



Michigan Business Tax Update

A Review of the MBT after the First Filing Season



By Wayne Roberts

Introduction

On April 30, 2009, business taxpayers faced a new reality in Michigan: for the first time in 30 years, no Michigan Single Business Tax (SBT) return was due. The SBT and its hated Form C-8000 were gone. The new Michigan Business Tax (MBT) and Form 4567 ushered in a new era in Michigan taxation that creates new challenges for taxpayers and tax preparers. One early accomplishment of the MBT has been its efficient replacement of the SBT as arguably the most misunderstood and hated tax in the state.

Comprehensive articles have analyzed the details of the MBT;¹ this article is not intended to be another. Instead, this article focuses on some of the specific issues Michigan attorneys should understand, including complexities related to the new MBT nexus standard, Michigan's new "unitary business" concept, and certain

business and estate planning considerations regarding choice-of-entity concerns. Before exploring these complex areas, however, it is important to begin with a basic overview of the MBT. The table on the following page provides the basic MBT structure in a user-friendly format and includes citations both to the governing law and to available resources that expand on each topic.

Overview of the MBT: The Structure of the MBT Effective in 2009

The MBT is included in a single tax act that contains four entirely separate component taxes along with a fifth tax applicable to a "small business" as that term is defined under the MBT Act.²

Fast Facts:

- In analyzing and planning for the MBT, many taxpayers will benefit from evaluating whether their structures are tax efficient under the new law.
- The MBT is significantly different from Michigan's prior SBT with respect to its adoption of required combined filing for certain groups of persons under common control.
- The Michigan Department of Treasury's Revenue Administrative Bulletin did not have authority to adopt federal check-the-box regulations and treat a separate SBT taxpayer as a disregarded entity.

The table below provides a summary of key elements of each separate MBT Act tax.

Regardless of which component tax applies in a given situation, the net total tax liability becomes the taxpayer's "MBT liability" for the tax year. For taxpayers other than financial institutions and insurance companies, this MBT liability generally will be the sum of the BIT and the MGRT, plus the surcharge. For a small business that is not a financial institution or an insurance company, the MBT liability generally will be limited to the 1.8 percent small business income tax, with no surcharge. Financial institutions and insurance companies are exempt from the BIT and the MGRT and are subject only to industry-specific taxes.¹⁵

Economic Nexus: The MBT Applies an Aggressive Nexus Standard to Non-Michigan Businesses

The concept of Michigan tax "nexus" refers to the minimum connection that a non-Michigan business must have with Michigan before the state can exercise tax jurisdiction over the non-Michigan entity's business activities. Under the SBT, a non-Michigan business had nexus and was subject to the SBT if it had some physical presence such as an office or an employee or independent sales representative in Michigan during the tax year.¹⁶ Under the MBT, a non-Michigan business will have nexus and be subject to the MBT if it has either (1) physical presence for more than one day during the tax year or (2) gross receipts apportioned to Michigan¹⁷ of at least \$350,000 and actively solicits sales in Michigan.¹⁸

The Michigan Department of Treasury (the Department) defined "actively solicits" to include activities such as radio and television advertising, direct mail solicitation, and other types of economic activities that do not require any physical presence in Michigan.¹⁹ Therefore, economic presence coupled with at least \$350,000 in Michigan sales creates nexus for purposes of the MBT. Because the BIT (and potentially the alternative small business tax) is an income tax, however, federal law specifically precludes a purely economic presence standard.²⁰ As a result, it is possible for a non-Michigan company that solicits sales in Michigan to be subject to the MGRT portion of the MBT but be exempt from the BIT.

