed when determining whether a unitary group exits and who the members of the group are.

U8. (Answer rescinded, replacement located at U33) What is a unitary business group?

U9. Can brother-sister corporations wholly owned by a single individual be members of a unitary business group? What if the corporations conduct no interrelated business activities?

Under the MBT, a unitary business group is:

> a group of United States persons, other than a foreign operating entity, 1 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 United States persons, and that has business activities or operations which result in a flow of value between or among persons included in the unitary business group or has business activities or operations that are integrated with, are dependent upon, or contribute to each other. For purposes of this subsection, flow of value is determined by reviewing the totality of facts and circumstances of business activities and operations. [MCL 208.1117(6).]

The Department will follow IRC § 318 or analogous authority to determine indirect, or constructive, ownership and control, except that the Department will apply IRC § 318 to all ownership interests regardless of entity type.

Thus, to qualify as a unitary business group under the MBT, a group must satisfy the *control test* and one of two *relationship tests*: business activities or operations that (1) result in a *flow of value* between members or that (2) are *integrated with, dependent upon, or contribute to* each other.

In the case of a brother-sister set of corporations wholly owned by an individual – for example, Motorcycle Dealer Co. and Architecture Inc. – the corporations will satisfy the control test under MCL 208.1117. Under IRC § 318(a)(3)(C), Motorcycle Dealer Co. is the indirect owner of more than 50% of the ownership interests in Architecture Inc. However, the brother-sister corporations will not comprise a unitary business group unless the corporations also satisfy one of the two relationship tests.

To the extent that Motorcycle Dealer Co. and Architecture Inc. have business activities or operations that result in a flow of value between them or have business activities or operations that are integrated with, are dependent upon, or contribute to each other, the corporations will comprise a unitary business group. Whether such relationship tests are met must be determined on a facts and circumstances basis. The fact that there are no interrelated business activities between the corporations is not dispositive. For example, centralized management; shared systems, programs, or benefits; or using the proceeds from one corporation to finance the activities of the other will satisfy the relationship test regardless of the absence of business activities conducted between the brother and sister.

U10. If a husband and wife are 100% owners in different businesses; do they form a unitary group?

Under MCL 208.1117(6), a unitary business group is defined – in part – as a group of U.S. persons, excluding foreign operating entities, one of which owns or controls, directly or indirectly, more than 50% of the ownership interests with voting or similar rights of the other U.S. persons and the business activities or operations result in a flow of value between the unitary group or are integrated with, dependent upon or contribute to each other. The “more than 50%” ownership for purposes of defining a unitary business group includes direct and indirect ownership.

For purposes of MCL 208.1117(6), the Department will follow IRC § 318 or analogous authority to determine indirect, or constructive, ownership and control, except that the Department will apply IRC § 318 to all ownership interests. For example, while IRC § 318 specifically governs constructive ownership of "stock," the Department will apply IRC § 318 to ownership interests in partnerships, limited liability companies, and other U.S. persons under the MBT. A spouse (other than a spouse who is legally separated from the individual under a decree of divorce or separate maintenance) is deemed to own the ownership interest of the other and vice versa.

Under these facts and circumstances the more than 50% ownership interest is met as each taxpayer business is deemed to own 100% of the other. If there is a flow of value between the business entities owned by the husband and wife or they are integrated with, dependent upon or contribute to each other, a unitary group will exist. A flow of value is determined by reviewing the totality of facts and circumstances of the business activities and operations.

U11. How does the MBT filing threshold apply to a unitary business group comprised of several members if one or more of the members has apportioned gross receipts of less than $350,000?

A taxpayer whose apportioned or allocated gross receipts are less than $350,000 is not required to file a return or pay the tax imposed under the MBT. MCL 208.1505(1). "Taxpayer" means "a person *or a unitary business group* liable for a tax, interest, or penalty under this act." MCL 208.1117 (emphasis added). Thus, so long as the apportioned or allocated gross receipts of the unitary business group equal or exceed $350,000, the unitary business group must file a return and pay the tax imposed by the MBT regardless of the gross receipts of the members of the unitary business group.

For example, a unitary business group is comprised of A, B, C, D, and E, each with $80,000 in gross receipts. Assuming allocation of the tax base and no intercompany transactions, the gross receipts of the unitary business group is $400,000. Since $400,000 exceeds the $350,000 filing threshold, the taxpayer is required to file a return and pay the tax imposed by the MBT. The fact that no member of the unitary business would meet the filing threshold if considered individually is immaterial under the MBT.

A taxpayer that is a unitary business group with apportioned or allocated gross receipts greater than $350,000 but less than $700,000 will qualify for the filing threshold credit under MCL 208.1411.

U12. How does a unitary business group file under the MBT when one or more of the members of the unitary business group do not have nexus with Michigan?

A taxpayer under the MBT includes a unitary business group. MCL 208.1117(5). A unitary business group is comprised of two or more U.S. persons. MCL 208.1117(6). Nexus exists if the taxpayer has (1) physical presence in Michigan for more than one day during the tax year *or* (2) actively solicits sales in Michigan and has gross receipts sourced to Michigan of $350,000.00 or more. MCL 208.1200. Thus, a taxpayer that is a unitary business group has nexus with Michigan so long as any one member of the unitary business group has nexus with Michigan. The taxpayer that is a unitary group is required to file a combined return under MCL 208.1511.

Example: Corporations X, Y, and Z form a unitary business group. Corporation X has nexus with Michigan. Therefore, the unitary business group of Corporations X, Y, and Z has nexus with Michigan and must file a combined return as a single taxpayer.

U13. How must a foreign insurer file for purposes of the retaliatory tax when the insurer's state of incorporation requires unitary filing?

A foreign insurer must calculate its burden for purposes of the Michigan retaliatory tax according to the laws of its state of incorporation. If the insurer's state of incorporation requires filing on a unitary basis, the insurer should compute its retaliatory tax burden using this method.

The retaliatory tax is calculated by first computing the burden to the foreign insurer doing business in Michigan and then computing the burden that would be imposed upon a hypothetical Michigan insurer as if it was performing the identical business activity in the foreign state. When making this calculation it should be assumed that the hypothetical Michigan insurer would calculate its liability in the same manner required of the foreign insurer.

U14. Section 511 of the Michigan Business Tax Act ("MBTA") states that "Each United States person included in a unitary business group or included in a combined return shall be treated as a single person..." Does this mean that all phase-ins, thresholds, credit limits and other aspects of the MBTA relating to the determination of tax liability apply to each person within a unitary business group rather than at the group level?

No. The phrase "shall be treated as a single person" in section 511 of the MBTA, MCL 208.1511, relates to the removal of transactions between unitary business group members from the determination of the business income tax base, the modified gross receipts tax base and the apportionment formula of a unitary business group as a distinct taxpayer. Phase-ins, thresholds, credit limits and other components to determining tax liability relate to the unitary business group as a distinct taxpayer, not to the individual persons that comprise the unitary business group. The unitary business group, to which individual "persons" might belong, is treated as the taxpayer -- a distinct entity -- for purposes of tax liability under the MBTA. Although a person can be a taxpayer under the MBTA, a person that is a member of a unitary business group is not the taxpayer, rather the unitary business group to which that person belongs is the taxpayer. Accordingly, the phrase in MCL 208.1511 does not cause the individual members of a unitary business group to be treated as separate, individual taxpayers for purposes of determining tax liability under the MBTA.

U15. Does a unitary group of insurance companies have to file a combined MBT return?
No. Insurance companies are not specifically excluded from the definition of a unitary business group, found at MCL 208.1117(6), and thus may constitute a unitary business group. In practice, however, there is no practical effect of this possibility. The tax on authorized insurance companies is equal to 1.25% of gross direct premiums written on property or risk located or residing in Michigan. MCL 208.1235. Because the tax is only on property or risk located in Michigan there will be no traditional apportionment for insurance companies. Thus, even if an authorized insurance company is unitary with another authorized insurance company under MCL 208.1117(6), this will have no effect in calculating the tax. A combined return will not be necessary.

U16. (Answer rescinded, replacement located at U59) If you are an entity within the unitary group that does not have nexus without application of the unitary principal, are your shareholders liable for Michigan personal income tax?

U17. How is the business income of a unitary business group determined when one member uses cash basis accounting and the other member uses the accrual method and their tax year ends are different?
The Michigan Business Tax Act does not require each member of a unitary business group to use the same method of accounting to determine its business income.

A taxpayer that is a unitary business group must file a combined return under MCL 208.1511 using the tax year of the designated member. On the combined return, the business income of each member should reflect the accounting method the member used to compute its federal taxable income, whether cash or accrual.

"Designated member" means a member of a unitary business group that has nexus with Michigan under MCL 208.1200 and that will file the combined return required under section 511. If the member that owns or controls the other members of the unitary business group has nexus with Michigan, then that controlling member must be the designated member.

The combined return of the unitary business group must include each tax year of each member whose tax year ends with or within the tax year of the designated member.

The business income of a unitary business group is the sum of the business income of each person included in the unitary business group, other than a foreign operating entity or a person subject to the tax on insurance companies or financial institutions, less any items of income and related deductions arising from transactions, including dividends, between persons included in the unitary business group. MCL 208.1201(4).

U18. How does the MBT filing threshold apply to a unitary business group comprised of several members if one or more of the members has apportioned gross receipts of less than $350,000?
A taxpayer whose apportioned or allocated gross receipts are less than $350,000 is not required to file a return or pay the tax imposed under the MBT. MCL 208.1505(1). "Taxpayer" means "a person *or a unitary business group* liable for a tax, interest, or penalty under this act." MCL 208.1117 (emphasis added). Thus, so long as the apportioned or allocated gross receipts of the unitary business group equal or exceed $350,000, the unitary business group must file a return and pay the tax imposed by the MBT regardless of the gross receipts of the members of the unitary business group.

