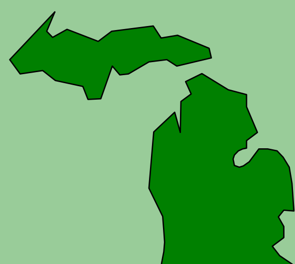
MICHIGAN BUSINESS TAX



Michigan Department of Treasury

FOUR IN ONE

- The Michigan Business Tax (MBT) is actually four taxes in one Public Act. It contains:
- Two general imposition provisions that apply to most business entities, and
- Two special imposition provisions that apply to insurance companies and to financial organizations.

GENERAL IMPOSITION PROVISIONS

- First, a 4.95% tax on a defined business income tax base,

AND

- Second, a 0.8% tax on a defined modified gross receipts tax base.

SPECIAL INSURANCE COMPANY IMPOSITION PROVISIONS

- A 1.25% tax on defined direct premiums or tax calculated under section 476a of the insurance code, whichever is greater.

SPECIAL FINANCIAL INSTITUTION IMPOSITION PROVISION

- A 0.235% franchise tax on net capital.
- Special single sales factor apportionment calculations are required.

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UNITARY GROUPS

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UNITARY FOUNDATIONS

- Under the unitary business principle, if a taxpayer is carrying on a single unitary business within and without the state, the state has the requisite connection to the out-of-state activities of the business to justify inclusion in the taxpayer's apportionable tax base of all of the property, income, or receipts attributable to the combined effect of the in-state and out-state activities.

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UNITARY IN THE MBT

- "Unitary business group" means:
  - A group of U.S. persons other than a foreign operating entity;
  - one of which owns/controls, directly or indirectly, more than 50% of the ownership interest of the other U.S. persons; and
  - that has business activities or operations that result in a *flow of value* between or among persons in the business group; or
  - that has business activities or operations that are *integrated with, are dependent upon, or contribute to* each other.

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UNITARY IN THE MBT (CONT'D)

- "Taxpayer" includes a unitary business group.
- A unitary business group shall file a combined return.
  - Must include each U.S. person other than foreign operating entities.
  - All transactions between persons included in the unitary business group must be eliminated from the business income tax base, the modified gross receipts tax base, and the apportionment formula.
  - Persons subject to the taxes under Chapters 2A and 2B of the MBT as insurance companies or financial institutions are excluded from the combined return.

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FOREIGN OPERATING ENTITIES

- A unitary group does not include a Foreign Operating Entity.
- "Foreign Operating Entity" is all of the following:
  - A U.S. person that would otherwise be a part of a unitary business group;
  - Has substantial operations outside the U.S. or any territory or possession;
  - At least 80% of its income is active foreign business income as defined by section 861(c)(1)(B) of the IRC.

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UNITARY: FLOW OF VALUE

- "The prerequisite to a constitutionally acceptable finding of unitary business is a *flow of value* . . ." *Container*, 463 US 159 (1983).
- Common tests for identifying unitary business (and a flow of value) include:
  - Functional integration (same line of business or steps in a vertically integrated process);
  - Centralized management (actual control; centralized departments or functions);
  - Economies of scale (exists whenever a function is enhanced through the sharing of the group's resources).

UNITARY: INTEGRATED, DEPENDENT, AND CONTRIBUTE

- Alternate Test – (integrated, dependent, and contribute):
  - A taxpayer is engaged in a unitary business when its activities within the state contribute to or are dependent upon its activities without the state.

BUSINESS

INCOME NEXUS

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SPECIAL BUSINESS INCOME NEXUS FOR SALES OF TPP

- *Tangible personal property* (TPP) sales are subject to the narrower PL 86-272 federal statutory jurisdictional standards, which provide that nexus does not exist if business activity in a state is limited to solicitation activities.
- Mere solicitation of TPP sales is insufficient to establish nexus.
- PL 86-272 is not applicable to receipts on “services” or “intangibles” which are subject to same nexus standard as for modified gross receipts.

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BUSINESS INCOME TAX BASE

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BUSINESS INCOME TAX BASE

- Starting point: federal taxable income from business activity.
- Applies to all entity types.
- S corps & partnerships include in taxable income any income or expense attributed to business activity reported separately to partners or shareholders.
- No casual transaction exclusion.

