

The Michigan Business Tax

by Jack Van Coevering

In July 2007, the Michigan Legislature passed the Michigan Business Tax (MBT).¹ The MBT took effect January 1, 2008, replacing the thirty-year-old Single Business Tax (SBT).

Among its many objectives, the MBT was developed to provide a stable revenue stream that did not have the complexity of the SBT.² To achieve this, the tax combines a separately calculated income tax³ (providing simplicity) with a separately calculated gross receipts tax⁴ (providing stability). Drafters hoped that the gross receipts levy would raise two-thirds of the business tax revenue with the business income tax raising the remaining one-third. The recent budget deficit was also addressed by imposition of a surcharge,⁵ which increases the total amount of tax calculated from both income and receipt taxes by 21.99 percent.⁶ Regardless of how the objectives were achieved, they were conditioned on limiting, if not reducing, the tax burden on Michigan businesses. Hence, the MBT's two most distinguishing features are its significant expansion of the taxpayer base, particularly as to nonresident businesses, and the substantial credits provided to Michigan businesses. The purpose of this article is to review those objectives, their conceptual underpinnings, and the constitutional challenges they raise.

Taxpayers and Exempt Entities

Most SBT taxpayers will continue to be MBT taxpayers.⁷ The MBT retains the same filing threshold as the SBT. Taxpayers with \$350,000 in allocated or apportioned "gross receipts" are required to file and pay the MBT.⁸

The MBT defines "taxpayer" to mean "a person or unitary business group liable for the tax, interest, or penalty under this act."⁹ The term "person," under the MBT, is similar to the SBT definition¹⁰ with the addition of three new entities: limited liability partnerships, subchapter S corporations, and limited liability companies.¹¹ The addition, however, is a clarification, as the SBT contained a general "catch-all" provision, which the MBT continues, for any "other group or combination acting as a unit." Both versions included trusts and estates.

What is new is the introduction of a "unitary business group" as a single "taxpayer."

The MBT defines a unitary business group as:

A group of United States persons, other than a foreign operating entity¹², 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.

The first half of the definition addresses a control test. The Michigan Department of Treasury has stated that it will use the attribution rules contained in IRC 318 to determine control.¹³ The second half of the definition incorporates standards enunciated by the United States Supreme Court in *Mobile Oil Corp v Commissioner of Taxes of Vermont*¹⁴ and *Container Corp of Am v Franchise Tax Bd*¹⁵ and represents alternative tests: flow of value, or contribution or dependency. The flow of value is often present with centralized management or economies of scale. Contribution or dependency might exist if one entity finances the other, but between the two, there may or may not exist centralized management or economies of scale.¹⁶

Because the "unitary business group" is considered a "taxpayer," everything from the determination of the filing threshold to the qualification or disqualification for credits are determined at the unitary business group level and not determined at the member level. A limited liability company with less than the \$350,000 in receipts and that would not have been required to file an SBT return will, if it is a member of a unitary business group with total receipts that exceed the

filing threshold, be required to be included in the “unitary business groups” return.¹⁷

The MBT exempts the agencies and political subdivisions of the United States, Michigan, and other states.¹⁸ It also exempts most entities that are exempt federally, i.e., charitable or education organizations. Organizations exempt under IRC 501(c)(12) or 501(c)(16) are not exempt from the MBT.¹⁹ For the remaining exempt entities, the MBT exemptions are limited to specific portions of the tax base attributable to specific nonprofit activities. The entities subject to this partial exemption include nonprofit cooperative housing corporations, farmers’ cooperative corporations, agricultural producers, an attorney-in-fact to reciprocal insurers, and multiple employer welfare arrangements for dental benefits.²⁰

Nonresident Taxpayers: Nexus

SBT and now MBT taxpayers will have more company. The MBT pursues an aggressively low nexus standard to subject the highest number of nonresident businesses to the tax. “Nexus” refers to federal constitutional limitations on a state’s jurisdiction. Due Process Clause “nexus” between a person and a state is established when the person purposefully avails itself of the state’s benefits.²¹ Michigan courts have held that Commerce Clause “nexus” requires a taxpayer’s physical presence in the state. A third restriction applies only to state income taxes by federal law, Pub L No 86-272 (also known as 15 USC 381), and prohibits states from imposing an income tax if the only activity in the state was sales solicitation. That law did not apply to the SBT, as the Michigan Court of Appeals in *Gillette*²² and *Guardian Industries*²³ determined that the SBT was *not* a tax on, or based on, net income.

Gillette and *Guardian* allowed Michigan to aggressively pursue nonresident businesses under the lower constitutional standard.²⁴ Though the expansion of the taxpayer base to nonresidents through a lower nexus standard was unanticipated when the SBT was first enacted, the state has gained a first-hand understanding of its revenue potential.²⁵ Nationally, fundamental nexus disputes remain regarding the extent to which a taxpayer must have physical presence or even whether a physical presence standard applies to a business tax at all.²⁶

Within this context, the MBT establishes, by statute, the lowest nexus standard known

to exist in the United States by mandating a finding of nexus if the taxpayer has *either* physical presence of more than one day in Michigan *or*, alternatively, “actively solicits” sales in the state that resulted in at least \$350,000 in gross receipts.²⁷ In other words, the MBT rejected prior SBT case law requiring physical presence. Instead, the MBT’s alternative test suggests the legal conclusion that there is no difference between the Commerce Clause and the Due Process tests.

