

The Death of the MBT: Michigan Enacts a New Corporate Income Tax

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Although the Michigan Business Tax (“MBT”) has been in effect for only three and a half years, on May 25, 2011, Governor Rick Snyder signed into law House Bills 4361, 4362, and 4479, which together repeal the MBT and create a new Michigan tax—the Corporate Income Tax (“CIT”). The CIT, effective as of January 1, 2012, marks a second attempt by the Michigan legislature to replace the despised Single Business Tax with a simpler tax. While most everyone can appreciate the need for greater simplicity—and no one is shedding tears over the death of the MBT—the new tax regime has been met with mixed reviews thus far. This article summarizes the important provisions of the new CIT, options available to certain taxpayers, and comments on the new law.

New Michigan Corporate Income Tax

Enrolled House Bill 4361 (2011 PA 38) revises the personal income tax and creates the new CIT. The CIT provisions are largely similar to the business income tax portion of the MBT. Unlike the MBT, however, which is levied on all businesses, the CIT will be levied only on businesses organized as C corporations or those that elect to be taxed as C corporations for federal income tax purposes. The CIT does not retain any of the tax credits offered under the MBT, with the exception of the alternate tax credit, which applies only to businesses with gross receipts of \$20.0 million or less and adjusted business income of \$1.3 million or less (similar to the small business credit under the MBT). *See* 2011 PA 38 § 671. Insurance companies and financial institutions, which are taxed under separate provisions of the CIT similar to the MBT, are not included in the discussion below.

Taxpayer

Effective January 1, 2012, Michigan imposes a corporate income tax on every taxpayer with business activity within Michigan (or ownership interest or beneficial interest in a flow-through entity that has business activity in Michigan) unless prohibited by Public Law 86-272. *See* 2011 PA 38 § 623. A “taxpayer,” for purposes of the CIT, is a corporation (an entity that is required or has elected to file as a C corporation under the Internal Revenue Code) or a unitary

business group.¹ The CIT retains the MBT's unitary filing requirements for corporations under common control, specifically providing that a unitary business group means:

a group of United States persons that are corporations, insurance companies, or financial institutions, 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 members, and that has business activities or operations which result in a flow of value between or among members included in the unitary business group or has business activities or operations that are integrated with, are dependent upon, or contribute to each other.

2011 PA 38 § 611(6).

All other entities, including S corporations, partnerships, and limited liability companies that do not elect to be taxed as C corporations for federal income tax purposes, are exempt from the CIT. However, flow-through entities with business activity in Michigan may be subject to withholding requirements on the distributive shares of their members' business income. *See* 2011 PA 38 § 703.

Taxpayers with less than \$350,000 in gross receipts allocated or apportioned to Michigan (or whose tax liability under the CIT does not exceed \$100) are not required to file a return or pay taxes under the CIT. *See* 2011 PA 38 § 685(1). The definition of "gross receipts" is substantially similar to the definition under the MBT. *See* 2011 PA 38 § 607(4).

Tax Rate and Base

The CIT is imposed on the tax base at the rate of 6 percent, after allocation or apportionment to Michigan. *See* 2011 PA 38 § 623(1). The CIT base is a taxpayer's "business income," defined as federal taxable income (excluding the effects of IRC §§ 168(k) and 199) subject to certain adjustments.² The business income of a unitary business group is the sum of the business income of each entity included in the unitary business group less any items of income and related deductions arising from transactions, including dividends between entities included in the unitary business group. *See* 2011 PA 38 § 623(3). Taxpayers are entitled to deduct from business income any business losses incurred after December 31, 2011, and may carry forward the losses for 10 taxable years. *See* 2011 PA 38 § 623(4). Losses generated under the business income tax portion of the MBT, however, cannot be deducted against the CIT tax base.

¹ *See* 2011 PA 38 §§ 605(1) (definition of "corporation") and 611(5) (definition of "taxpayer"). Insurance companies and financial institutions are also included in the definition of "taxpayer" but are taxed under separate provisions of the CIT and are not discussed in this article.

² *See* 2011 PA 38 §§ 603(2) (definition of "business income"); 607(1) (definition of "federal taxable income"); 623(2) (provisions regarding tax base, including subtractions and additions to federal taxable income).