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BUSINESS INCOME TAX BASE (CONT'D)

- SBT modifications to tax base that have been deleted:
  - Compensation
  - Depreciation and capitalized expenses
  - Royalty and interest add backs

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BUSINESS INCOME TAX BASE (CONT'D)

- SBT modifications to tax base that have been retained:
  - Dividends and interest received on obligations of other states.
  - Taxes on or measured by income
  - Federal net operating losses.
  - Income /losses from other entities subject to this tax.
  - Income from U.S. obligations.

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BUSINESS INCOME TAX BASE (CONT'D)

- New modification to tax base:
  - Deduct net earnings from self employment included in federal taxable income unless they are a return of capital.
  - Add intangibles expenses included in federal taxable income made to related parties not part of the unitary group.

BUSINESS INCOME TAX BASE (CONT'D)

- Exceptions to intangibles expense add back:
  - Taxpayer must demonstrate transaction is not to avoid taxes.
  - Transaction was at arms-length.
  - AND satisfies one of the following:

BUSINESS INCOME TAX BASE (CONT'D)

- The arms length transaction was:
  - A pass through from a 3rd party to the related person with comparable rates and terms, or
  - Would be taxed by another jurisdiction, or
  - Addition is unreasonable based on facts and circumstances.

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UNITARY BUSINESS INCOME TAX BASE

- Group files combined return – transfer pricing not allowed.
- Add tax bases of group members – apply combined apportionment %.
- Foreign operating entities, insurance companies, & financial institutions cannot participate.

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BUSINESS LOSS CARRYOVER

- 2008 1st year allowed – apportioned loss may be carried forward 10 years.
- Apportion in year incurred – carryover to next year after apportionment.
- Portion of unused SBT loss carryover used in gross receipts tax base.

MODIFIED GROSS RECEIPTS TAX

NEXUS

NEXUS

- Taxpayer has a *physical presence* for more than 1 day per tax year,

OR

- Taxpayer *actively solicits* sales and has MI gross receipts of $350,000 or more.

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NEXUS

- Physical presence means "*any activity*" by:
  - A taxpayer, or
  - its independent contractor, or
  - its representative
- SBT RAB 1998-1 remains helpful for determining physical presence, but by its own terms is limited to SBT. A new MBT Nexus RAB will be developed.

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NEXUS

- Physical presence *exclusion* for:
  - *Professionals* providing services in a professional capacity, or
  - Other *service providers* if the activity is NOT associated with establishing a MI market.

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NEXUS

- "Actively solicits" is to be defined by the department.
- Applied prospectively

Note: Modified Gross Receipts Nexus standard differs from that of the business income tax portion of the MBT applicable to sales of tangible personal property.

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MODIFIED GROSS RECEIPTS TAX BASE

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MODIFIED GROSS RECEIPTS TAX BASE

- Gross Receipts defined as:
  - The entire amount received by the taxpayer from any activity whether in intrastate, interstate, or foreign commerce carried on for gain to the taxpayer or others.

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MODIFIED GROSS RECEIPTS TAX BASE - EXCLUSIONS

- Amounts received as an agent on behalf of the principal.
- Certain amounts realized from the sale of marketable instruments.
- Receipt of the loan principal by residential mortgage companies.
- Receipts by a professional employer organization of the cost of wages paid under the professional employer arrangement.
- Amounts received by auto dealers subsidizing interest expenses.

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MODIFIED GROSS RECEIPTS TAX BASE (CONT'D)

- The tax base is a taxpayer's gross receipts less "purchases from other firms" before apportionment.
- "Purchases from other firms" means:
  - Inventory acquired during the tax year.
  - Depreciable assets acquired during the tax year.
  - Materials and supplies, including repair parts and fuel.

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MODIFIED GROSS RECEIPTS TAX BASE (CONT'D)

- Compensation of personnel supplied to customers of a staffing company.
- Payments by contractors to subcontractors.
- A unitary business group's modified gross receipts is the sum of each person's modified gross receipts in the group, less modified gross receipts from transactions between persons in the group.

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SBT LOSS CARRYFORWARD MODIFICATION

- For tax year 2008, firms may deduct 65% of business loss carryforward left from the Single Business Tax Act, "actually incurred in the 2006 or 2007 tax year."
- For a unitary group, the deduction may only be taken against the modified gross receipts of the person with the loss.