Regarding the physical presence test, the MBT defines “physical presence” to mean “any activity conducted by the taxpayer or on behalf of the taxpayer.”²⁸ The Department of Treasury has indicated that it will supplement this definition with reference to published standards contained in an SBT Revenue Administrative Bulletin (RAB) regarding SBT nexus.²⁹ For the alternative test of solicitation and sales, the MBT gives the Department of Treasury discretion to define the phrase “actively solicits,” though it requires that any guidance be written and that it apply prospectively.³⁰ In December 2007, the Department of Treasury issued a Revenue Administrative Bulletin defining the term “actively solicits” to mean “purposeful solicitation of persons within this state” that “explicitly or implicitly invite[]” an order or are entirely “ancillary to requests for an order.”³¹ Solicitation, according to the RAB, is purposeful when “it is directed at or intended to reach persons within Michigan or the Michigan market.” Some examples in the RAB include the use of mail, telephone, radio, Internet, television, including the maintenance of an Internet site over which sales transactions occur.

Though the MBT does not address Pub L No 86-272, the Department of Treasury has said that Pub L No 86-272 would only apply to the business income tax portion of the MBT.³² Once any activity in the state exceeds the solicitation of sales threshold (the Pub L No 86-272 standard), the taxpayer will be subject to the Business Income Tax (BIT) on its entire tax base for the tax year. Conceivably a taxpayer could be subject only to the gross receipts tax, if the taxpayer’s sole activity was the solicitation of sales. A taxpayer soliciting through an Internet site, for example, would be protected under Pub L No 86-272 from the Michigan Business Tax but would be still be subject to the modified gross receipts tax because its activity meets the definition of “actively solicits.” The low

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nexus standard also has implications to related entities of the taxpayer. If the taxpayer is a flow-through entity that has nexus, the individual partners and shareholders will be subject to apportionment under Michigan's Income Tax Act on their distributive share of income.³³ While the nexus impact on partners and shareholders has not changed, the MBT's lower nexus standard will affect more flow-through entities, and, consequently, more partners and shareholders. A similar dynamic applies to the unitary business group. If one member of a unitary group has nexus, the income and receipts for all the members will be apportioned to Michigan.

A statutory nexus standard does provide a clearer starting point for the battles that will follow. It does not, however, eliminate the likelihood that the ultimate standard will be framed by courts. Having the most aggressive nexus standard may make meaningful compliance by nonresident businesses more difficult, generate more litigation, provide less meaningful insight into the nexus, and engender a considerable risk of large refunds.

The Business Income Tax

The BIT is imposed on every taxpayer with business activity in the state, unless prohibited by Pub L No 86-272.³⁴ It is calculated by imposing a 4.95 percent rate on the "business income tax base" after allocation and apportionment.³⁵ The base is determined by making several adjustments to "business income," before allocation and apportionment, and by deducting MBT business losses after allocation and apportionment. The adjustments reverse the federal tax treatment by adding income items to the extent they were excluded from federal taxable income and subtracting to the extent the item was included in federal taxable income. A summary of the adjustments follows:

- Add back interest and dividends from non-Michigan obligations and securities.
- Add back taxes imposed on or measured by net income.
- Add back carryback or carryover net operating losses.
- Subtract dividends and royalties received from non United States persons or from a "foreign operating entity," (United States persons that would be part of a unitary group with substantial operations in foreign coun-

tries and that derive 80 percent of their income from active foreign business). See MCL 208.1109 (5))

- Subtract interest income from United States securities.
- Subtract net earnings from self-employment of the taxpayer, or a partner or limited liability company member of the taxpayer, except to the extent that the net earnings represent a reasonable return on capital.
- Add the loss or subtract the income attributable to another entity whose business activities are taxable under the BIT, or would be subject to the BIT if the business activities were in this state.
- Add back any royalty, interest, or other expense paid to a related person for the use of an intangible asset, if that person is not included in the taxpayer's unitary business group.³⁶

The last adjustment addresses tax plans using intangible holding companies to redirect royalty income to another entity in a non-taxing state, reducing the taxpayer's income by expensing a royalty payment. See *Geoffrey, Inc v So Carolina Tax Comm'n*, 437 SE2d 13 (1993), cert den 114 S Ct 550. Thus, this planning tool is denied under the MBT. The MBT presumptively adds back royalty, interest, or other expenses unless the taxpayer can overcome four rather significant hurdles. These include a nontax business purpose other than avoidance of the tax, arms-length pricing, rates and terms as applied by IRC 482³⁷ and 1274(d), and one of three exceptions is satisfied: the item represents a pass-through of another transaction between a third-party and the related person with comparable rates and terms, or it results in double taxation because the transaction is subject to tax in another jurisdiction, or it is unreasonable as determined by the Department of Treasury.³⁸

Given the long-voiced complaints regarding the SBT's inclusion of compensation in the SBT tax base, it bears underscoring the MBT's more favorable treatment of compensation. In addition to the very significant credit for compensation in Michigan that potentially eliminates half of the MBT liability, the BIT has eliminated compensation both in the definition of "business income"³⁹ and as an adjustment, noted above, for "any earnings that are net earnings from self-employment...of the taxpayer or a partner or limited

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liability company member of the taxpayer except to the extent that those net earnings represent a reasonable return on capital.”⁴⁰

The “business income” of a unitary business group is the sum of the business income of each person. In addition to the adjustments described above, the group would also subtract any items of income and related deductions from transactions between members of the unitary business group. The “business income” of “foreign operating entities,” financial institutions, and insurance companies is excluded.⁴¹

What is “business income”? The MBT’s statutory definition of “business income”⁴² lacks an exception for income functionally and transactionally *unrelated* to a taxpayer’s regular trade or business. The Due Process Clause requires that, for nonresident businesses, the income must still have some constitutionally sufficient relationship, under the unitary business principle, to the activity of the business in the taxing state.⁴³ “Business income” is defined as “that part of federal taxable income derived from business activity.” However, the broad SBT definition of “business activity”⁴⁴ has been retained without the exception for a “casual transaction.” As a result, there is no connection to “transactions and activity in the regular course of the taxpayer’s trade or business.”⁴⁵ Whether the MBT’s definition of “business activity” meets the requirements of Due Process when applied to income from “incidental” activity in “interstate or foreign commerce,” having only “indirect” benefit to the nonresident business’s regular trade or business in Michigan, is questionable.