Nexus

Except as prohibited by Public Law 86-272, a taxpayer has substantial nexus in Michigan and is subject to the CIT if the taxpayer: (i) has a physical presence in Michigan for more than one day during the tax year; (ii) actively solicits Michigan sales and has gross receipts of at least \$350,000 sourced to Michigan; or (iii) has an ownership interest or a beneficial interest in a flow-through entity, directly or indirectly (through one or more other flow-through entities), that has substantial nexus in Michigan. *See* 2011 PA 38 § 621(1). The term “actively solicits” is to be defined by written department guidance. *See* 2011 PA 38 § 621(2). The term “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. “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 Michigan. *See* 2011 PA 38 § 621(3).

Allocation and Apportionment

The CIT allocation and apportionment mechanics are similar to those of the MBT. For example, the CIT applies the *Finnigan* approach (a member of a unitary group has nexus with the state if any group member has nexus),³ sources services on the basis of the location where the customer received the service benefit, and requires single-sales-factor apportionment. *See* 2011 PA 38 §§ 661–669. Enrolled House Bill 4479 (2011 PA 40) clarifies that beginning on January 1, 2011, multistate companies are not permitted to elect three-factor apportionment under the state’s Multistate Tax Compact provisions. Businesses operating in other states that are subject to the MBT (or the newly created CIT) are now required to allocate and apportion their receipts using single-sales-factor apportionment.

Optional—Exhaustion of Credits Under the MBT

Enrolled House Bill 4362 (2011 PA 39) effectively repeals the MBT but allows taxpayers that have been awarded MBT credits through 2011 to file returns under the MBT rather than the new CIT until the taxpayer’s MBT credit or any carryforward of such credit has been used.⁴ Specifically, 2011 PA 39 amends the MBT Act to provide that beginning January 1, 2012, “taxpayer” will include only a person or unitary business group with a certificated credit that wishes to claim the credit and either is not subject to the new CIT or elects to file under the MBT rather than the new CIT. “Certificated credits” are defined as credits obtained as a result of a taxpayer’s entering into an agreement with the state under the MBT before January 1, 2012. The new law also provides that the MBT Act will be fully repealed once Michigan’s secretary of state receives a written notice from the Department of Treasury that all certificated credits have been exhausted.

³ *Appeal of Finnigan Corp.*, No. 88-SBE-022-A (Cal. State Bd. of Equalization, Jan. 24, 1990).

⁴ *See* 2011 PA 39; *see also* 2011 PA 38 § 680(3) (taxpayers electing to file under the MBT are not required to file annual returns under the CIT).

Commentary

Tax burdens on businesses are expected to drop by 80 percent, with the biggest benefit going to small businesses not organized as C corporations. The net fiscal impact of Enrolled House Bills 4361, 4362, and 4479 is expected to be a reduction in Michigan's revenue of approximately \$535.2 million in fiscal year 2011–12 and \$224.0 million in fiscal year 2012–13.⁵ Governor Snyder, who championed the changes to Michigan's personal and corporate income tax regime as part of his budget, maintains that the new tax regime is “simple, fair and efficient” and will lead to the creation of needed jobs in the state.⁶ Members of the Michigan business community have largely come out in support of the CIT, but it is the voters who may ultimately decide if the CIT has a future as short as the MBT.

Simplicity for Simplicity's Sake

It is fair to say that the CIT is simpler than its predecessors, although the transition to the CIT may be anything but simple for many taxpayers. For example, because eligible taxpayers can elect to file under the MBT until their certificated credits are exhausted, many taxpayers will need to calculate their liability under both the CIT and the MBT to evaluate which method is more favorable. Fiscal-year taxpayers who are subject to the CIT (and do not elect to file under the MBT to exhaust their certificated credits) may need to file a final short-period return under the MBT for the period ending December 31, 2011, and a short-period return under the CIT for the period beginning January 1, 2012.

The transition to the CIT will be even less simple and efficient for the Michigan Department of Treasury. Implementation costs are expected to be “significant” (currently estimated at \$25.0 million) as the Department of Treasury develops forms and policy advice, alters its computer systems, promulgates administrative rules, and trains its people.⁷ Furthermore, the Department of Treasury will be required to administer both the MBT and the CIT concurrently for a number of years.