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CARS & BOATS

- New motor vehicle and watercraft dealers may separately itemize the modified gross receipts tax on invoices to their customers and collect the tax in addition to the sales price.
- The amount remitted to Treasury for the tax cannot be less than the stated and collected amount.

Note: Amounts separately itemized as modified gross receipts tax are subject to sales tax on taxable sales of motor vehicles and watercraft.

APPORTIONMENT

ALLOCATION AND APPORTIONMENT

- Single factor apportionment based on sales.
- No throwback sales.
- Sales are sourced to another state if that state has jurisdiction to tax even if that state does not do so.

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SALES FACTOR

- Formula: MI sales/sales everywhere
- "Finnegan" is applied to unitary groups when at least one person in the group has Nexus, all MI sales by persons in the unitary group are included in the numerator.

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SOURCING SALES OF TPP, ELECTRICITY AND GAS

- Ultimate destination test is applied.
- Sourced to where property comes to rest regardless of shipping terms.
- Gas and electricity sourced based on where contract requires delivery.

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SOURCING OF REAL PROPERTY RECEIPTS

- Real property is sourced where the property is located.

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SOURCING RECEIPTS OF TPP LEASES

- Leased tangible personal property is sourced where the property is utilized.
- "Utilized" is determined by the number of MI rental days/rental days everywhere.
- Default is where lessee obtained possession of TPP.

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SOURCING RECEIPTS OF MOBILE PROPERTY

- Leased mobile transportation property is sourced where property is used.
- Aircraft use is determined by MI landings/landings everywhere.
- Default is principal base of operations.

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SOURCING RECEIPTS OF ROYALTIES AND INTANGIBLES

- Royalties and intangibles are sourced where the property is used by the purchaser.
- Multistate use apportioned by MI use/use everywhere.
- Default-exclude from numerator and denominator.
- Customer location is irrelevant.

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SOURCING RECEIPTS OF SERVICES

- Service income is sourced where recipient receives the benefit.
- Multistate use apportioned by recipient's MI benefit/benefit everywhere.
- "Cost of performance" sourcing no longer applicable.

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OTHER SOURCING PROVISIONS

- Securities brokerage service receipts are sourced to customer's address.
- Regulated investment companies receipts are based on shareholders domicile/mailing address.

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OTHER SOURCING PROVISIONS (CONT'D)

- Financing activities receipts (generally follow RAB 2002-14).
- Transportation receipts (generally sourced MI revenue miles/ revenue miles everywhere).

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OTHER SOURCING PROVISIONS (CONT'D)

- Telecommunications receipts have several sourcing rules.
- Telecommunications terms follow the Streamlined Sales and Use Tax Agreement.

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SOURCING IN GENERAL

- New default sourcing rule:
  - Where the benefit to customer is received.
  - If benefit received is undeterminable to customer's location.

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SOURCING

- Retained alternative sourcing along lines of SBT section 69
  - Department's discretion.
  - Alternate method may only be used if department approves.
  - Statutory apportionment is presumed to represent activity.
  - Taxpayer has burden of proof.
  - Amended returns are not a petition for relief.

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FILING THRESHOLD

- Taxpayers other than Insurance Companies or Financial Organizations not required to file or pay if apportioned gross receipts less than $350,000.

- Filing threshold annualized for tax year less than 12 months.

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PORTION OF MBT EARMARKED TO SCHOOL AID FUND(SAF)

- In fiscal year (FY) 2007-2008, $136 million collected will be distributed to the SAF. The balance goes into the general fund. In FY 2008-2009, $479 million will go into the SAF. After FY 2009, the amount earmarked to the SAF is increased by the rate of inflation.
- SBT Comparison: All SBT revenue goes into the general fund.

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SEVERABILITY CLAUSE

- If a final order of a court of competent jurisdiction determines that any provision of this act that provides a deduction, credit, or exemption with respect to employment, person, services, investments, or other activity in the state is unconstitutional or applies to a similar activity outside of the state, that provision shall be severed and the remaining provisions would remain in effect.

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REVENUE LIMIT FOR MBT

- If net cash payments exceed specified amounts for 2008, 2009 and 2010, half of excess goes to the Budget Stabilization Fund (BSF) and half is refunded on a pro rata basis.
- For 2008, net cash payments include SBT payments.
- Revenue from insurance companies is excluded from the calculation.