The definition of “business income” continues with entity-specific guidelines for: a partnership or S Corp; an exempt cooperative electric company; an exempt entity; and “an individual, estate, or partnership organized exclusively for estate or gift planning purposes.”⁴⁶ The first three guidelines parallel federal tax treatment. The last item addresses the income from trusts, family limited partnerships, and other estate planning entities. As to this last set of entities, however, the language raises some questions regarding whether the qualifier, “organized exclusively for estate or gift planning purposes,” excludes other business purposes that may be required under federal case law.⁴⁷

The Modified Gross Receipts Tax

A general business tax measured by gross receipts is not new to Michigan. The precursor to Michigan’s corporate income tax was a Business Activities Tax that imposed an excise tax on gross business activities, measured by gross receipts. Though gross receipts taxes use some of the same receipts that are used to determine a retail sales tax, gross receipt taxes are not taxes on the sales to the ultimate consumer and are not collected on a sales transaction basis. Typically, exclusions for business inputs are not present, and the tax itself is not deductible from the base. These distinctions exist because the gross receipts tax seeks to encompass all of the business’ activity in the state, not just sales.

For 25 years, Michigan held to roughly the same definition of “gross receipts” that had been used in the Business Activities Tax. The definition changed significantly in 2000, when the Department of Treasury sought to remedy seemingly inconsistent court cases and resolve the pending litigation.⁴⁸ In addition to new exceptions,⁴⁹ the MBT retains the SBT’s definition of “gross receipts” and all of the definition’s exceptions.⁵⁰ The definition of “gross receipts” was not as important with the SBT, which used the definition of “gross receipts” to set the parameters of the tax, establishing a filing threshold and a maximum cap on the SBT liability—the maximum SBT liability. By contrast, the MBT uses gross receipts both to determine the MBT filing threshold and to calculate the modified gross receipts tax base. Having a tax based on gross receipts under which all taxpayers will pay means the MBT may have ramifications for taxpayers who generally did not incur a tax liability under the SBT.

The MBT’s modified gross receipt tax reflects both the breadth of a gross receipts tax and the problem of including business inputs that may not always logically portray a business’s activity. Both characteristics are found in the MBT’s definition of “gross receipts,” which is not tied to a trade or business (i.e., sale of inventory or services) but applies to any “direct or indirect gain, benefit, or advantage to the taxpayer or *to others*.”⁵¹ The retained SBT exceptions took out receipts that benefited someone other than the taxpayer, such as a taxpayer-property manager’s receipt of rent for the owner or receipts that did not represent an actual profit to the taxpayer (such as an exchange of like-kind property), the receipt of a security deposit, a purchaser

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discount, or insurance reimbursements for stolen or damaged property. For mortgage companies, sales finance companies, or securities brokers or dealers, the new MBT exceptions eliminate from “gross receipts” the repayment or sale of the *principal* amount of loans, bonds, mutual funds, certificates of deposit, or marketable instruments.⁵² Another new MBT exception from “gross receipts” for professional employer organizations (PEO) excepts the amounts a PEO would receive to pay a covered employee of the employer-client.⁵³ Finally, an amendment similar to the “business income” exception addresses the gross receipts of trusts, family limited partnerships, and other estate planning entities, but this is limited to those entities that are “exclusively organized for estate or gift planning purposes.”⁵⁴ The new MBT exceptions are the first statutory effort to except passive investment receipts from “gross receipts” for individuals, estates, and for trusts or partnerships “organized exclusively for estate or gift planning purposes.” As to this last set of entities, however, it is unclear whether the qualifier “organized exclusively for estate or gift planning purposes” excludes other business purposes.⁵⁵ Receipts from personal investment activity and disposition of property held for personal use and enjoyment are also excluded.⁵⁶

A taxpayer’s gross receipts are modified by the subtraction for “purchases from other firm.”⁵⁷ The MBT defines this phrase to mean:

- a) Inventory acquired during the tax year, including freight, shipping, delivery, or engineering charges included in the original contract price for the inventory.
- b) Assets, including the cost of fabrication and installation, acquired during the tax year...that are, or under the internal revenue code will become, eligible for depreciation, amortization, or accelerated capital cost recovery...
- 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) .payments to subcontracts for a construction project under a contract specific to that project.

- f) For the 2009 tax year, 50% of film rental or royalty payments paid by a theater owner to a film distributor, a film producer, or a film distributor or producer. For the 2010 tax year and each tax year after 2010, all film rental or royalty payments paid by a theater owner to a film distributor, a film producer, or a film distributor and producer.⁵⁸

The definition of “purchases from other firms” raises a number of questions. First, a number of terms are not defined, i.e. “materials,” “supplies,” etc. Second, intangible personal property or services are not excluded. It may not be clear with respect to the inventory deduction whether these items could be treated as part of the inventory cost (i.e. warranties) if they were included in the contract price for inventory. The Department of Treasury has stated that “labor” is not included as a “purchase from other firms.” While a staffing company may deduct compensation paid to personnel supplied to the staffing company’s clients, the client’s payments to the staffing company do not constitute “purchases from other firms.”⁵⁹

For a unitary business group, the modification (or deduction for “purchases from other firms”) from gross receipts is a sum of the individual calculations by each member, and the deduction of “modified gross receipts arising from persons included in the unitary business group.”⁶⁰ For the 2008 year only, both individual businesses and unitary business groups may also subtract unused business loss carryforwards from the 2006 and the 2007 tax years. For unitary business groups, the loss carryforward may only be deducted by the individual members as if the member were not included in the group.⁶¹