For example, a unitary business group is comprised of A, B, C, D, and E, each with $80,000 in gross receipts. Assuming allocation of the tax base and no intercompany transactions, the gross

receipts of the unitary business group is $400,000. Since $400,000 exceeds the $350,000 filing threshold, the taxpayer is required to file a return and pay the tax imposed by the MBT. The fact that no member of the unitary business would meet the filing threshold if considered individually is immaterial under the MBT.

A taxpayer that is a unitary business group with apportioned or allocated gross receipts greater than $350,000 but less than $700,000 will qualify for the filing threshold credit under MCL 208.1411.

U19. (Answer rescinded, replacement located at U60) Is an individual a member of a unitary business group with the entities in which the individual has a controlling interest? It depends. Under the MBT, a unitary business group is:

U20. A unitary business group under the MBTA is required to file a combined return. For purposes of calculating the unitary business group's modified gross receipts tax base, does the group eliminate all inter-company transactions between members of the group, including "purchases from other firms"?
Yes. Section 203 of the MBTA provides in part that:

> The modified gross receipts of a unitary business group is the sum of modified gross receipts of each person, other than a foreign operating entity or [an insurance company or financial institution], included in the unitary business group less any modified gross receipts arising from transactions between persons included in the unitary business group.

MCL 208.1203(3). A taxpayer calculates its modified gross receipts tax base by determining its gross receipts and then subtracting "purchases from other firms," a term that is defined at MCL 208.1113(6). Therefore, each member of a unitary business group must subtract any "purchases from other firms" in order to arrive at its individual modified gross receipts, whether those qualifying purchases were made from fellow group members or from outside companies. In addition, section 511 of the MBTA specifically provides that, in filing the required combined return, all transactions between members of a unitary business group are to be eliminated from the business income tax base, the modified gross receipts tax base, and the apportionment formula. MCL 208.1511. "All transactions" includes those transactions meeting the definition of "purchases from other firms," as well as other kinds of transactions between group members.

U21. When members of a unitary business group have different accounting methods (for example, cash and accrual) is uniformity required or do they report using each member's accounting method? How does this affect eliminations made for activity between entities?
A similar question concerning the business income tax base of a unitary business group is addressed in a previous FAQ. As noted in FAQ U17, the MBTA does not expressly require each member of a unitary business group to use the same method of accounting. A taxpayer that is a unitary business group must file a combined return under section 511 using the tax year of the designated member. On the combined return, the business income and other reported information of each member should reflect the accounting method the member used to compute its federal taxable income, whether cash or accrual. Eliminations made for activity and transactions between group members would reflect and be determined based on the members' respective accounting methods.

U22. Can a pre-2008 Brownfield credit or Historic Preservation credit of a unitary business group member be used in 2008 and thereafter against the tax liability of the entire unitary business group?
Yes. To the extent that a qualified taxpayer under the Brownfield credit or Historic Preservation credit provisions is included within a unitary business group taxpayer for relevant tax years, the qualified taxpayer's unused pre-2008 Brownfield credit and/or Historic Preservation credit (i.e. such

credits earned under the SBT) may be applied against the tax liability imposed on the entire unitary business group taxpayer (of which the qualified taxpayer is a member) for the tax years the carryforward would have been available under the SBT. See MCL 208.1435(8) and 208.1437(18).

U23. (Answer rescinded, replacement located at U48) How does a unitary business group register under the MBT?

U24. (Answer rescinded, replacement located at U51) If five or fewer persons who are unrelated individuals, estates or trusts own a controlling interesting in a brother-sister group of entities, will that satisfy the control test for purposes of qualifying as a unitary business group?

U25. Can brother-sister corporations wholly owned by a single person be members of a unitary business group? If so, how are the tax bases calculated?

Yes. To qualify as a unitary business group under the MBT, a group must satisfy the control test and one of two relationship tests: business activities or operations that (1) result in a flow of value between members or that (2) are integrated with, dependent upon, or contribute to each other. MCL 208.1117.

In the case of a brother-sister set of corporations wholly owned by a person, the corporations will satisfy the control test under MCL 208.1117. That is, the brother corporation – under IRC 318 – is the indirect owner of more than 50% of the ownership interests the sister corporation; and vice versa. However, the brother-sister corporations will not comprise a unitary business group unless the corporations also satisfy one of the two relationship tests.

If the brother-sister corporations have business activities or operations that result in a flow of value between them or have business activities or operations that are integrated with, are dependent upon, or contribute to each other, the corporations will comprise a unitary business group.

A unitary business group must file a single combined return. MCL 208.1511. Furthermore, the tax bases must be calculated on a combined basis. For purposes of calculating the business income tax base of a taxpayer that is a unitary business group, the business income of each group member must be combined less any income and related deductions arising from intragroup transactions. MCL 208.1201(4). This total is then adjusted to arrive at the unitary business group's business income tax base. MCL 208.1201(2). The modified gross receipts tax base of a taxpayer that is a unitary business group is the sum of the modified gross receipts of each member of the group less any modified gross receipts derived from intra-group transactions. MCL 208.1203(3).

So long as one member of a unitary business group has nexus with Michigan, all members of the unitary business group must be included when calculating the taxpayer's business income and modified gross receipts tax bases and apportionment formula.

U26. Can a unitary group, as defined in the MBT, enter into a voluntary disclosure agreement with the Department of Treasury under MCL 205.30c if one member of the group would be disqualified on its own?

No, apart from nexus, a disqualification present for one member of a unitary business is imputed to the entire group. As a threshold matter, a person must make an application, be a non-filer, have nexus with Michigan and/or have a reasonable basis to contest liability. MCL 208.30c(2). "Person" is defined at MCL 205.30c(15)(c) as

> an individual, firm, bank, financial institution, limited partnership, copartnership, partnership, joint venture, association, corporation, limited liability company, limited

> liability partnership, receiver, estate, trust, or any other group or combination acting as a unit. [Emphasis added].

A unitary group is a "group or combination acting as a unit." Thus, if one member of the group cannot meet the qualifications for an agreement neither can the unitary group.

U27. How are the Business Income and Modified Gross Receipts tax bases calculated for a unitary business group?

Under MCL 208.1201(3), the tax base of a unitary business group for the Business Income factor of the MBT is the sum of the business income of each group member minus any income and related deductions arising from inter-group transactions. This total is then adjusted by the additions and subtractions outlined in MCL 208.1201(2) to arrive at the unitary group's business income tax base. After the tax base is allocated or apportioned according to MCL 208.1301, the tax base is adjusted by available business loss as outlined in MCL 208.1201(4).

The modified gross receipts tax base is defined as gross receipts minus purchases from other firms under MCL 208.1203(3). Within a unitary business group, each member must calculate gross receipts minus purchases from other firms. These individual calculations are then summed. Finally, modified gross receipts from inter-group transactions are removed. This produces the unitary business group tax base.

U28. How will MCL 208.1503, which gives taxpayers the choice of two filing methods for the first MBT return, apply to a unitary group where members of the group have different tax years?

MCL 208.1503 provides the general rule that a fiscal year taxpayer may elect to file its first MBT return by either annualizing business income and modified gross receipts as if the MBT where in effect on the first day of the taxpayer's annual accounting period, or by computing MBT liability based on actual business income and modified gross receipts for the portion of the accounting period in which the MBT was in effect.

"Taxpayer" means a person or a unitary business group in accordance with MCL 208.1117(5). A unitary business group must file a combined return under MCL 208.1511 using the tax year of the designated member.

If the designated member is a calendar year taxpayer, Section 503 is inapplicable to the group. However, if the designated member uses a fiscal year, that member must choose one of the two methods available in Section 503. Its final return under the SBT must be consistent with this choice. All other members of the group will conform to this method.

This election only applies to the first MBT return for taxpayers with tax years ending before December 31, 2008.

U29. How must a unitary business group file its combined return when members of the group have different tax years?

A taxpayer that is a unitary business group must file a combined return under MCL 208.1511 using the tax year of the designated member. The combined return of the unitary business group must include each tax year of each member whose tax year ends with or within the tax year of the designated member. For example, Taxpayer ABC is a unitary business group comprised of three corporations: Corporation A, the designated member with a calendar tax year, and Corporations B and C with fiscal years ending March 31 and September 30 respectively. Taxpayer ABC's tax year is that of its designated member. Thus, Taxpayer ABC's tax year ends

December 31, its annual return is due April 30. That annual return must include the tax years of Corporations B and C ending March 31 and September 30.

A taxpayer that becomes a member of a unitary business group or ceases to be a member of a unitary business group during that member's tax year must file as part of the combined return for that portion of the member's tax year during which the member was part of the unitary business group. For example, if Corporation C from the above example ceased to be a member of Taxpayer ABC on July 31, Corporation C must include October 1- July 31 on Taxpayer ABC's annual return, but file as a separate taxpayer – or as part of a new unitary taxpayer – for the period August 1 – September 30.

U30. (Answer rescinded, replacement located at U36) Are foreign entities includable in unitary business group? What if the foreign entity is the single member of a domestic single member limited liability company disregarded for federal tax purposes?

U31. (Answer rescinded, replacement located at U36) Are controlled foreign corporations ("CFC's") under IRC 957 taxpayers under the MBT? Can controlled foreign corporations be members of a unitary business group? What if the controlled foreign corporation is a disregarded entity of a U.S. parent?

