



BDO Seidman, LLP
Accountants and Consultants

Subject:
**Elimination of
Michigan's Service Tax
and Changes to the
Michigan Business Tax**

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State and Local Tax Alert

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Summary

Governor Jennifer Granholm has signed a bill (codified in Public Act 145) that adds an annual surcharge to the Michigan business tax (MBT) and repeals the use tax on services. The bill also makes changes to the compensation, investment, and research and development credits allowed against the MBT and potential refunds if MBT collections exceed certain targets.

Background

On December 1, 2007, Michigan Governor Jennifer Granholm signed into law Public Act 145 to repeal the use tax on services that was enacted on October 1, 2007 and amend 2007 Public Act 36, the Michigan Business Tax Act. For background and details on the Michigan Business Tax (MBT) see the State and Local Tax Alert that was issued July 2007 (see BDO Seidman Alert dated July 2007: New Michigan Business Tax Signed into Law at <http://www.bdo.com/about/publications/tax/alerts/TaxAlert-MIBusTax.pdf>). The modifications impact many of the provisions in the initial MBT Act and will impact all MBT taxpayers. The major provision within Public Act 145 is the imposition of a new surcharge on taxpayers' MBT liabilities to replace the revenue that was expected to be collected with the new use tax on services. The surcharge, as well as the other notable provisions, are outlined below.

Use Tax on Services

Under 2007 Public Act 93, the use tax on services became effective December 1, 2007. However, under Public Act 145, the repeal of section 3d of the use tax act, which imposed use tax on a variety of services, is retroactive and effective immediately on December 1, 2007. Since the bill was not signed until the evening of December 1, 2007, any taxes that were collected are to be either refunded by the vendor to the customer or remitted to the Department of Treasury for the customer to seek a refund from the Department.

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Changes to the Michigan Business Tax

The most notable changes to the MBT Act are provided below. Please note that this list is not intended to be all inclusive.

Imposition of the Surcharge

Public Act 145 has enacted an annual surcharge to be imposed on each MBT taxpayer's tax liability under the MBT Act after allocation and apportionment but before credits. For all persons, other than insurance companies and financial institutions, the rate is 21.99%. For financial institutions, the surcharge rate for tax years ending after December 31, 2007 but before January 1, 2009 is 27.7% and 23.4% for tax years ending after December 31, 2008. Financial institutions that are authorized to exercise only trust powers, and all insurance companies, are exempt from the surcharge. There is a sunset clause for the surcharge which provides that, if certain economic conditions are met, then the surcharge will not be imposed on or after January 1, 2017. The annual amount of the surcharge is limited to \$6,000,000 for any taxpayer.

Business Income

Definition of Business Income

Under Public Act 145, the definition of business income has been modified to clarify that for an individual, estate, or partnership or trust organized exclusively for estate or gift planning purposes, business income is that part of federal taxable income derived from transactions, activities, and sources in the regular course of the taxpayer's trade or business, including the following:

- All income from tangible and intangible property if the acquisition, rental, management, or disposition of the property constitutes integral parts of the taxpayer's regular trade or business operations.
- Gains or losses incurred in the taxpayer's trade or business from stock and securities of any foreign or domestic corporation and dividend and interest income.
- Income derived from isolated sales, leases, assignment, licenses, divisions, or other infrequently occurring dispositions, transfers, or transactions involving property if the property is or was used in the taxpayer's trade or business operation.
- Income derived from the sale of a business.

Income that is excluded from business income for an individual, estate, or partnership or trust organized exclusively for estate or gift planning purposes, includes the following:

- Personal investment activity, including interest, dividends, and gains from a personal investment portfolio or retirement account.
- Disposition of tangible, intangible, or real property held for personal use and enjoyment, such as a personal residence or personal assets.
- Other income, if not generated in the regular course of a taxpayer's trade or business, although such items are not specifically enumerated.