Apportionment and Allocation of the Tax Base

To identify business activity in Michigan, both the business income tax base and the modified gross receipts tax base are subject to apportionment or allocation.⁶² If the taxpayer’s “business activity” is confined solely to Michigan, then the MBT tax base will be *allocated* to Michigan. Taxpayers whose “business activities” are both in Michigan and in other states must *apportion* the tax base by use of a sales factor, the numerator of which represents the taxpayer’s total sales in Michigan and the denominator of which represents total sales everywhere else.⁶³

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The MBT does not include any “throw back” provision for apportionment in which sales occurring outside of Michigan would nevertheless be “thrown back” into the Michigan numerator if the other state could not tax the sale. Sales remain in the denominator regardless of whether they are taxed or whether the other state has constitutional nexus to tax. There is a caveat: if the taxpayer does not have nexus with at least one other state, regardless if it has sales in that state, the taxpayer cannot apportion its MBT tax base at all.⁶⁴

The MBT’s provisions sourcing sales revenue utilize three general rules: the location of the property being sold, the location of where the property is used, and where the service customer is located or where the benefit is received. At the risk of over-simplification, the following guidelines are a starting point to determine whether the business activity is attributable to Michigan:

Location of the property

- Sales of tangible personal property are sourced by the shipping or delivery point
- Sales of gas or electricity are sourced to the ultimate destination point
- Receipts from origination of a loan, interest from a loan secured by real property
- Loan servicing fees on loans secured by real property

Location of use

- Lease or rental of tangible personal property
- Lease or rental of mobile transportation property
- Royalties, use or right to use intangible property, licenses, franchises, copyrights
- Receipts from transportation services

Location of customer or the benefit received

- Performance of services
- Security brokerage services
- Management, distribution, administration of brokerage services
- Interest from a loan not secured by real property
- Receipts from credit card receivables, the sale of credit cards, and interest
- Receipts from the sale of securities or other investment instruments

- Receipts from the sale of telecommunication services
- Receipts from live radio or television programming⁶⁵

Exceptions to the above generalization are the various sales of telecommunication services,⁶⁶ which largely reflect the industry’s capability in tracing the service. The rules also contain a general rule for receipts that have not been specifically addressed, requiring that the receipts be sourced based on where the benefit to the customer is received, or, if that cannot be determined, the customer’s location.⁶⁷ A number of the provisions have similar default sourcing rules if the first sourcing rule cannot be determined.

One constitutional question is whether a single sales factor itself is constitutional. Though a single sales factor apportionment increases the tax for businesses with less physical presence and generally less business activity in the state, the United States Supreme Court approved of a single sales factor in *Moorman Manufacturing Co v Bair*,⁶⁸ concluding that a single sales factor was not “inherently arbitrary” and “did not produce an unreasonable result.” However, the MBT single sales factor apportionment may present some additional questions. One issue may be the disparity between the significant number of site-based credits given to businesses with a significant physical presence in the state but utilizing a different measure of business activity to apportion the tax base. Another similar issue may be the difference that exists between the income and receipts in the MBT tax base and the MBT’s definition of sales used as a basis for apportionment.⁶⁹ The MBT defines “sales” in part to be:

the amounts received by the taxpayer as consideration from...[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. For intangible property, the amounts received shall be limited to any gain received from the disposition of that property....⁷⁰

By contrast, the definition of “sales” excludes income/receipts from isolated transactions and excludes income/receipts from trans-

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actions that are not functionally related to the taxpayer's trade or business. The same income and receipts are included in the tax base but not included in the apportionment factor.⁷¹ It is unclear, particularly in the instance of large out-of-Michigan asset sales, liquidations, and mergers or acquisitions, whether this narrow apportionment scheme is reasonable.

Another issue concerns the treatment of the unitary business group. A unitary business group is required to include the sales in Michigan of every person included in the unitary business group without regard to whether the person has nexus in this state.⁷² The obvious question this raises is whether it is constitutional to include as Michigan sales, sales made by a member of the unitary business group, even though the member has no nexus with Michigan. Is the MBT taxing income and receipts that would not otherwise be taxed?

While this method of unitary apportionment has been litigated in other states, most notably California,⁷³ most states have three-factor formulary apportionment schemes (property, payroll, and sales); that is to say, that even if the sale factor "overstated" the taxable sales in the state, the lack of a property or payroll in the state would have "dampened" extent of the purported "overstatement." Coupled with the MBT's aggressive nexus standard, these issues may suggest that the MBT's single sales apportionment factor, even under *Moorman*, has produced an "unreasonable result."

The MBT's alternative apportionment provisions may ultimately be the method of resolving these questions.⁷⁴ If the Department of Treasury determines that the apportionment provisions of the act do not "fairly represent the taxpayer's business activity in this state," the Department of Treasury is authorized to "use any other method" that will achieve an "equitable allocation and apportionment of the taxpayer's tax base."⁷⁵ The alternative apportionment provision leaves much to the Department of Treasury's discretion.

Credits

In General

One goal underlying the MBT was to attract jobs to Michigan, particularly in research and development and manufacturing. To achieve this goal, the MBT provides a number of tax credits that reduce the tax liability for quali-

fying taxpayers and addresses common complaints regarding the SBT: the compensation credit, the personal property tax credit, the "phase in" credit, and changes to the small business credit.