U32. For a unitary business group, MBT Section 201(3) requires the deduction of items of income and related deductions including dividends between members of the group when computing the business income tax base. Section 203(3) requires the deduction of any modified gross receipts arising from transactions between members of the group when computing the modified gross receipts tax base. Is there a difference in what is excluded under the two tax bases?

It is possible different items will be excluded from each tax base. A unitary business is required to file a combined return. MCL 208.1511. This section also requires the elimination of all transactions between members of the unitary business group that affect the business income tax base, modified gross receipts tax base and the apportionment formula. The elimination of all transactions between members will effectively accomplish the inter-member eliminations required under Sections 201(3) and 203(3). It is irrelevant whether the same items are excluded from both tax bases. What controls is that the transactions between members are eliminated. Because business income and gross receipts are statutorily unique, it is likely different components of the eliminated transactions will affect the computation of one tax base but not the other. For example, the elimination of income will impact the calculation of both tax bases because income received affects both business income and gross receipts. However, a transaction that includes the elimination of an expense that does not meet the definition of a "purchases from other firms" will affect only the business income tax base.

U33. What is a unitary business group?

Generally, a unitary business group is a group of related persons whose business activities or operations are interdependent. More specifically, a unitary business group is two or more persons that satisfy both a *control test* and one of two *relationship tests*. MCL 208.1117(6). A unitary business group is a single taxpayer under the MBT and must file a combined return. MCL 208.1117(5), 208.1511. Foreign persons and foreign operating entities cannot be part of a unitary business group.

Control Test. The control test is satisfied when one person owns or controls, directly or indirectly, more than 50% of the ownership interest with voting or comparable rights of the other person or persons. Indirect ownership is generally determined using IRC 318 or analogous authority, except that the Department will apply IRC 318 to all forms of ownership interests, such as partnership and membership interests, and not just corporate stock.

A parent-subsidiary controlled group of entities satisfies the control test. A parent-subsidiary controlled group of entities means any group of one or more chains of entities connected through ownership with a common parent if (1) the common parent directly owns more than 50% of the ownership interest with voting or comparable rights of at least one other entity, and (2) an ownership interest meeting the more than 50% test in each entity other than the common parent must be owned directly by one or more of the other entities. For example, Corporation A owns 51% of Corporation B, which owns 51% of Corporation C, which owns 51% of Corporation D. The common parent owns more than 50% of the stock in at least one other entity (Corporation B), and more than 50% of the stock of each entity other than the common parent is owned by at least one other entity in the chain. Thus, Corporations A, B, C, and D are part of a parent-subsidiary controlled group of entities and satisfy the control test for unitary business groups.

Similarly, a brother-sister group of entities may satisfy the control test through the indirect ownership rules of IRC 318. For example, one corporation of a pair of corporations wholly owned by an individual will indirectly own and control 100% of the other through IRC 318.

Relationship Tests. In addition to satisfying the control test, the group of persons must have business activities or operations that (1) result in a *flow of value* between or among persons in the group, or (2) are *integrated with, are dependent upon, or contribute to each other*.

Flow of value is established when members of the group demonstrate one or more of functional integration, centralized management, and economies of scale. Examples of functional integration include common programs or systems and shared information or property. Examples of centralized management include common management or directors, shared staff functions, and business decisions made for the group rather than separately by each member. Examples of economies of scale include centralized business functions and pooled benefits or insurance. Groups that commonly exhibit a flow of value include vertically or horizontally integrated businesses, conglomerates, parent companies with their wholly owned subsidiaries, and entities in the same general line of business. Flow of value must be more than the mere flow of funds arising out of passive investment.

Businesses are *integrated with, are dependent upon, or contribute to each other* under many of the same circumstances that establish flow of value. However, this alternate relationship test is also commonly satisfied when one entity finances the operations of another or when there exist intercompany transactions, including financing.

U34. For purposes of determining a unitary business group, how is the control test interpreted and applied?

Generally, a unitary business group is a group of related persons whose business activities or operations are interdependent. More specifically, a unitary business group is two or more persons that satisfy both a *control test* and one of two *relationship tests*. MCL 208.1117(6). A unitary business group is a single taxpayer under the MBT and must file a combined return. MCL 208.1117(5), 208.1511. Foreign persons and foreign operating entities cannot be part of a unitary business group.

Control Test. The control test is satisfied when one person owns or controls, directly or indirectly, more than 50% of the ownership interest with voting or comparable rights of the other person or persons. In particular:

> "Unitary business group" means a group of United States persons, other than a foreign operating entity, 1 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 United States persons . . . . [MCL 208.1117.]

A person owns or controls more than 50% of the ownership interest with voting rights or ownership interest that confer comparable rights to voting rights of another persons if that person owns (1) more than 50% of the total combined voting power of all ownership interests with voting (or comparable) rights *or* (2) more than 50% of the total value of all ownership interests with voting (or comparable) rights.

Indirect ownership is generally determined using IRC 318 or analogous authority, except that the Department will apply IRC 318 to all forms of ownership interests, such as partnership and membership interests, and not just corporate stock. For example, attribution to and from a partnership may be determined under IRC 318(a)(2)(A) and 318(a)(3)(A). However, the attribution will be of ownership interests, including – but not limited to – partnership interests, stock, and membership interests; attribution will not be limited to corporate stock.

Parent-Subsidiary Controlled Group of Entities. A parent-subsidiary controlled group of entities satisfies the control test. A parent-subsidiary controlled group of entities means any group of one or more chains of entities connected through ownership with a common parent if (1) the common parent directly owns more than 50% of the ownership interest with voting or comparable rights of at least one other entity, and (2) more than 50% of the ownership interest with voting or comparable rights of each entity other than the common parent is owned directly by one or more of the other entities. For example:

Corporation A owns 51% of Corporation B, which owns 51% of Corporation C, which owns 51% of Corporation D. The common parent owns more than 50% of the stock in at least one other entity (Corporation B), and more than 50% of the stock of each entity other than the common parent is owned by at least one other entity in the chain. Corporations A, B, C, and D are part of a parent-subsidiary controlled group of entities and satisfy the control test for unitary business groups.

Brother-Sister Controlled Group of Entities. A brother-sister group of entities may also satisfy the control test. An individual that is not a sole proprietor or owner of a disregarded entity or otherwise engaged in a trade or business resulting in business income or gross receipts under the MBT is not unitary with the entities in which that individual has a controlling interest. However, brother-sister group of entities may satisfy the control test through the indirect ownership rules of IRC 318 – this is referred to as a brother-sister controlled group of entities. For example:

An individual owns 51% each of a pair of limited liability companies taxed as partnerships – Tweedledee LLC and Tweedledum LLC. Under IRC 318(a)(3)(A) as applied to the MBT, Tweedledee LLC owns 51% of Tweedledum LLC. Tweedledee LLC and Tweedledum LLC constitute a brother-sister controlled group of entities and meet the control test for unitary business groups.

Combined Controlled Group of Entities. Finally, a combined controlled group of entities satisfies the control test. A combined controlled group of entities means three or more entities each of which is a member of a parent-subsidiary controlled group of entities or brother-sister controlled group of entities and one of which is a common parent entity of a parent-subsidiary controlled group of entities and also is included in a brother-sister controlled group of entities. For example:

An individual owns 51% each of a pair of corporations – Corporations L and M. Corporation L owns 51% of Corporation N, which owns 51% of Corporation O. Corporation L is the common parent of the L, N, and O parent-subsidiary controlled group of entities and is also a member of

the L and M brother-sister controlled group of entities. Corporations L, M, N, and O are members of a combined controlled group of entities and meet the control test for unitary business groups.

Excluded Ownership Interests. For purposes of determining ownership or control under the control test, the Department will apply IRC 1563 to exclude certain ownership interests from determination of ownership and control, except that the Department will apply IRC 1563 to all forms of ownership interests and not just corporate stock. For example:

Corporation X owns 50% of Partnership Y. The remainder of Partnership Y is owned by an individual that is also a principal stockholder under IRC 1563 of Corporation X. The ownership interest of the individual are treated as excluded ownership interests under IRC 1563(c) as applied to the MBT. For purposes of the control test for unitary business groups, Corporation X owns 100% of Partnership Y.

U35. Do the $350,000 threshold amount for taxpayer nexus under MCL 208.1200, the $350,000 threshold amount for filing of returns and payment of MBT under MCL 208.1505, and the range of gross receipts between $350,000 and $700,000 concerning the Gross Receipts Filing Threshold Credit under MCL 208.1411 relate to Michigan gross receipts before or after inter-company transactions receipts are eliminated?

Elimination of inter-company transactions does not occur when directly determining the level of a unitary business group taxpayer's overall gross receipts; however, inter-company transactions will affect a unitary business group taxpayer's gross receipts threshold amount through application of the apportionment formula. When determining the gross receipts filing threshold and the eligibility for the Threshold Credit under MCL 208.1411, the taxpayer's overall gross receipts are first apportioned using the sales factor under MCL 208.1303(2). Because inter-company transactions between unitary business group members are eliminated when determining a unitary business group taxpayer's sales factor, the application of sales factor to a unitary business group taxpayer's overall gross receipts would indirectly eliminate inter-company transactions from the threshold amount.

The MBTA states that a unitary business group is required to file a combined return that includes each U.S. person included in the unitary business group, and that "all transactions between the persons included in the unitary business group shall be eliminated from the business income tax base, modified gross receipts tax base and the apportionment formula under this act." MCL 208.1511. A "unitary business group" is defined in the MBTA in pertinent part as "a group of United States persons…1 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 United States persons, and that has business activities or operations which result in a flow of value between or among persons included in the unitary business group or has business activities or operations that are integrated with, are dependent upon, or contribute to each other." MCL 208.1117(6).