Tax	Tax Base	Rate	Surcharge ³	Effective Rate	Apportionment
Business income tax (BIT) ⁴	Federal taxable income, as adjusted for MBT, apportioned to Michigan	4.95%	21.99% \$6M cap	6.0385%	100% sales ⁵ $\frac{\text{MI sales}}{\text{Total sales}}$
Modified gross receipts tax (MGRT) ⁶	Gross receipts less "purchases from other firms," apportioned to Michigan	0.8%	21.99% \$6M cap	0.976%	100% sales ⁷ $\frac{\text{MI sales}}{\text{Total sales}}$
Financial institution (FI) franchise tax ⁸	Net capital computed in accordance with generally accepted accounting principles (GAAP) less certain adjustments ⁹	0.235%	2008—27.7% 2009—23.4% No cap	0.300095% 0.28999%	Gross business factor ¹⁰ $\frac{\text{Gross Michigan FI business}}{\text{Total gross FI business}}$
Insurance company premiums tax ¹¹	Gross direct premiums written on Michigan property or risk	1.25%	N/A no surcharge	1.25%	Michigan risk ¹²
Alternate small business tax ¹³	Adjusted business income	1.8%	N/A no surcharge	1.8%	100% sales ¹⁴ $\frac{\text{MI sales}}{\text{Total sales}}$



Mandatory Unitary Combined Filing

The MBT is significantly different from the SBT with respect to its adoption of required combined filing for certain groups of persons under common control. The SBT was a separate company tax; in fact, under the SBT, combined filing was allowed by permission only and taxpayers often had to work very hard to obtain permission to file combined returns. The MBT uses the opposite approach and requires a combined return for any group of taxpayers if (1) the taxpayers are owned more than 50 percent by one person (the ownership test) and (2) there is a flow of value between or among the taxpayers (the relationship test).²¹

The Department has informally indicated that it will presume a unitary relationship in cases in which only the ownership test is satisfied. Therefore, whenever individuals, trusts, partnerships, and other entities are owned more than 50 percent by a common parent, they are exposed to an assertion that a unitary combined return is required. Michigan's unitary approach applies to groups of persons that do business and are located exclusively in Michigan; it could also apply to certain estate planning structures that typically would not be considered business taxpayers. This approach is a clear departure from traditional unitary theory, which was created to address multistate business operations or assets.

Despite the general aversion to a required "unitary" combined return, however, there are situations in which a unitary filing can reduce the overall MBT liability. Therefore, in analyzing and planning for the MBT, many taxpayers will benefit from an evaluation of whether their structures are tax efficient under the new law. Although there may be exceptions, prior SBT structures generally are not efficient under the MBT.

Choice of Entity: Will a Corporate Structure Be Respected under the MBT?

Many business structures in Michigan use disregarded entities, including LLCs, grantor trusts, and qualified subchapter S subsidiaries (QSSSs). Under federal law, such entities are disregarded for federal income tax purposes such that their income, loss, assets, liabilities, and tax attributes are deemed to belong directly

to the sole member, grantor, or shareholder. Moreover, much prior planning under the SBT and current planning under the MBT has relied on administrative guidance under both the SBT²² and the MBT²³ that Michigan tax classification generally will conform to federal entity classification under federal check-the-box regulations. A great deal of this planning may need to be re-evaluated. In a recent decision in the *Kmart Michigan Property Services, LLC v Dep't of Treasury*²⁴ case, the Michigan Court of Appeals generally held that, based on the SBT Act definition of the term "person," a single-member LLC that was disregarded for federal income tax purposes was a separate SBT taxpayer and that the Department's Revenue Administrative Bulletin did not have authority to adopt federal check-the-box regulations and treat a separate SBT taxpayer as a disregarded entity.

The MBT, like the prior SBT, is an entity-level tax that is imposed on a "person" with nexus in Michigan. Importantly, "person" is defined broadly under the MBT, using a definition similar to the SBT Act's definition, to include any corporation, partnership, limited liability company, trust, estate, individual, or any "group or combination" of groups acting as a unit.²⁵ Accordingly, although the Department has issued informal guidance indicating that federally disregarded entities will be disregarded under the MBT, taxpayers are advised to temper their reliance on these frequently asked questions. A better approach is to carefully review the MBT Act definition of person and the Court of Appeals holding in *Kmart* and to perform an independent analysis of each particular corporate structure.