The calculation of credits is made after allocation and apportionment and the surcharge. There is an order in which the credits may be taken. The largest three credits (compensation, net investment, and research and development) are all new under the MBT and must be taken before any other credits.⁷⁶ The compensation and net investment credits, together, are capped at 50 percent of the taxpayer's total liability after the surcharge. The cap increases to 52 percent in 2009.⁷⁷ The cap also rises to 65 percent of the taxpayer's liability with the inclusion of the third credit for research and development.⁷⁸ After the three large credits, the taxpayer must take the Alternate (formerly Small Business) Credit.⁷⁹ Thereafter the taxpayer may take a "phase-in" credit, which was created for the purpose of providing a gradual increase of the MBT for those small MBT taxpayers that are just over the \$350,000 filing threshold but under \$700,000.⁸⁰ Other credits may then be taken.

Most of the credits have a lower rate for the 2008 tax year, again the result of the surcharge tax and the effort to resolve the state's budget crisis. For 2009 and subsequent tax years, the rate for most credits increase. The MBT permits any unused SBT credit carry-forwards to be taken in the 2008 and 2009 tax years. Thereafter, the SBT credit carry-forwards are extinguished⁸¹ with the exception of two SBT credits: the Michigan Historic Preservation Credit and the Brownfield Credits.⁸² The credits are generally, with a few exceptions (personal property tax credit and the disability act credit) not refundable.

New Credits

Compensation Credit

For the 2008 tax year, taxpayers may claim a credit of 0.296 percent of the "taxpayer's compensation in this state" against their MBT liability.⁸³ The credit increases to 0.37 percent for the 2009 tax year and afterwards. The MBT retains, for the most part, the SBT's definition of "compensation." There is no definition for determining the phrase "in this state." Professional employer organizations (PEO) are not excluded from this credit, but are limited to the compensation paid to their own officers and employees who operate the PEO. The PEO may not claim the compensa-

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tion paid to the leased officers and employees of the client.⁸⁴

*Net Investment Credit*⁸⁵

The MBT permits taxpayers to claim a credit for the cost to acquire tangible assets “physically located in this state for use in a business activity in this state” and for “mobile tangible assets” that are “transferred into the state and purchased or acquired for use in a business activity.” The costs include fabrication and installation but are netted against the gross proceeds from the sale or disposition of similar property. The rate for 2008 is 2.32 percent. For 2009 and thereafter, the rate increases to 2.9 percent.

*Research and Development Credit*⁸⁶

Taxpayers may claim a credit for “research and development expenses in this state.” The phrase “research and development expenses” references IRC 41(b), which covers wages, supplies, and computer licenses for both “in-house” and “contract” research. For the 2008 tax year, the credit is 1.52 percent but increases in 2009 to 1.9 percent. Combined with the other credits—compensation and net investment—this credit is capped at 65 percent.

*The Alternate (formerly Small Business) Credit*⁸⁷

The SBT’s small business credit⁸⁸ became a focal point for tax planning, in which different entities were created to disperse income and compensation and thus avoid the small business credit’s income and compensation disqualifiers. The Department of Treasury was not successful in combining non-Michigan parent companies with a Michigan subsidiary seeking the credit.⁸⁹

Since the entire unitary business group constitutes a “taxpayer,” the group must meet the income, gross receipts, and compensation tests. The threshold for those three tests has increased. The gross receipts maximum is now \$20 million. “Adjusted business income” (“business income” with the addition of compensation and fees of active shareholders and losses) has been increased to \$1.3 million. The maximum single officer or shareholder compensation is now set at \$180,000. Like the compensation credit, PEO clients must include, in the calculation of the credit, compensation and fees of the client’s officers, owners, or shareholders even if they are leased from the PEO. The SBT attribution rules to determine “active shareholders” and

“shareholder” for the SBT will likely continue to be used to determine these same, nearly identical terms, in the MBT.

*Phase-In Credit*⁹⁰

A criticism of the SBT was that once a taxpayer exceeded the \$350,000 filing threshold—by as little as a dollar—the taxpayer paid the full amount of the SBT. The MBT phases in the tax for those taxpayers with gross receipts between \$350,000 and \$700,000. The “phase in” credit is calculated by multiplying the MBT liability by a fraction, the numerator of which is the difference between the taxpayer’s apportioned gross receipts and \$700,000 and the denominator of which is \$350,000.

*MEGA Approved Research and Development Credit*⁹¹

This credit is different in several respects from the more general research and development credit. First, it is very targeted. The credit applies to “eligible taxpayers” who must propose to work with an “eligible business” and invest no less than \$350,000 in the business. Further, the taxpayer must not have received the credit in the previous year. An “eligible business” is generally a small business of less than 50 employees and less than \$10 million in gross receipts. Second, the credit is equal to 30 percent of the taxpayer’s “eligible contribution” but is capped at \$300,000. Third, the taxpayer must first obtain a certificate from the Michigan Economic Growth Authority, which may only grant 20 credits a year.

*Entrepreneurial Credit*⁹²

For the 2008 through 2010 tax years, qualified businesses that create or transfer new jobs into the state are able to claim a 100 percent credit against an adjusted tax liability (which is the taxpayer’s total tax liability multiplied by a fraction of the payroll due to increased jobs and the taxpayer’s total payroll in the state). To qualify, the taxpayer may not be a retail establishment (though some small restaurants are permitted), must have less than \$25 million in gross receipts, make a capital investment of not less than \$1.25 million in the state, and create or transfer to Michigan 20 or more jobs.

*Personal Property Tax Credit*⁹³

In late 2005, the Michigan Legislature added a refundable personal property tax credit of 15 percent for taxes levied and paid on industrial personal property in the tax year.⁹⁴

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The MBT increased the credit to 35 percent of the taxes paid on industrial personal property. Together with the exemption from the 6-mill state education tax and the 18-mill local school property tax, industrial personal property would realize an average effective personal property tax reduction of 64.9 percent. Credits for eligible telephone personal property (23 percent), and eligible natural gas pipeline property (13.5 percent) were also provided. No credit was provided for commercial personal property.