The MBTA expressly provides that the calculation of a unitary business group's business income tax base is determined as "the sum of the business income of each person included in the unitary business group…less items of income and related deductions arising from transactions including dividends between persons included in the unitary business group." MCL 208.1201(3). Likewise, the MBTA expressly states that for a unitary business group taxpayer, the modified gross receipts tax base (a taxpayer's gross receipts less purchases from other firms) is "the sum modified gross receipts of each person…included in the unitary business group less any modified gross receipts arising from transactions between persons included in the unitary business group." MCL 208.1203(3). Further, the MBTA clearly states that in calculating the sales factor for apportioning the business income and modified gross receipts tax bases for a unitary business group, sales between the unitary business group members are eliminated. MCL 208.1303(2).

In contradistinction, the MBTA's provisions governing taxpayer nexus (MCL 208.1200), the filing threshold (MCL 208.1505) and the Gross Receipts Filing Threshold Credit (MCL 208.1411) do not contain any language providing that for a unitary business group taxpayer the respective gross receipt threshold amounts are determined after eliminating inter-company transactions. The provision regarding taxpayer nexus (MCL 208.1200) states merely that the $350,000 gross receipts amount is that sourced to Michigan, with no prescribed adjustment for inter-company transactions. Similarly, the provisions regarding the threshold amount of gross receipts for filing an MBT return (MCL 208.1505) and the range of gross receipts to qualify for the Gross Receipts Filing Threshold Credit (MCL 208.1411) provide only that the gross receipt amounts are those after allocation and apportionment, with no prescribed adjustment for inter-company transactions.

U36. (Answer rescinded, replacement located at U61) Are foreign entities includable in unitary business group? What if the foreign entity is the single member of a domestic single member limited liability company disregarded for federal tax purposes?

U37. Is it possible to have a unitary group of financial institutions under the MBT? How will such groups file a combined return?

Under MCL 208.1261 a "financial institution" is defined as a bank holding company, a national bank, a state chartered bank, an office of thrift supervision chartered bank or thrift institution, or a savings and loan holding company other than a diversified savings and loan holding company as defined in 12 USC 1467a(a)(F).

This definition also includes any subsidiary of a financial institution, owned directly or indirectly, other than an insurance company as defined in MCL 208.1111(2), if that subsidiary is a member of a unitary business group with the financial institution. MCL 208.1261(f)(*ii*). This broad language also encompasses any disregarded entity owned by the financial institution. A unitary business group of financial institutions is permitted by definition. MCL 208.1261(f)(*iii*).

Thus, if a financial institution or its subsidiary satisfies the control test and one of the two relationship tests outlined in MCL 208.1117(6) with another financial institution and its subsidiaries, the unitary business group will file a combined return. MCL 208.1511. A unitary business group of financial institutions will eliminate inter-group gross business when calculating the gross business factor. MCL 208.1261(f) and MCL 208.167(4).

In contrast, financial institutions and their subsidiaries cannot file on a unitary basis with nonfinancial institution entities even though they may be unitary with such entities. When a financial institution or its subsidiary is unitary with a non-financial institution, all intercompany transactions must be eliminated along with any business income attributable to [the financial institution or subsidiary] from the business income tax base, any modified gross receipts attributable to [the financial institution or subsidiary] from the modified gross receipts tax base, and any sales attributable to [the financial institution or subsidiary] from the apportionment formula. MCL 208.1511.

This calculation will be represented on the combined return of the unitary group, but the financial institution member(s) will essentially be excluded from that return. The financial institutions member(s) must then file either a stand-alone return in accordance with MCL 208.1263 or a combined return with other financial institutions as explained above.

In summation, a financial institution will file either a stand-alone return if it is not unitary with another financial institution or has been excluded from unitary group containing non-financial institution entity types, or a combined return with other financial institution members of a unitary group.

U38. For purposes of the private equity fund credit under MCL 208.1453, if a private equity fund manager is an entity that is a member of a unitary business group, does the calculated credit percentage apply to the tax liability of the entire unitary business group, or the separate tax liability of the fund?

The credit is based on the tax liability of the private equity fund. If the unitary business group is comprised of members other than private equity funds, a pro forma may be used to calculate the tax liability of the private equity fund for purposes of determining the amount of the credit. The resulting credit is applied to the tax liability of the unitary business group.

U39. Are partners deemed to own each others' holdings by attribution under section 318 of the Internal Revenue Code?

No. Section 318 of the Internal Revenue Code ("IRC") establishes the attribution rules for constructive ownership of stock for federal income tax purposes. IRC sections 318(2) and 318(3) address the attribution rules for partners and partnerships. Under IRC §318(2), stock owned, directly or indirectly, by or for a partnership is considered as owned proportionately by its partners. Conversely, under IRC §318(3), stock owned, directly or indirectly, by or for a partner is considered as owned by the partnership.

However, under IRC §318(5)(c), a partnership that constructively owns a partner's stock by application of the attribution rules as stated in IRC §318(3) cannot use the attribution provisions of IRC §318(2) to make another partner the constructive owner of such stock. For example, if partner A owns 100% of the stock in corporation C, and partner B owns 100% of the stock in corporation D, the partners are not deemed to own each other's stock merely because partnership AB is considered a constructive owner of all stock in both corporations by attribution under IRC §318(3).

The Department makes use of the IRC §318 attribution rules to determine if a group of persons meets the ownership or control tests necessary to form a unitary business group under section 117 of the MBT act (MCL 208.1117). In the example given above, corporations C and D and partnership AB could be part of the same unitary group because more than 50% of the ownership interest in each corporation is deemed to be owned or controlled by the same person, partnership AB, through attribution under IRC §318. However, IRC §318(5)(d) would operate to prevent corporations C and D from being considered brother-sister corporations (because partners A and B are not deemed to own each others stock), and therefore corporations C and D alone could not constitute a unitary business group for MBT.

U40. (Answer rescinded, replacement located at U62.) A dental practice organized as a sole proprietorship became a professional limited liability company ("PLLC") effective January 1, 2008. For federal income tax purposes, the PLLC is a disregarded entity and the member reports his income as a sole proprietor on federal schedule C. Can the owner of the dental practice continue to file as a sole proprietor for Michigan individual and MBT purposes?

U41. With respect to a unitary business group, what is the liability of the individual entities that make up the group for payment of the tax? If payment is not made, which member will be charged with penalties and interest?

The business income and modified gross receipts taxes, both components of the Michigan Business Tax (MBT), are levied upon each "taxpayer" that has nexus with (or business activity in) Michigan. MCL 208.1201; 208.1203. The MBT Act defines a "taxpayer" as "a person or a unitary business group liable for a tax, interest, or penalty under this act." MCL 208.1117(5). A unitary business group is defined as two or more U.S. persons, including entities (but excluding foreign operating entities), one or which owns or controls, directly or indirectly, more than 50% of the ownership interests with voting or similar rights of the other U.S. persons, and whose business

activities or operations either (i) result in a flow of value between the unitary business group members, or (ii) are integrated with, dependent upon, or contribute to each other. MCL 208.1117(6). A taxpayer that is a unitary business group is required to "file a combined return that includes each United States person, other than a foreign operating entity, that is included in the unitary business group." MCL 208.1511.

The MBT Act does not specifically state which member of a unitary business group must actually file the return or remit any tax that is owed. The Department has determined that the members of a unitary business group must elect a designated member who has nexus with Michigan to serve as the group's agent with respect to the Department. Thus, the Department will look to the designated member to file the group's combined return and remit estimates and annual payments. (See FAQ U23.) Although the designated member is responsible for filing the return and remitting payments, any MBT liability belongs to the "taxpayer" – i.e., the unitary business group – and not merely to the designated member. Accordingly, if the group's MBT liability is not paid, the Department may look to each member of the unitary business group that has nexus with Michigan to collect the entirety of the tax that is due, as well as any penalties and interest that may be assessed. In other words, assuming nexus, each member of a unitary business group is jointly and severally liable for any MBT assessment, and the Department may pursue any or all such members to satisfy the entirety of the assessment. Joint and several liability means that all members of the unitary business group with nexus with Michigan are collectively and individually liable for the full amount of the group's tax liability.

U42. If a taxpayer that is a unitary business group has a business loss carry forward under MCL 208.1201(5), what happens to the business loss carry forward if membership in the unitary business group changes?

When the membership of a taxpayer that is a unitary business group changes, the business loss carryforward of the unitary business group is divided among the unitary business group and the departing members in proportion to the losses the members would have generated had each member filed separately. Specifically, the portion of the business loss carryforward of a taxpayer that is a unitary business group attributable to a departing member is an amount equal to the business loss carryforward of the unitary business group multiplied by a fraction, the numerator of which is what would have been the business loss of that member had that member filed a separate return, and the denominator of which is the sum of what would have been the separate business losses of all members of the group in that year having business losses if those members filed separate returns.

> Example. Taxpayer LMNOP is a unitary business group comprised of Corporations L, M, N, O, and P. The 2008 tax year generated an apportioned business loss of $100 to be carried forward to the 2009 tax year. However, due to a change in ownership, Corporation P is not part of the unitary business group for the 2009 tax year. If each member calculated their business income tax base on a separate basis for 2008, only Corporations N, O, and P showed losses of 50, 70, and 30 respectively. P gets a business loss carryforward of $20 [(30/(50+70+30))*100) for the 2009 tax year. Taxpayer LMNO retains a business loss carryforward of $80.