MBT Taxation of Similarly Situated Taxpayers: Choice of Entity Traps

Typically, the S corporation and the multiple-member LLC are considered to be comparable entities with respect to their tax treatment. This is largely because, generally, S corporations and multiple-member LLCs are taxed for federal income tax purposes as flow-through entities.²⁶ Notwithstanding these similarities under federal law, the MBT's impact on a business could vary materially depending on whether the business is operated as an S corporation or an LLC. Consider the example below:

Entity (actuarial services firm)	Modified Gross Receipts	Business Income	Comp/Wages	Distributions (partnership or S corp non-wage distributions)	Est. MBT Liability
S Corporation	\$21M	\$10M	\$8M	\$2M	\$325,730
LLC	\$21M	\$10M	N/A all p/s distribution	\$10M	\$204,960



This somewhat simplistic example may magnify the disparity, but it serves to illustrate one significant anomaly in the MBT Act. Because an LLC is allowed a deduction for federal self-employment earnings and an S corporation is not, a personal services firm typically will incur additional MBT costs if it operates as an S corporation.²⁷

Conclusion

The MBT remains in its infancy—statutory amendments, additional administrative guidance, and MBT disputes are likely in the near future. As 2009 passes, Michigan attorneys should be aware of not only the basic structure of the tax, but also current issues such as the impact of Michigan's new nexus standard on non-Michigan companies, the potential impact of unitary combined filing requirements on both Michigan and non-Michigan businesses, the uncertainties surrounding whether the MBT follows federal entity classification, and the disparate MBT treatment of different types of entities such as S corporations. ■



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FOOTNOTES

1. See Grob & Roberts, *The Michigan Business Tax Replaces the State's Much-Vilified SBT*, 17 JMT 8 (October 2007); Grob & Roberts, *Michigan Business Tax Update: Significant Amendments Enacted as the New MBT Goes Into Effect*, 18 JMT 16 (March/April 2008).
2. MCL 208.1417 (a "small business" is a business that has no more than \$20M in gross receipts, no more than \$1.3M in business income, and officer/shareholder/member compensation of no more than \$180,000; the alternative tax on a small business is calculated by using a credit equal to the amount necessary to reduce the total MBT liability to 1.8 percent of adjusted business income).
3. MCL 208.1281, PA 145 of 2007, which was enacted December 1, 2007, repealed the short-lived Michigan use tax on services and imposed in its place a "temporary" MBT surcharge on specified MBT liabilities.
4. MCL 208.1201.
5. MCL 208.1303.
6. MCL 208.1203.
7. MCL 208.1303.
8. MCL 208.1263.
9. MCL 208.1265(1).
10. MCL 208.1267(3).
11. MCL 208.1235.
12. MCL 208.1235(2).
13. MCL 208.1417.
14. MCL 208.1303.
15. See Grob & Roberts, *The Michigan Business Tax: In lieu of taxes applicable to financial institutions and insurance companies*, 53 Wayne L R 1499 (2007) (the detailed provisions applicable to financial institution and insurance company taxation under the MBT are beyond the scope of this article).
16. RAB 1998-1 (February 24, 1998).
17. No provision in the MBT Act defines how "gross receipts" must be "apportioned" to Michigan for this purpose; only "sales" are apportioned under the MBT Act.
18. MCL 208.1200(1).
19. RAB 2007-6 (December 28, 2007); MCL 208.1200(2).
20. PL 86-272, 73 Stat 555.
21. MCL 208.1117(6).
22. RAB 1999-9 (November 29, 1999).
23. State of Michigan, Michigan Taxes: Michigan Business Tax, *Frequently Asked Question Mi25* <<http://www.michigan.gov/taxes/0,1607,7238-47449-190419--F,00.html>>; *Frequently Asked Question Mi28* <<http://www.michigan.gov/taxes/0,1607,7238-47449-190411--F,00.html>> [accessed November 14, 2009].
24. *Kmart Michigan Property Services, LLC v Dep't of Treasury*, 283 Mich App 647; 770 NW2d 915 (2009).
25. MCL 208.1113(3).
26. 26 USC 1361 et seq.; 26 USC 7701 et seq.
27. MCL 208.1201(h).