To qualify for this credit, the taxpayer must have filed a personal property tax statement by February 20 of the tax year and have paid the personal property tax before claiming the credit on the taxpayer's annual MBT return. The Department of Treasury will likely require proof of timely filing and of payment. An important consideration is that the personal property must be classified as industrial, as opposed to commercial personal property. To appeal classifications, the taxpayer must appeal to the March Board of Review and, if not satisfied, to the State Tax Commission.

*Arts and Culture Charitable Credit*⁹⁵

The MBT provides a credit to taxpayers that make a charitable contribution of at least \$50,000 to art, historical, or zoological institutes and other museums that "care, study and display...objects of lasting interest or value." This last phrase, the Department of Treasury has determined, is a "facts and circumstances" test.⁹⁶ The credit is equal to 50 percent of the amount that exceeds the threshold of \$50,000.

Industry-Specific MBT Credits

Various other credits are provided to specific industries, such as, retail enterprises headquartered in Michigan with specified square feet of retail space,⁹⁷ motor sports complexes,⁹⁸ and motor vehicle dealer inventory.⁹⁹

SBT Credits Retained in the MBT

In addition to the Renaissance Zone Credit and the Brownfield Credit, the MBT retains a number of SBT credits, such as: an Early Stage Venture Credit,¹⁰⁰ a Start-up Business Credit,¹⁰¹ Next-Energy Credit,¹⁰² MEGA Credits,¹⁰³ Charitable Contribution Credits,¹⁰⁴ Foundation Contribution Credit,¹⁰⁵ Food Bank and Homeless Credit,¹⁰⁶ and Disability Compensation Credit.¹⁰⁷

With taxes, the line between encouraging economic growth and discriminating against

nonresident businesses is thin. Undeniably, the MBT credits favor businesses with substantial investments in plants and personnel in the state. On the other hand, the constitutional law in this area has not yielded predictable results. A challenge to the MBT's site-based tax scheme as unconstitutional continues litigation that has never found success in Michigan.¹⁰⁸ While the Michigan cases do not comfortably fit within the broad language of a number of United States Supreme Court decisions,¹⁰⁹ the interpretation of that jurisprudence is also debated. The United States Supreme Court's reversal of the Sixth Circuit Court of Appeals decision in *Cuno*, which invalidated a site-based state credit for machinery and equipment on jurisdictional grounds, leaves the area unsettled.¹¹⁰

Filing and Administration

Taxpayers that expect an annual liability exceeding \$800 are required to file estimated returns and pay the tax for each quarter.¹¹¹ For calendar year filers, those due dates are April 15, July 15, October 15, and January 15. Fiscal year filers must file estimated returns "on the appropriate due date which in the taxpayer's fiscal year corresponds to the calendar year."¹¹² This is the 15th day of the first month of each quarter. The return form will contain both BIT and modified gross receipts taxes. No underpayment interest will be assessed if the estimated payment for the month is at least 85 percent of the liability.¹¹³ The Department of Treasury anticipated mailing quarterly estimated Michigan Business Tax forms this January, and it has provided an "MBT Estimator" on its Web site (<https://treas-secure.state.mi.us/MBTEstimator/MBTEstimator-start.asp>) to assist taxpayers.

Annual returns are due on the last day of the fourth month after the end of the taxpayer's tax year, or, if the taxpayer is a calendar year filer, April 30.¹¹⁴ As with the SBT, an extension for filing the federal income tax return does not extend the time for filing and paying the MBT return unless the taxpayer takes several specific steps including, filing a copy of the request for extension with a tentative return and payment of the estimated tax by the due date for filing the annual return. The extension will be "automatic" to the last day of the eighth month following the original due date.¹¹⁵ Also like the SBT, a longer extension may be available "for cause," provided the taxpayer files a timely application

and pays the remaining unpaid estimated tax liability.¹¹⁶ For the 2008 fiscal year, fiscal year filers with years ending in 2008 will be granted an automatic extension for their annual fiscal year MBT return, which will be due the same date as the return for calendar year filers, April 20, 2009. At the option of the taxpayer, SBT overpayments from the final SBT return may be carried forward and applied to the MBT or refunded.¹¹⁷

Special provisions address taxpayers whose tax year is less than 12 months.¹¹⁸ The MBT gives such taxpayers an election to either:

- Compute the tax as if it were effective on the first day of the taxpayer's accounting period and apportion the tax by a fraction the numerator of which is the number of months in the taxpayer's first year and the denominator of which is 12; or,
- Compute the tax base by a method approved by the Department of Treasury.

Unitary business groups are required to file a "combined return." A combined return includes the income and receipts for all firms other than foreign operating entities, but it eliminates transactions between members of the group from the business income tax base, the modified gross receipts tax base, and the apportionment formula.¹¹⁹ Though it is unclear how Michigan will apportion for unitary groups, since typically the total income and receipts sourced to taxing state for the unitary business group are determined by the unitary group's apportionment factor. From the group's sourced income and receipts, each member then is apportioned an amount that represents the ratio of the member's apportionment factor to the groups apportionment factor. Thus, while members included within the unitary business group that lack nexus with Michigan will not be taxed, other members of the group with nexus will be paying a greater portion of the unitary business group's tax.

Conclusion

The discussion thirty years ago after the SBT was passed is similar to the public discussion over the past year.¹²⁰ Like the SBT then, the MBT in its present form is merely a starting point. A good part of the MBT's further development, and there will be development, has been left to tax professionals. That there are a number of constitutional ques-

tions concerning the MBT is not necessarily a critique of the policy makers and legislators that crafted the MBT. In some respects, it may illustrate that the state's experience with the SBT produced an institutional knowledge such that the state was willing to put down markers for the constitutional litigation that will follow. From that standpoint, the tax has gone where no other state has, fully aware of the potential challenges, but compelled to address important policy questions. At this time, judgments as to the tax's success may be premature. More probably, the extent to which the MBT is a success now depends on the work of tax professionals. There is a lot to do.