U43. At what point in time must two entities meet the test for being members of a unitary business group?

A unitary business group is comprised of two or more U.S. persons that satisfy both a *control test* and one of two *relationship tests*. MCL 208.1117(6).

There is no annual date on which members must meet the requirements of a unitary business group to be a unitary business group. Rather, a person becomes a member of a unitary business group whenever both the control test and one of the two relationship tests are met and remains a

member of that unitary business group so long as the control test and one of the two relationship tests continue to be met. Conversely, a member of a unitary business group that fails either the control test or the relationship tests may no longer be included in the unitary business group.

Control Test. The control test is satisfied when one person owns or controls, directly or indirectly, more than 50% of the ownership interest with voting or comparable rights of the other person or persons. Changes in ownership or control may result in one or more persons joining or dropping from a unitary business group. The date of changes to the unitary business group due to the control test is determined by identifying the transactions that result in relevant ownership or control changes.

Relationship Tests. The relationship test is satisfied when related persons have business activities or operations that (1) result in a flow of value between or among persons in the group, or (2) are integrated with, are dependent upon, or contribute to each other. Flow of value is established when members of the group demonstrate one or more of functional integration, centralized management, and economies of scale. Members are integrated with, are dependent upon, or contribute to each other under many of the same circumstances that establish flow of value. For example, related persons may meet one or both relationship tests if there is a flow of goods and services between them. However, the fact that transactions between the persons do not occur daily does not mean the persons drop in and out of unitary status. If the relationship tests are satisfied during the tax year, the group will generally only subsequently fail such tests if there are substantial changes to operations or management. Thus, the Department will presume that one or both relationship tests are established for the entire tax year – and each subsequent year – if one or both are satisfied at any point during the tax year. The unitary business group or member in question may rebut such presumption by proving that the relationship test was met – or failed – as of a specific date.

Finally, any person that becomes a member of a unitary business group or ceases to be a member of a unitary business group during that member's tax year must file as part of the combined return for that portion of the member's tax year during which the member was part of the unitary business group. For example, Taxpayer ABC is a unitary business group comprised of three corporations: Corporation A, the designated member with a calendar tax year, and Corporations B and C with fiscal years ending March 31 and September 30 respectively. Taxpayer ABC's tax year is that of its designated member. Thus, Taxpayer ABC's tax year ends December 31, its annual return is due April 30, and that annual return must include the tax years of Corporations B and C ending March 31 and September 30. If Corporation C ceased to be a member of Taxpayer ABC on July 31, Corporation C must include October 1- July 31 on Taxpayer ABC's annual return, but file as a separate taxpayer – or as part of a new unitary taxpayer – for the period August 1 – September 30.

U44. An individual owns a controlling interest in multiple limited liability companies that hold rental property or manage real estate. There are no intercompany transactions between them, but each limited liability company shares an accountant and each has the same managing member responsible for managing the daily operations of the entities and for making operational decisions. Due to the controlling interests of the individual in each of the limited liability companies, the limited liability companies are brother-sister entities that satisfy the unitary business group control test under MCL 208.1117(6). Do the limited liability companies satisfy the relationship test and comprise a unitary business group?
Generally, a unitary business group is a group of related persons whose business activities or operations are interdependent. More specifically, a unitary business group is two or more persons that satisfy both a control test and one of two relationship tests.

The relationship test is met if a group of persons have business activities or operations that (1) result in a flow of value between or among persons in the group, or (2) are integrated with, are dependent upon, or contribute to each other.

Flow of value is established when members of the group demonstrate one or more of functional integration, centralized management, and economies of scale. Examples of functional integration include common programs or systems and shared information or property. Examples of centralized management include common management or directors, shared staff functions, and business decisions made for the group rather than separately by each member. Examples of economies of scale include centralized business functions and pooled benefits or insurance. Groups that commonly exhibit a flow of value include vertically or horizontally integrated businesses, conglomerates, parent companies with their wholly owned subsidiaries, and entities in the same general line of business. Flow of value must be more than the mere flow of funds arising out of passive investment.

Businesses are integrated with, are dependent upon, or contribute to each other under many of the same circumstances that establish flow of value. However, this alternate relationship test is also commonly satisfied when one entity finances the operations of another or when there exist intercompany transactions, including financing.

In the present case, each of the limited liability companies are engaged in the same general line of business. Furthermore, each of the entities shares a common accountant and is managed by a common manager. Given this centralized management, there appears to be a flow of value between the limited liability companies. Thus, the relationship test is satisfied and the limited liability companies comprise a unitary business group.

However, the relationship test is evaluated on a facts and circumstances basis. The conclusion reached in this Q&A may differ upon the disclosure of additional or different facts.

U45. How does a unitary business group ("UBG") composed of financial institutions that includes a bank authorized to exercise only trust powers, which is exempt from the MBT surcharge under MCL 208.1281(4)(b), calculate the surcharge?

Financial institution entities authorized to exercise only trust powers do not lose their identity when they are a part of a unitary business group. When a financial institution authorized to exercise only trust powers is unitary with other financial institutions it maintains its identity as an entity exempt from the surcharge, even though it will file a combined return with other financial institutions. Financial institutions authorized to exercise only trust powers will file a combined return with the UBG but will be removed from the surcharge calculation and not from overall liability. This computation will be performed in calculating Form 4590, 2008 Michigan Business Tax Annual Return for Financial Institutions.

U46. Does a unitary business group calculate its gross receipts for purposes of the gross receipts filing threshold and the filing threshold credit before or after the elimination of gross receipts arising from inter-company transactions?

The gross receipts filing threshold and the filing threshold credit are both calculated before a unitary business group eliminates inter-company transactions. Under the MBT Act, a unitary business group is required to file a combined return that includes all group members that are U.S. persons. MCL 208.1511. Section 511 further mandates that "all transactions between the persons included in the unitary business group shall be eliminated from the business income tax base, modified gross receipts tax base and the apportionment formula under this act." MCL 208.1511. The language of the statutory sections specifically addressing the tax bases and the apportionment formula is consistent with this mandate.

Conversely, the sections of the MBT Act providing for the $350,000 gross receipts filing threshold and the gross receipts filing threshold credit (the phase-in credit for taxpayers whose gross receipts are between $350,000 and $700,000) do not contain language requiring, or authorizing, unitary business groups to eliminate inter-company transactions when making the necessary calculations to determine the applicability of the thresholds. These sections state that the stipulated gross receipts amounts are those after allocation and apportionment, with no other prescribed adjustment for transactions between members of a unitary business group. MCL 208.1505(1); MCL 208.1411.

U47. Can a unitary business group with one or more fiscal year members use the annual method for calculating its first MBT return? If so, must all fiscal year members in the group make the same election between annual and actual methods? What if a fiscal year group, rather than fiscal group member has made the opposite choice with respect to its final SBT return? Also, if the unitary business group can use the annual method, and the group has members with different year ends, how is the percentage in MCL 208.1503(a) calculated?

Section 503 of the MBTA provides that a fiscal year taxpayer may elect to file its first MBT return (a short year return) by either reporting business income and modified gross receipts as if the MBT were in effect on the first day of the taxpayer's annual accounting period and prorating those numbers (the annual method), or by computing MBT liability based on actual business income and modified gross receipts for the portion of the accounting period in which the MBT was actually in effect (the actual method). MCL 208.1503.

Under the MBTA, "taxpayer" is defined to mean either a person or a unitary business group. MCL 208.1117(6). Thus, in the case of a unitary business group filing a combined return under section 511, the filing method election permitted by section 503 is applicable to the group as a whole, and not to the group's members individually. A unitary business group will file its combined return using the tax year of the group's designated member. If the designated member is a calendar year taxpayer, section 503, which allows a choice of filing methods for *fiscal year* taxpayers, will be inapplicable to the group. Calendar year filers use the actual method; therefore, if the designated member is a calendar year filer, all members of the unitary business group will be required to use the actual method.

If the designated member is a fiscal year taxpayer, however, the designated member must choose one of the two filing methods available under section 503, consistent with the choice made for its final individual return under the SBT. All other members of the unitary business group must then conform to the method chosen by the designated member. In some cases, this may mean that an individual member of a unitary business group that is a fiscal year filer will have to calculate its MBT tax bases using a method different than the one that it used in filing its final short period SBT return (if, for example, the member did not realize that it would be a member of a unitary business group under the MBT). Because the Department has required that filing methods be consistent between a fiscal filer's final short period SBT return and its initial short period MBT return, such group members will be required to amend their final SBT returns so that their filing methods are consistent. RAB 2007-5.

If the various fiscal year unitary business group members have different year ends, it will be necessary for each such group member to calculate its own section 503(a) ratio for purposes of annualization, based upon the number of months in its own short period.

U48. How does a unitary business group register under the MBT?

The designated member of a unitary business group must register with the Department for the MBT. "Designated member" means a member of a unitary business group that has nexus with

Michigan under MCL 208.1200 and that will file the combined return required under MCL 208.1511 for the unitary business group. If the member that owns or controls the other members of the unitary business group has nexus with Michigan, then that controlling member must be the designated member. Otherwise, the designated member can be any member of the unitary business group with nexus. The designated member must remain the same every year unless the designated member ceases to be a member of the unitary business group or the controlling member engages in activity in Michigan that subjects that member to nexus.

If the designated member was registered under the SBT, then it will automatically be registered under the MBT. If the designated member was not registered under the SBT, the designated member must register with the Department using Form 518, *Complete Registration Booklet*, or online at www.michigan.gov/businesstaxes.