Aside from the transitional problems, the CIT *is* relatively simple. Simple taxes can be beneficial because they tend to be more predictable and easier to implement. But simplicity alone does not necessarily make a tax better for business or taxing authorities in the long term. Why else are many states moving away from traditional income taxes in favor of the alternatives, such as taxes based on gross receipts? Lest we forget, Michigan had a corporate income tax in the late 1960s and early 1970s, and that didn't work out so well.⁸

⁵ See H.B. 4361, 4362 & 4479 Bill Analysis (Senate Fiscal Agency, May 26, 2011).

⁶ See Governor Snyder Unveils Recommended Budget to Provide Foundation for Michigan's Reinvention, *Michigan Governor's Office Press Release*, Feb. 17, 2011, available at <http://www.michigan.gov/snyder/0,1607,7-277--251733--,00.html> (web sites herein last visited June 12, 2011).

⁷ See H.B. 4361, 4362 & 4479 Bill Analysis (Senate Fiscal Agency, May 26, 2011).

⁸ See *Michigan Business Taxes on the Rocks*, TAX ANALYSTS, Mar. 14, 2011.

Fair to Whom?

Most individual taxpayers in Michigan (*a.k.a.* the voters) will likely disagree with Governor Snyder that the new tax regime is “fair,” given that individual income tax liabilities may actually increase. Although the fiscal impact of the new tax regime is expected to be a reduction in Michigan’s revenue of approximately \$535.2 million in fiscal year 2011–12 alone, that decrease is a net result of a decrease in business tax liabilities of \$1,094.3 million and an increase in individual income taxes of \$559.1 million.⁹ Unpopular changes to the personal income tax include significant reduction of the earned income tax credit for low-income working families, elimination of the dependent child deduction, elimination of most nonrefundable tax credits, phase-out of the personal exemption, and elimination or restriction of pension and retirement exemptions from taxation. *See* 2011 PA 38 §§ 2-532. While Michigan needed to make up for the revenue lost by cutting taxes on businesses, doing so at the expense of individuals has been unpopular with Michigan voters.¹⁰

Job Creation—Without Incentives

While the tax law changes provide significant benefits to businesses in terms of reduced tax liabilities, we don’t yet know whether the reduction in corporate income taxes alone will ultimately lead to significant job creation in Michigan. Businesses located in Michigan may like the simplicity of the new tax code, but one wonders how the lack of tax credits will be viewed once the “certificated credits” under the MBT run out. Not tying the benefit of reduced taxes under the CIT to job creation or business relocation risks putting Michigan at a competitive disadvantage. For example, Wisconsin has recently enacted favorable relocation tax incentives.¹¹ Will companies looking to relocate choose Wisconsin over the credit-less Michigan? Job creation and relocation incentives are popular and plentiful in surrounding states—only time will tell whether Michigan’s “simple” tax code is enough to attract new companies to Michigan or entice existing Michigan companies to create new jobs.

What’s Next?

Given that Michigan has once again enacted a new tax with a short window until it takes effect, many taxpayers are left scrambling to get up to speed in a hurry. There is still a need for guidance from the Michigan Department of Treasury regarding how various provisions of the CIT will be administered and interpreted. For example, questions remain concerning how unitary groups that have members not taxed as C corporations for federal income tax purposes will be treated under the CIT. If Michigan’s economy does not improve in the near term, or if the voters

⁹ *See* H.B. 4361, 4362 & 4479 Bill Analysis (Senate Fiscal Agency, May 26, 2011).

¹⁰ *See Gov. Snyder, 15 GOP Legislators Target of Recall Efforts*, THE DETROIT NEWS, June 9, 2011, available at <http://detnews.com/article/20110609/METRO/106090385/Gov.-Snyder--15-GOP-legislators-target-of-recall-efforts#ixzz1Op5oaJoU>.

¹¹ *See* Wisconsin AB 3. Enacted on January 31, 2011, the new law creates a two-year, nonrefundable income and franchise tax credit for businesses that relocate to Wisconsin. The credit is equal to the amount of the taxpayer’s income or franchise tax liability after all other credits, deductions, and exclusions have been applied.

take their anger out at the ballot box, could we be commenting on a new Michigan tax in another couple of years? Stay tuned!



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