NOTES

1. 2007 PA 36, adding MCL 208.1101 et seq.
2. In lieu of the MBT, insurance companies are subject to a direct premiums tax and financial institutions are subject to a franchise tax on net equity capital. Both taxes are separate from a general business tax, the MBT.
3. MCL 208.1201.
4. MCL 208.1203.
5. MCL 208.1281, *et seq.*; Chapter 2C; 2007 PA 145. A surcharge is also imposed on franchise taxpayers. There is no surcharge imposed on insurance companies. The primary purpose of the surcharge was to close a budget deficit that resulted from repeal of state's short-lived (four hours) service tax (2007 PA 93).
6. MCL 208.1281(1)(a).
7. The Department planned to send them the required tax returns in January 2008. Michigan Business Tax Frequently Asked Questions, A 10.
8. MCL 208.1505(1).
9. MCL 208.1117(5).
10. MCL 208.6(1) "Person" means an individual, firm, bank, financial institution, limited partnership, copartnership, partnership, joint venture, association, corporation, receiver estate, trust, or other group or combination acting as a unit.
11. MCL 208.1113(3).
12. MCL 208.1109(5) "Foreign operating entity" means a United States person that satisfies each of the following:
 - Would otherwise be part of a unitary business group that has at least 1 person included in the unitary business group that is taxable in this state.
 - 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.
 - At least 80% of its income is active foreign business income as defined in section 861 (c) (1) (B) of the internal revenue code.
13. Michigan Business Tax Frequently Asked Questions, U6, U8.
14. 445 US 425, 100 S Ct 1223, 63 L Ed 2d 510 (1980).
15. 463 US 159, 103 S Ct 2933, 77 L Ed 2d 545 (1983).
16. Michigan Business Tax Frequently Asked Questions, U8.

17. Michigan Business Tax Frequently Asked Questions, C5, U11, U18.
18. MCL 208.1207(1)(a)
19. MCL 208.1207(1)(b)(i).
20. MCL 208.1207(1)(c)-(h).
21. *Burger King v Rudzewicz*; 471 US 462, 105 SCt 2174; 85 LEd 2d 528 (1985).
22. *Gillette Co v Dept of Treas*, 198 Mich App 303, 497 NW2d 595 (1993).
23. *Guardian Industries v Dept of Treas* 198 Mich App 363, 499 NW2d 349 *lv app den* 444 Mich 943, 512 NW2d 846 (1994).
24. See, Gandhi, *International Home Foods, Inc.: A Final Determination of the Retroactive Application of Michigan's Single Business Tax Nexus Standards*, Michigan Tax Lawyer, XXXIII, No. 1, Winter, 2007.
25. *Syntax v Dept of Treas.*, 233 Mich App 286, 590 NW2d 612 (1998).
26. ¹ *MBNA America Bank v Tax Comm'r of West Virginia*, 640 SE2d 226 (W Va S Ct, 2006), *cert den*; *FLA Card Services v Tax Comm'r of West Virginia*, 127 S Ct 2997 (2007); *Lanco, Inc v Director, New Jersey Div of Taxation*, 879 A2d 1234 (NJ Super Ct App Div, 2005), *cert den* 127 S Ct 2974 (2007); *A&F Trademark, Inc v North Carolina*, 605 SE2d 187 (NC Ct App, 2004), *cert den* 546 US 821 (2005); *Geoffrey, Inc v So Carolina Tax Comm'n*, 437 SE2d 13 (1993), *cert den* 114 S Ct 550;
27. MCL 208.1200(1).
28. MCL 208.1200(3).
29. Michigan Business Tax Frequently Asked Questions, N2 (referencing RAB 1998-1).
30. MCL 208.1200(2).
31. Rev Admin Bulletin 2007-6.
32. Michigan Business Tax Frequently Asked Questions, N2.
33. Michigan Business Tax Frequently Asked Questions, N3.
34. MCL 208.1201.
35. MCL 208.1201(1).
36. MCL 208.1201(2).
37. 26 USC 482. "Allocation of income and deductions among taxpayers. In any case of two or more organizations, trades, or businesses (whether or not incorporated, whether or not organized in the United States, and whether or not affiliated) owned or controlled directly or indirectly by the same interests, the Secretary may distribute, apportion, or allocate gross income, deductions, credits, or allowances between or among such organizations, trades, or businesses, if he determines that such distribution, apportionment, or allocation is necessary in order to prevent evasion of taxes or clearly to reflect the income of any of such organizations, trades, or businesses...."
38. MCL 208.1201(2)(f).
39. The definition of "business income," MCL 208.1105 (2), reduces the effect of compensation somewhat indirectly. The definition of "business income" captures that part of federal taxable income derived from "business activity." The later definition excepts, "services rendered by an employee to his or her employer or services as a director of a corporation." MCL 208.1105(1).
40. MCL 208.1201(2)(h).
41. MCL 208.1201(3).
42. MCL 208.1105(2).
43. *Allied-Signal, Inc. v Director of Division of Taxation*, 504 US 768; 112 SCt 2251; 119 L Ed 2d 533 (1992).
44. MCL 208.1105 (1) "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, 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.
45. The Uniform Division of Income for Tax Purposes Act (UDITPA) MCL 205.581, Art. IV (1) (a). "Business income" means income arising from transactions and activity in the regular course of the taxpayer's trade or business and includes income from tangible and intangible property if the acquisition, management and disposition of the property constitute integral parts of the taxpayer's regular trade or business operations.
46. MCL 208.1105(2).
47. Recent federal court decisions suggest that family limited partnerships must serve a legitimate business purpose to be excluded from the value of the gross estate for federal estate and gift taxes. See *Estate of Thompson v Commissioner*, 382 F3d 367 (3rd Cir. 2004) and *Estate of Strangi v Commissioner*, 417 F3d 468 (5th Cir. 2005).
48. *Stratton-Cheeseman Management Co v Dept of Treas*, 159 Mich App 719, 407 NW2d 398 (1987); *Systems Parking, Inc. v Dept of Treas*, MTT No. 91346 (1988); *Credit Acceptance Corp v Dept of Treas*, MTT No. 204459 (1997); 236 Mich. App. 478, 601 NW2d 109 (1999), *app den* 462 Mich 865, 616 NW2d 686; *PM One, Ltd, v Dept of Treas*, 240 Mich App 255, 611 NW2d 318 (2000).
49. MCL 208.1111(1) (q)-(v).
50. MCL 208.1111(1) (a)-(p). See also subsection 7(3) of the Single Business Tax Act (SBTA), MCL 208.7(3).
51. MCL 208.1111(1).
52. MCL 208.1111(1) (q)-(s).
53. MCL 208.1111(1) (t).
54. MCL 208.1111(1)(v).
55. Recent federal court decisions suggest that family limited partnerships must serve a legitimate business purpose to be excluded from the value of the gross estate for federal estate and gift taxes. See *Estate of Thompson v Commissioner*, 382 F3d 367 (3rd Cir. 2004) and *Estate of Strangi v Commissioner*, 417 F3d 468 (5th Cir. 2005).
56. MCL 208.1111(1)(v).
57. MCL 208.1203 (3).
58. MCL 208.1113 (6).
59. Michigan Business Tax Frequently Asked Questions, M7, M9.
60. MCL 208.1203 (4).
61. *Id.*
62. MCL 208.1301.
63. MCL 208.1303(1).
64. Michigan Business Tax Frequently Asked Questions, Ap3.
65. MCL 208.1305.
66. MCL 208.1305(13).
67. MCL 208.1311.
68. 437 US 267, 98 S Ct 2340, 57 L Ed 2d 197 (1978).
69. MCL 208.1115.
70. MCL 208.1115(1).
71. Michigan Business Tax Frequently Asked Questions, Ap1.
72. MCL 208.1303 (2). The group is also required to eliminate sales between members of the unitary business group.
73. *Appeal of Huffey Corp*, Cal St Bd of Equal, April 22, 1999; *Appeal of Finnegan Corp* Cal St Bd of Equal, August 25, 1988; *Appeal of Joyce, Inc* Cal St Bd of Equal,