MBT returns must be filed under the designated member's FEIN. All members of the unitary group must be listed on the group's annual return.

Estimated payments for a unitary business group under the MBT must be made by the designated member on behalf of the unitary business group. Estimates filed and paid separately by members other than the designated member will be consolidated and applied to the unitary business group by the Department, so long as the combined annual return filed by the designated member includes a complete and accurate schedule of the unitary business group members. Carryforwards generated on separately filed SBT returns will also be consolidated and applied to the MBT unitary business group based on the schedule supplied with the MBT return.

U49. Three entities, an operating farm, a trucking company, and a rental company, meet the "more than 50% ownership" test for a unitary business group. The farm pays rent to the rental company for the use of the farm land, and pays the trucking company to ship its goods. Without the farm, which is subject to the agricultural exemption, the other two entities do not have a "flow of value" between them. Are the three entities a unitary business group? If so, and the farm does not file because of the agricultural exemption, are the receipts received by the other two entities from the farm eliminated as intercompany transactions?

Section 207(d) of the MBT, rather than providing a blanket exemption for an entity engaged in the production of agricultural goods, instead exempts from the MBT "[t]hat portion of the tax base attributable to the production of agricultural goods by a person whose primary activity is the production of agricultural goods." MCL 208.1207(d). Thus, an entity whose primary activity is commercial farming is exempt from the MBT only to the extent that its tax base is attributable to the production of agricultural goods. In other words, the revenue from any other non-agricultural goods producing activities conducted by the farming entity (for example, income from an on-site produce stand at which the farm's agricultural products are sold at retail) will remain in the farming entity's tax base and be subject to the MBT. The exemption provided by section 207(d) is not one that exempts the farming entity from all MBT liability or that automatically releases it from the obligation of filing an MBT return.

The agricultural exemption is, in essence, an adjustment to a taxpayer's MBT tax base. Because the term "taxpayer" under the MBT includes a unitary business group, MCL 208.1117(5), the determination whether a group of entities constitutes a unitary business group must be made at the outset, before the taxpayer's tax base is calculated. The MBT defines a unitary business group, in part, as a group of U.S. persons, one of which owns or controls, directly or indirectly, more than 50% of the ownership interests with voting or similar rights of the other U.S. persons, and whose business activities or operations (i) result in a flow of value between the members or (ii) are integrated with, dependent upon, or contribute to each other. MCL 208.1117(6). Thus, to constitute a unitary business group, the three entities in the example must meet *both* the

ownership test *and* one of the two relationship tests. If the three entities satisfy both tests, they form a unitary business group, regardless of the applicability of the agricultural exemption.

A unitary business group files a single, combined MBT return which includes all members of the unitary business group. MCL 208.1511. Assuming that the three entities in the example do comprise a unitary business group, in preparing its return, each member of the group would first calculate its individual business income and modified gross receipts tax bases. The farm entity member would subtract from its tax bases the portion of each base that is related to its production of agricultural goods. MCL 208.1207(d). Each group member must then eliminate from its tax bases all intercompany transactions. MCL 208.1511. In the example given, this step would eliminate both the income received by the trucking company and the rental income received by the rental company, since all of the underlying transactions would have taken place between members of the unitary business group. The unitary business group (the taxpayer) would then calculate its business income and modified gross receipts tax bases by combining the tax bases of the group's individual members. The group's tax bases would then be allocated or apportioned, and the amount allocated or apportioned to Michigan will be subject to the MBT. If the unitary business group has apportioned or allocated gross receipts of less than $350,000, the group will not be required to file a return or pay the tax imposed by the MBT. MCL 208.1505(1).

U50. Can nonstock nonprofit organizations be included in a unitary business group?
Yes. Under the MBT, a unitary business group is a taxpayer that consists of:

> a group of United States persons, other than a foreign operating entity, 1 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 United States persons, and that has business activities or operations which result in a flow of value between or among persons included in the unitary business group or has business activities or operations that are integrated with, are dependent upon, or contribute to each other. For purposes of this subsection, flow of value is determined by reviewing the totality of facts and circumstances of business activities and operations. [MCL 208.1117(6).]

So long as the control and relationship tests are satisfied, a tax exempt organization, including a nonstock nonprofit organization, can be part of a unitary business group. In the case of the control test and nonstock nonprofit organizations, one person controls more than 50% of the ownership interests with voting or comparable rights of the nonstock nonprofit organization if more than 50% of the directors or trustees of that organization are either representatives of or controlled by the parent organization.

U51. Would a group of companies who have a flow of value between them but are owned by two unrelated persons, each owning 50%, be considered a unitary business group?
Yes. To meet the definition of a unitary business group in the Michigan Business Tax Act (MBTA) the U.S. persons, other than foreign operating entities, which cannot be included in the group, must pass a control test and 1 of 2 relationship tests. MCL 208.1117(6). The control test requires that one of the U.S. persons own or control, directly or indirectly, more than 50% of the ownership interests with voting rights or similar rights of the other U.S. persons. MCL 208.1117(6).

For purposes of MBTA section 117(6), the Department will use as guidance attribution rules expressed in IRC § 318 or analogous authority to determine indirect or constructive ownership and control. While IRC § 318 specifically pertains to corporate stock ownership, the Department will apply its principles to all forms of entities subject to the MBT.

In the case of a brother-sister set of corporations, for example, each owned by 2 unrelated individuals, the corporations will satisfy the control test under MCL 208.1117. Under IRC

318(a)(3)(C), one corporation is the indirect owner of 100% of the ownership interests in the other. However, the brother-sister corporations will not comprise a unitary business group unless the corporations also satisfy one of the relationship tests.

U52. If five or fewer persons who are unrelated individuals, estates or trusts own a controlling interesting in a brother-sister group of entities, will that satisfy the control test for purposes of qualifying as a unitary business group?
It depends on the type of entities in the brother-sister group of entities.

Under the SBT, controlled groups and entities under common control were generally defined to include situations where the same five or fewer unrelated individuals, estates or trusts owned a controlling interest in two or more entities taking into account the ownership of each such person only to the extent such ownership is identical with respect to such entity. See, e.g., RAB 1989-48. However, under the MBT, a unitary business group is:

> a group of United States persons, other than a foreign operating entity, 1 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 United States persons, and that has business activities or operations which result in a flow of value between or among persons included in the unitary business group or has business activities or operations that are integrated with, are dependent upon, or contribute to each other. For purposes of this subsection, flow of value is determined by reviewing the totality of facts and circumstances of business activities and operations. [MCL 208.1117(6).]

The Department will follow IRC 318 or analogous authority to determine indirect, or constructive, ownership and control, except that the Department will apply IRC 318 to all ownership interests. The attribution rules of IRC 318 vary depending on whether ownership and control is attributed to or from a corporation, partnership, trust, or estate.

For corporations, so long as none of the five or fewer unrelated individuals, estates or trusts own more than 50% of the brother-sister group of corporations, or no two individuals, estates or trusts own 50% each, then the unitary business group control test under the MBT <u>will not be</u> satisfied. Under IRC 318(a)(3)(C), a corporation will only be deemed to own the stock of any shareholder if the shareholder owns 50% or more of the stock in that corporation.

Example: Alice, Bernice, Carol, Donna, Eunice each own 20% of Corporations A and B. Neither Corporation A nor Corporation B will have indirect control or ownership of the other through IRC 318 since none of the shareholders owns 50% or more of either corporation. The MBT unitary business group control test fails.

In contrast, for partnerships, so long as any group of individuals, estates or trusts own more than 50% combined of the brother-sister group of partnerships, then the unitary business group control test under the MBT <u>will be</u> satisfied. Under IRC 318(a)(3)(A) as applied to the MBT, a partnership is deemed to own the ownership interests owned by any of its partners.

Example: Al, Brett, Carl, Dave, and Ed each own 20% partnership interests in Partnerships Y and Z. Under IRC 318, Partnership Y indirectly owns and controls 100% of Partnership Z (and *vice versa*) since Partnership Y is deemed to own all the partnership interests owned by Al, Brett, Carl, Dave, and Ed (which totals 100% of Partnership Z). The MBT unitary business group control test is met.

U53. In applying the agricultural exemption contained in the Michigan Business Tax Act (MBTA) at MCL 208.1207(1)(d) to a unitary business group (UBG), is the primary activity test to qualify for the exemption performed at the member entity level or group-wide level?
The primary activity test, which is the determination whether an entity's farm activity exceeds its non-farm activity to qualify as a person whose primary activity is the production of agricultural goods, is performed at the member entity level in a UBG.

Section 207(1)(d) contains the same language as the section that supplied the agricultural exemption in the Single Business Tax Act (SBTA), MCL 208.35(1)(h). Section 207(1) directs that:

> [t]he following are exempt from the tax imposed by this act:

(d) 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. . . .

As the language granting the agricultural exemption in the MBTA repeats the section granting the agricultural exemption in the SBTA, guidance can be obtained from Revenue Administrative Bulletin (RAB) 1989-47, which explained the exemption for the Single Business Tax. RAB 198947 directs that, "The agricultural production exemption is not an exemption for the person, but is an exemption for the activity of producing agricultural goods." In a UBG, the activity of producing agricultural goods is conducted at the member-entity level. Thus, the primary activity test is performed at the member-entity level.

