

### Michigan enacts major business tax reform along with other tax changes

Michigan has enacted a major business tax reform package, along with other important tax law changes. On May 25, 2011 Governor Snyder signed Public Act 38 of 2011 (the Act) which repealed the much criticized Michigan Business Tax (MBT). The Act replaces the MBT with a new Corporate Income Tax (CIT).

#### Business taxes

The new Michigan CIT:

- > Applies only to businesses taxed as C corporations under Section 1361 (a)(2) and Section 7701 (a)(3) of the Internal Revenue Code
- > Is imposed on federal net income with modifications at a tax rate of 6 percent
- > Excludes S corporations, limited liability companies, and sole proprietors, which will no longer be subject to Michigan tax at the entity level
- > Is effective Jan. 1, 2012
- > Apportions income using a single sales factor, similar to the MBT
- > Continues to require combined reporting by affiliated companies that conduct a unitary business
- > Does not require companies with Michigan apportioned gross receipts of less than \$350,000 to file a return
- > Opens up eligibility for small business tax credits to corporations with gross receipts of less than \$20 million and income less than \$1.3 million. Additional limits apply based on compensation and director fees paid to individual shareholders and officers. Taxpayers that qualify for the small business tax credit will pay a tax equal to 1.8 percent of business income.
- > Does not provide for any of the other credits previously available under the MBT
- > Contains a provision for a taxpayer to continue filing the MBT to claim certain tax credits. (The election cannot be revoked until the credits expire. Taxpayers that file the MBT to claim certain awarded credits will be required to pay a tax based on the greater of their MBT liability or a modified version of the new CIT.)
- > Must be computed without a deduction for federal bonus depreciation and the domestic production activities deduction
- > Requires fiscal year taxpayers to file a final short-year MBT return ending on Dec. 31, 2011

#### Individuals

The following changes were made to the individual income tax:

- > The tax rate decreases to 4.25 percent from 4.35 percent; starting Jan. 1, 2013.
- > Business income earned by individuals will be apportioned using a 100 percent sales formula, instead of the current equally weighted three factor apportionment formula based on property, payroll, and sales.
- > The exemption for various types of pension and retirement income will be significantly restricted, possibly resulting in many retirees facing higher Michigan personal income taxes.
- > Individuals born after 1945 will not be able to deduct a portion of interest, dividends, and capital gains as under prior law.
- > Nonresident estates and trusts will not receive a credit related to reciprocity agreements with other states.
- > All nonrefundable credits are eliminated, including: (1) the City Income Tax Credit, (2) the Public Contribution Credit, (3) the Community Foundations Credit, (4) the Homeless/Food Bank Credit, (5) the College Tuition Credit, (6) the Vehicle Donation Credit, and (7) the credit for contributions to individual and/or family development accounts.
- > A variety of changes would be made to the Homestead Property Tax Credit, including but not limited to, ending eligibility for the credit for taxpayers if the taxable value of their homestead exceeds \$135,000. The credit will be phased out starting at total household resources of \$41,000 and eliminated once total household resources reach \$50,000.

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These Michigan tax law changes will have a substantial impact on businesses as well as individuals. Many will experience a sizable reduction in their tax burden. Others – such as corporations with large tax credits or certain individuals with retirement income – could see their state tax liabilities go up. It is not too early to start planning for Michigan's dramatically different tax landscape.

**For more information or any questions you might have on this topic, we encourage you to contact your Baker Tilly tax advisor or send an e-mail to [tax@bakertilly.com](mailto:tax@bakertilly.com).**