Nov. 23, 1966; See also, *Great Northern Nekoosa Corp v State Tax Assessor*, 675 A2d 963 (1996); *Dover Corp v Dept of Rev* 648 NE2d 1089 (1995).

74. MCL 209.1309.

75. In *Jones & Laughlin v Dept of Treas*, 145 Mich App 405, 377 NW2d 397 (1985) *lv den* 424 Mich 895 (1986), the Court of Appeals upheld a finding that where a taxpayer's apportioned compensation under the SBT exceeded the taxpayer's actual compensation in Michigan by more than 50% that the apportionment was not fair.

76. MCL 208.1403(1).

77. *Id.*

78. MCL 208.1405.

79. MCL 208.1417.

80. MCL 208.1411.

81. MCL 208.1401.

82. MCL 208.1435, .1437.

83. MCL 208.1403 (1).

84. MCL 208.1403 (2)

85. MCL 208.1403(3).

86. MCL 208.1405

87. MCL 208.1417.

88. MCL 208.36.

89. *Alameda Gage Corp v Dept of Treas*, 159 Mich App 693, 407 NW2d 61 (1987).

90. MCL 208.1411.

91. MCL 208.1407.

92. MCL 208.1441.

93. MCL 208.1413.

94. 2005 PA 289.

95. MCL 208.1422.

96. Michigan Business Tax Frequently Asked Questions, C15.

97. MCL 208.1449.

98. MCL 208.1409.

99. MCL 208.1445.

100. MCL 208.1419.

101. MCL 208.1415.

102. MCL 208.1429.

103. MCL 208.1431.

104. MCL 208.1422.

105. MCL 208.1425.

106. MCL 208.1427.

107. MCL 208.1423.

108. *Caterpillar, Inc v Dept of Treas*, 440 Mich 400, 488 NW2d 182 (1992); *Jefferson Smurfit Corp v Dept of Treas*, 248 Mich App 271, 639 NW2d 269 (1999); *Dana Corp v Dept of Treas*, 267 Mich App 690, 706 NW2d 204 (2005).

109. *Armco, Inc v Hardesty*, 467 US 638, 104 S Ct 2620, 81 L Ed 2d 540 (1984); *Tyler Pipe Industries, Inc v Washington Dept of Rev*, 483 US 232, 107 S Ct 2810, 97 L Ed 2d 199 (1987); *West Lynn Creamery, Inc v Healy*, 512 US 186, 114 S Ct 2205, 129 L Ed 2d 157 (1994).

110. *Cuno v DaimlerChrysler*, 386 F3d 738 (CA 6, 2004) *lv app den* 126 S Ct 2286 (2006).

111. MCL 208.1501.

112. MCL 208.1501 (2).

113. MCL 208.1501 (4) (a).

114. MCL 208.1505 (1).

115. MCL 208.1505 (4).

116. MCL 208.1515(3).

117. Michigan Business Tax Frequently Asked Questions, A16.

118. MCL 208.1503.

119. MCL 208.1511.

120. *Symposium on the Single Business Tax*, 22 Wayne L R 1017-1213 (1976); Getz, *Questions and Answers on the Michigan Single Business Tax: A Review*, Det. C. L. R 489 (1976).



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