

Introduction to the Michigan Business Tax— MBT 101

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The recent enactment of the Michigan Business Tax (the “MBT”) represents a fundamental change in Michigan business taxation. The MBT passed the Legislature and was signed into law by Governor Granholm on July 12, 2007.

STRUCTURE OF THE MBT. The MBT is structured as a single tax with two separate component taxes: a business income tax; and a modified gross receipts tax.

Business Income Tax (“BIT”). The BIT is imposed at 4.95% of the taxpayer’s business income, which generally is federal taxable income, with specific statutory additions and subtractions.

- *Tax Base for Partnerships, LLCs and S-Corporations* generally is the total of the Schedule K-1 income items, with certain adjustments. Possibly the most notable adjustment is a deduction for the amount of self-employment income otherwise included.

Modified Gross Receipts Tax (“MGRT”). The MGRT is imposed at .8% of the taxpayer’s modified gross receipts, which generally is the taxpayer’s gross receipts less “purchases from other firms”.

- The MGRT is a hybrid tax that, depending on the circumstances, can be somewhat similar to either a gross receipts tax, or a gross margin tax.
- **Purchases from Other Firms Defined** – This deduction will prove critical for most taxpayers and will likely have great impact on the nature of the tax

Unitary Filing Required. The MBT requires combined filing for unitary business groups. Very generally, a unitary business group will be found to exist if there is common ownership of more than 50% and there is a specified amount of flow of value/unitary business activity among the entities under common ownership. Unitary taxation can be extremely complex and guidance from the Department of Treasury will likely be forthcoming.

APPORTIONMENT. The MBT is apportioned based on a 100% sales factor.

Sourcing. For sales of tangible personal property, the MBT sources sales using “ultimate destination”, which is similar to sourcing used under the SBT. However for sales of services and intangible income, the MBT shifts to a market-based sourcing methodology, which is very different from the “costs of performance” method used under the SBT.

CREDITS. A significant portion of the MBT is dedicated to tax credits. In fact, of the 161 pages of text that make up the MBT, 93 of those pages address tax credits. There are some entirely new tax credits, and some tax credits that generally are carried over from the SBT. Some of the more significant new credits are the following:

Compensation Credit. Credit for .37% of Michigan compensation paid.

Investment Credit. Credit for 2.9% of the cost of capital assets located in Michigan.

Research and Development Credits. (1) 1.9% credit for R&D Expenses; (2) 30% of contributions to eligible business for R&D – approved by MEGA.

Phased Filing Credit. Credit to eliminate filing cliff caused by \$350,000 filing threshold.

Entrepreneurial Credit

Credit for Contributions to Art/Historical Organizations.

Taxpayer/Industry Specific Credits. Credits for specific industries/taxpayers.

Credits carried over from the SBT: Small Business Credit, Renaissance Zone credits, Brownfield credits, MEGA credits, Historic Preservation credits, Public Contributions Credits, Startup Business credits, Michigan Early Stage Venture credit, Next Energy credits, Worker's Disability Comp. credits, Community foundation cont. credits, and Food Bank and homeless Shelter Cont. credits.

PERSONAL PROPERTY TAX RELIEF AND THE ENACTMENT OF THE MBT.

Michigan's taxation of personal property used in business has been criticized as a serious disincentive to business locating in Michigan. In response to these criticisms, two forms of personal property tax relief are included in Michigan's tax restructuring: personal property tax credits and personal property tax exemptions.

Personal Property Tax Credits. The MBT includes credit for personal property taxes levied after December 31, 2007 on the following types of property:

- Industrial personal property: 35% credit
- Qualified telephone company personal property: 23% credit
- Natural gas pipeline personal property: 10% credit
- No credit for tax paid on more general "commercial property"

Personal Property Tax Exemptions Amendments to the Michigan General Property Tax Act. In connection with the enactment of the MBT, four tie-barred laws were also enacted:

- *Enrolled Bill 4369* – exempts industrial personal property from the 18-mill local school property tax and commercial personal property from 12 mills of the 18-mill local school property tax.
- *Enrolled Bill 4370* – exempts industrial personal property from the 6-mill State education tax.
- *Enrolled Bill 4371* – exempts personal property taxed under the industrial facilities tax from the 6-mill State education tax and the 18-mill local school property tax.

- *Enrolled Bill 4372* – amends the General property Tax Act to exempt commercial and industrial personal property from the local school property tax and the State education property tax consistent with the exemptions contained in HB 4369, 4370, and 4371.

SPECIAL TAXES ON INSURANCE COMPANIES AND FINANCIAL INSTITUTIONS

Insurance Company Tax. Insurance companies are exempt from both the BIT and the MGRT and instead pay a tax imposed at 1.25% of gross direct premiums written on property or risk located in Michigan. Insurance companies will also be subject to sales and use tax. The prior tax on Insurance Companies was imposed at 1.0735 of “adjusted receipts”.

Financial Institutions Tax. Financial Institutions are exempt from both the BIT and the MGRT and instead pay a franchise tax imposed at .0235% of net capital. Net capital is equal to the taxpayer’s equity reduced by goodwill and United States obligations.