U54. Financial Institutions pay tax under the MBT on net capital. Computation of this tax base requires a financial institution to average the past five years of net equity with certain deductions. How does a unitary business group of financial institutions perform this calculation for entity members that have not been a part of the UBG for five years but became members of the group sometime within the five year look-back period?
The term "financial institution" includes a unitary business group of financial institutions. MCL 208.1261(f). A financial institution must compute the current tax year tax base by taking a five year average of net capital. MCL 208.1265(2). For a UBG of financial institutions each member entity of the group must compute net capital, using the five year average, individually. Instructions for Form 4580, MBT Unitary Business Group Combined Filing Schedule. The group then sums the results of the entities' calculations to reach net capital for the group. *Id*. This requirement applies equally to the first year of the MBT, when no members of a UBG of financial institutions will have been members for five years, as it does to tax years ten years out from the first year. Once a member entity is considered a part of a UBG of financial institutions it must compute its individual net equity in accordance with this requirement. This means that an entity that was newly added to the UBG will compute its net capital by using the average of five years of net capital and then adding this result to the results of the other member entities of the group. A shorter look-back period may apply if the new UBG member has not itself been in existence for five years. MCL 208.1265(2).

U55. How is the book-tax deduction to the business income tax base affected if the various members of a unitary business group each have and report a book-tax difference on Form 4593 with the initial required MBT return and the unitary business group's (UBG) membership later changes?
MCL 208.1201(2)(i) provides a future deduction to a taxpayer's business income tax base, calculated as the lesser of the taxpayer's book-tax difference for the first fiscal period ending after July 12, 2007 or the taxpayer's net deferred tax liability as computed in accordance with generally accepted accounting principles. MCL 208.1201(2)(i)-(3). The deduction will be claimed by deducting a percentage of this figure beginning in the 2015 tax year. MCL 208.1201(2)(i).

The deduction (phased in over 15 years) equals the lesser of either the taxpayer's book-tax difference for the stated fiscal period *or* the taxpayer's net deferred tax liability, as computed in accordance with GAAP. Therefore, both the book-tax calculation and the net deferred tax liability are necessary to compute the deduction to business income. Thus, when UBG members depart or arrive they must consider both the book-tax difference and the net deferred tax liability.

In the instance of a member leaving the group, the departing member will leave the group with its individually calculated book-tax number as reported on Form 4593 with the UBG's initial MBT return. Likewise, the departing member leaves the group with its share of the net deferred tax liability. If the group members calculated this amount individually then the departing member would simply leave the group with its individual amount. If the group calculated the net deferred tax liability only at the group level then the departing member must figure its pro rata share of the amount, computed as if the member had been a single entity filing a stand alone return when the liability was booked.

A new member which calculated and timely reported its own book-tax difference as well as calculated its own net deferred tax liability is later added to a UBG that has calculated its own book-tax difference and net deferred liability for the group. The added member contributes its book-tax difference and its net deferred liability to those of the group. The group may use, in addition to the group's existing numbers, the book-tax difference and net deferred liability of the added member which would have resulted had the member remained a single entity.

U56. If the parties in a corporate acquisition are members of the same unitary business group, is the gain and expense eliminated as an intercompany transaction?

Under MCL 208.1511, "[e]ach United States person included in a unitary business group or included in a combined return shall be treated as a single person and all transactions between those persons included in the unitary business group shall be eliminated from the business income tax base, modified gross receipts tax base, and the apportionment formula under this act." "All transactions" includes intercompany stock or asset acquisitions. Gain or loss on intercompany transactions must be deferred until the time immediately preceding disposition of the property in question outside the unitary business group or when either party to the transaction ceases to be a member of the unitary business group.

U57. How must a unitary business group file its final MBT annual return in order to properly report the final MBT year of all its members?

The combined return is filed on the basis of the designated member's (DM) tax year. A combined return thus includes all member tax years that end with or within the tax year of the DM. All taxpayers must file a final MBT return for the period ending December 31, 2011.[1] This is true regardless of whether the group will continue as a group for the 2012 tax year. A fiscal year taxpayer with a tax year ending after that date is considered to have two separate tax years: the first short tax year is for the part of fiscal year ending before January 1, 2012, and the second short tax year is for the part of the fiscal year beginning after December 31, 2011.[2] In order for the entire group to file as unitary for the final MBT tax year, the final MBT unitary return must contain all member tax years ending before January 1, 2012, including any short periods which may be created by operation of the statutory cut-off. In the instance where a member must include more than twelve months of activity with the group's final return, that member will file two Form 4580s, MBT UBG Combined Filing Schedule for Standard Members, to report its data.

[1] MCL 208.1117(4).

[2] Id.

Example 1. UBG consists of three members, DM A, Member B, and Member C. DM A is a calendar year taxpayer. Member B is a fiscal year taxpayer with a tax year of April 1 through March 31. Member C's tax year is October 1 through September 31. The final MBT return will contain:

- DM A's 2011 calendar year; filing one supporting schedule.
- Member B's full fiscal year ending March 31, 2011, and its short year ending December 31, 2011; filing two supporting schedules with the group's return.
- Member C's full fiscal year ending September 30, 2011, and its short year ending December 31, 2011; filing two supporting schedules with the group's return.

Example 2. Same facts as Example 1, except DM A has a fiscal year ending July 31, 2011. The UBG's tax year will end July 31 and its annual return will be due November 30, 2011. That combined return for the UBG will include DM A's fiscal year ending July 31, 2011, Member B's fiscal year ending March 31, 2011, and Member C's fiscal year ending September 30, 2010.

In addition, because all three members are required to report a short state tax year ending December 31, 2011, this group must file an additional return for that end date, which will include:

- DM A's short year ending December 31, 2011.
- Member B's short year ending December 31, 2011.
- Member C's full fiscal year ending September 30, 2011, and a short year ending December 31, 2011; filing two supporting schedules.

U58. Are controlled foreign corporations ("CFC's") under IRC 957 taxpayers under the MBT? Can controlled foreign corporations be members of a unitary business group? What if the controlled foreign corporation is a disregarded entity of a U.S. parent?

CFC's as Taxpayers. Under the MBT, taxpayer means "a person or a unitary business group liable for a tax, interest, or penalty." MCL 208.1117(5). "Person" means "an individual, firm, bank, financial institution, insurance company, limited partnership, limited liability partnership, copartnership, partnership, joint venture, association, corporation, subchapter S corporation, limited liability company, receiver, estate, trust, or any other group or combination of groups acting as a unit." MCL 208.1113(3). Other than the definition of unitary business group under MCL 208.1117, which is limited to U.S. persons, the MBT does not distinguish between foreign and U.S. persons. Thus, controlled foreign corporations are taxpayers under the MBT.

CFC's as Members of a Unitary Business Group. A unitary business group is defined, in part, as:

> a group of United States persons, other than a foreign operating entity, 1 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 United States persons . . . . [MCL 208.1117(6) (emphasis added).]

"United States person" means "that term as defined in [IRC] 7701(a)(30)." MCL 208.117(7). Under IRC 7701(a)(30), "United States person" means:

(A) a citizen or resident of the United States,
(B) a domestic partnership,
(C) a domestic corporation,
(D) any estate (other than a foreign estate, within the meaning, of paragraph (31)), and

(E) (E) any trust if -
(i) a court within the United States is able to exercise primary supervision over the administration of the trust, and
(ii) one or more United States persons have the authority to control all substantial decisions of the trust. [IRC 7701(a)(30).]

A controlled foreign corporation means:

any foreign corporation if more than 50 percent of –
(1) the total combined voting power of all classes of stock of such corporation entitled to vote, or
(2) the total value of the stock of such corporation, is owned (within the meaning of section 958(a)), or is considered as owned by applying the rules of ownership of section 958(b) , by United States shareholders on any day during the taxable year of such foreign corporation. [IRC 957(a).]

As a foreign corporation, a controlled foreign corporation is not a U.S. person and is thus excluded from the definition of unitary business group under the MBT.

CFC's as Disregarded Subsidiary of U.S. Parent. A controlled foreign corporation that is a disregarded entity for federal income tax purposes is classified as a disregarded entity for MBT purposes. MCL 208.1512. That is, the disregarded entity is treated as a branch or division of its owner and will be included in a unitary business group as part of its owner if the owner is a member of a unitary business group. However, a controlled foreign corporation that is a disregarded entity for federal income tax purposes that filed separate from its owner under MCL 208.1512(2) or (3) is treated as a person separate from its owner for MBT purposes. Therefore, the controlled foreign corporation that files separate from its owner is a foreign person and would not be includable in any unitary business group.

U59. If you are an entity within the unitary group that does not have nexus without application of the unitary principal, are your shareholders liable for Michigan personal income tax?
No. If the (flow through) entity standing alone lacks nexus with the State of Michigan under the Due Process and Commerce Clauses of the U.S. Constitution, or under the statutory jurisdictional standards for activities protected under P.L. 86-272, the shareholders, partners, or other individual owners are not subject to Michigan income tax on their share of profits from the business activity. The Michigan Income Tax Act, 1967 P.A. 281, MCL 206.1 - 206.532, does not provide for unitary groups or combined reporting with regard to personal income taxes, and apportionment must be determined on a separate entity basis. For purposes of this determination, separate entities do not include entities disregarded for federal tax income purposes, such as federal Qualified Subchapter S Subsidiaries (Q-Subs) or unincorporated single member limited liability companies (SMLLCs). Under MCL 208.1512, entities disregarded for federal income tax purposes are classified as disregarded for MBT purposes, except for certain exceptions described in the Department's *Notice to Taxpayers Regarding Federally Disregarded Entities and the Michigan Business Tax*, issued January 26, 2012.

U60. Is an individual a member of a unitary business group with the entities in which the individual has a controlling interest?
It depends. Under the MBT, a unitary business group is:

> a group of United States persons, other than a foreign operating entity, 1 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

> United States persons, and that has business activities or operations which result in a flow of value between or among persons included in the unitary business group or has business activities or operations that are integrated with, are dependent upon, or contribute to each other. For purposes of this subsection, flow of value is determined by reviewing the totality of facts and circumstances of business activities and operations. [MCL 208.1117(6).]

An individual that owns a controlling interest in one or more entities but is not otherwise engaged in a trade or business will have neither business income nor gross receipts under the MBT. MCL 208.1105, 208.1111. Furthermore, an individual not engaged in a trade or business has no business activities or operations which would result in a flow of value with, or would be integrated with, dependent upon, or contribute to, the entities in which the individual owns a controlling interest. Thus, an individual not engaged in a trade or business is not unitary with the entities in which that individual has a controlling interest.

On the other hand, an individual that is a sole proprietor or owner of a federally disregarded entity, which under MCL 208.1512 is classified as a disregarded entity under MBT, or is otherwise engaged in a trade or business resulting in business income or gross receipts under the MBT, may be unitary with the entities in which that individual has a controlling interest if the individual has business activities or operations (1) which result in a flow of value between or among persons included in the unitary business group or (2) that are integrated with, are dependent upon, or contribute to each other. MCL 208.1117(6).

U61. Are foreign entities includable in unitary business group? What if the foreign entity is the single member of a domestic single member limited liability company disregarded for federal tax purposes?

A unitary business group is defined - in part - as:

> a group of United States persons, other than a foreign operating entity, 1 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 United States persons . . . . [MCL 208.1117(6) (emphasis added).]

"United States person" means "that term as defined in [IRC] 7701(a)(30)." MCL 208.117(7). Under IRC 7701(a)(30), "United States person" means:

(A) a citizen or resident of the United States,
(B) a domestic partnership,
(C) a domestic corporation,
(D) any estate (other than a foreign estate, within the meaning, of paragraph (31)), and
(E) any trust if-
  (i) a court within the United States is able to exercise primary supervision over the administration of the trust, and
  (ii) one or more United States persons have the authority to control all substantial decisions of the trust. [IRC 7701(a)(30).]

A partnership or corporation is "domestic" when that entity is "created or organized in the United States or under the law of the United States or of any State unless, in the case of a partnership, the Secretary provides otherwise by regulations." IRC 7701(a)(4).

In other words, a foreign entity is not a U.S. person and is therefore excluded from unitary business groups. Similarly, foreign operating entities are also excluded from unitary business groups under the MBT. "Foreign operating entity" means a U.S. person that:

> (a) Would otherwise be a part of a unitary business group that has at least 1 person included in the unitary business group that is taxable in this state.
>
> (b) Has substantial operations outside the United States, the District of Columbia, the Commonwealth of Puerto Rico, any territory or possession of the United States, or a political subdivision of any of the foregoing.
>
> (c) At least 80% of its income is active foreign business income as defined in section 861(c)(1)(B) of the Internal Revenue Code. [MCL 208.1109(5).]

A foreign entity that is the single member of a domestic limited liability company disregarded for federal income tax purposes would likewise not be included in a unitary business group. Under MCL 208.1512, an entity that is disregarded for federal income tax purposes is classified as a disregarded entity for MBT purposes. That is, the disregarded entity is treated as a branch or division of its owner and will be included in a unitary business group as part of its owner if the owner is a member of a unitary business group. Since a foreign entity is not a U.S. person and, thus, may not be included in a unitary business group, the domestic disregarded entity treated as a branch or division of the foreign entity owner would likewise not be includible in a unitary business group.

U62. A dental practice organized as a sole proprietorship became a professional limited liability company ("PLLC") effective January 1, 2008. For federal income tax purposes, the PLLC is a disregarded entity and the member reports his income as a sole proprietor on federal schedule C.

Can the owner of the dental practice continue to file as a sole proprietor for Michigan individual and MBT purposes?

The owner or single member of the PLLC also owns the building the PLLC uses for the dental practice, and effective January 1, 2008, will be renting the building to the PLLC. The owner and spouse also own an additional rental property. Should the rental income be combined with the PLLC income for MBT purposes, or should the PLLC and rental activity each be separately reported?

A group of businesses that meets the definition of unitary group is a taxpayer and is required to file a combined return for MBT. Under the MBT, a unitary business group is defined in section 117 (MCL 208.1117(6)) as:

> a group of United States persons, other than a foreign operating entity, 1 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 United States persons, and that has business activities or operations which result in a flow of value between or among persons included in the unitary business group or has business activities or operations that are integrated with, are dependent upon, or contribute to each other. For purposes of this subsection, flow of value is determined by reviewing the totality of facts and circumstances of business activities and operations. [MCL 208.1117(6).]

A single member PLLC that is a disregarded entity for federal income tax purposes is considered a sole proprietorship and similarly classified as a disregarded entity for Michigan Business Tax purposes under, MCL 208.1512(1). The single member PLLC also may be unitary with any other entities in which that individual owner has a controlling interest if the individual has business activities or operations (1) which result in a flow of value between or among persons included in the unitary business group or (2) that are integrated with, are dependent upon, or contribute to each other. MCL 208.1117(6).

In the case of an individual who owns and leases an office building or any other real or tangible property to a sole proprietorship, single member limited liability company, or any other business entity in which he or she has a controlling interest (greater than a 50% ownership interest), the business activity and rental activity will constitute a unitary group under MCL 208.1117 because the individual owns a controlling interest in each activity and there is a flow of value between the business activity and the rental activity, and they are integrated with, dependent upon, and contribute to each other.

If the individual owns another rental property that is not leased or rented to the business entity owned by the individual, the rental property will be part of the unitary group if there is a flow of value between the activities or if they are integrated with, dependent upon, and contribute to each other. As a general rule, rental properties owned and managed by the same individual owner will be integrated with, dependent upon, and contribute to each other, and therefore be considered a unitary group under the MBT.

For purposes of these ownership requirements, property owned by a spouse (other than spouses who are legally separated under a decree of divorce or separate maintenance) is deemed to be owned by the other spouse and vice versa.

U63. Can a UBG with one or more fiscal year members make the election between the actual and annual method for calculating its final MBT return?

Yes, if the group's designated member (DM) is a fiscal year filer and the taxpayer continues under the CIT or the MBT after December 31, 2011.

All taxpayers must file an MBT return for the period ending December 31, 2011. MCL 208.1117(4). A fiscal year taxpayer with a tax year ending after that date is considered to have two separate tax years: the first short tax year is the part of the fiscal year ending December 31, 2011, and the second short tax year is for the part of the fiscal year beginning January 1, 2012. MCL 208.1117(4).

Fiscal year taxpayers continuing to the CIT or making the MBT election may choose between two methods of calculating the short period return ending December 31, 2011, and the return beginning January 1, 2012:

1. Annual - The tax is computed as if the relevant tax was effective on the first day of the taxpayer's annual accounting period and the amount computed shall be multiplied by a fraction, the numerator of which is the number of months in the taxpayer's short period tax year and the denominator of which is the number of months in the taxpayer's annual accounting period (typically 12).

2. Actual - The tax is computed by determining the tax base in the short period tax year in accordance with an accounting method satisfactory to the department that reflects the actual tax base attributable to the period. The method of accounting used in prior fiscal years will be assumed to reflect the actual tax base attributable to the period. MCL 208.1503; MCL 206.683.

The taxpayer must use the same method for its short period return ending December 31, 2011, and for its first CIT or MBT election return. MCL 208.1503; MCL 206.683.

If the taxpayer will not continue under the CIT or the MBT after December 31, 2011, it may use only the actual method for its short period return ending December 31, 2011.

For a unitary business group, the tax year of the group is the tax year of the DM. If the DM is a fiscal year filer, it will choose between the annual and actual methods and this choice will apply to all group members. All members of the UBG that continue as a group into the CIT or that make the MBT election must file consistent with the method chosen for the short period return ending December 31, 2011. If the DM is a calendar year filer, or will not continue as a taxpayer, the group must file using the actual method. MCL 208.1503; MCL 206.683.

If a member of a UBG will be a separate filer beginning January 1, 2012, that member is statutorily permitted the choice between the annual and actual methods on its first CIT return; regardless of the choice made by the member's previous UBG. MCL 206.683.

If a member was a separate filer for the period ending December 31, 2011, and joins a UBG for the first CIT return, that member should amend its short period return ending December 31, 2011, to use the same method used by the group. If, however, the member is switching groups from the period ending December 31, 2011, to the first CIT return, the member should follow the general rule and use the filing choice of the group, regardless of the method used by the member's previous group.

If a member of the MBT UBG holds a certificated credit and the group makes the MBT election, the membership of the group will not change unless there is a change to relationship or control. MCL 208.1500; MCL 208.1680. The UBG electing the MBT must file its short period return for the period beginning January 1, 2012, using the same method used on the group's short period return ending December 31, 2011. MCL 208.1503(3).

Example 1. UBG consists of three members, DM Corporation A, Member Corporation B, and Member Partnership C. DM A is a fiscal year filer. It elects the annual method for the group. The group will file its final MBT return using the annual method. DM A and Member B will file their first CIT return, as a UBG, using the annual method.

Example 2. UBG consists of three members, DM Corporation A, Member Corporation B, and Member Partnership C. DM A is a calendar year taxpayer. The DM does not have the statutory authority to choose between the annual and actual methods. The group will file its final MBT return using the actual method. DM A and Member B will file their first CIT return as a UBG, using the actual method.