Deferred Tax Implications

On September 30, 2007, House Bill 5104 was passed and provides relief for taxpayers that would have had a net deferred tax liability impact on their financial statements as a result of the enactment of the business income and modified gross receipts portions of the new MBT. This relief allowed for a deduction from a taxpayer's business income tax base equal to the book-tax difference for qualifying assets, if the taxpayer ended up in a net deferred tax liability situation due to the imposition of the MBT. For background and details on the MBT deferred tax implications see the State and Local Tax Alert that was issued October 2007 (see BDO Seidman Alert dated October 2007: Michigan Business Tax and Deferred Tax Implications at <http://www.bdo.com/about/publications/tax/alerts/TaxAlert-MIDTL.pdf>).

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It appears that this deduction, provided with House Bill 5104, was not expanded to cover any increased net deferred tax liabilities resulting from the imposition of the new surcharge. Although Public Act 145 references the surcharge within the subsection providing for the deduction, it only seems to indicate that the amount of the deduction previously calculated, based on the imposition of the new income and modified gross receipts taxes, can reduce the surcharge imposed. This means that the deduction, allowed beginning in tax year 2015, can be taken against a taxpayer's business income tax base prior to calculating the applicable surcharge. Therefore, taxpayers that previously may have reported no impact to their financial statements as a result of the allowable deduction might now have a financial statement impact due to the surcharge.

Gross Receipts

The definition of gross receipts was also modified by Public Act 145 for an individual, estate, or partnership or trust organized exclusively for estate or gift planning purposes. Gross receipts for these persons now include amounts received from transactions, activities and sources in the regular course of the taxpayer's trade or business, including:

- Receipts from tangible and intangible property if the acquisition, rental, management, or disposition of the property constitutes integral parts of the taxpayer's regular trade or business operations.
- Receipts received in the course of the taxpayer's trade or business from stock and securities of any foreign or domestic corporation and dividend and interest income.
- Receipts derived from isolated sales, leases, assignment, licenses, divisions, or other infrequently occurring dispositions, transfers, or transactions involving property if the property is or was used in the taxpayer's trade or business operation.
- Receipts derived from the sale of a business.

Under the Act, receipts excluded from the definition of gross receipts for an individual, estate, or partnership or trust organized exclusively for estate or gift planning purposes include the following:

- Personal investment activity, including interest, dividends, and gains from a personal investment portfolio or retirement account.
- Disposition of tangible, intangible, or real property held for personal use and enjoyment, such as a personal residence or personal assets.
- Other receipts may be excluded if they are not generated in the regular course of the taxpayer's trade or business, although they are not specifically enumerated.

Insurance Companies

Under Public Act 36, the compensation credit was limited to insurance companies that did **not** make certain payments to the Michigan worker's compensation placement facility, Michigan basic property insurance association, Michigan automobile insurance placement facility or to the property and casualty guaranty association. Now, all insurance companies are eligible for both credits: (1) for payments made to the previously mentioned state facilities/associations; and (2) the compensation credit for compensation in Michigan.

It is important to note that although the limitation for the use of the compensation credit (along with the investment tax credit) was reduced with the new Act (see Credits section below), the credit limitation did not change for insurance companies. The limitation for the use of the compensation credit is 65% of the insurance company's tax liability for the tax year after claiming the other allowable credits.

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Financial Institutions

Public Act 145 also expanded the compensation credit to financial institutions and changed the definition of “net capital” for purposes of calculating the tax. A financial institution is now allowed to subtract all goodwill and the average daily book value of U.S. and Michigan obligations in calculating net capital.

Credits

Initially under Public Act 36, a taxpayer claiming the compensation and/or investment tax credits was limited to a combined credit of 65% of the total MBT liability. Public Act 145 reduced the allowable limit to 50% of a taxpayer’s MBT liability for the 2008 tax year and 52% for the 2009 tax year and thereafter, **before the imposition of the surcharge**. The new Act also changed the rate of these credits for the 2008 tax year. Previously, taxpayers were allowed a compensation credit equal to .37% of compensation in the State of Michigan. The rate for 2008 is now .296%. Additionally, all taxpayers, including insurance companies and financial institutions, are eligible for the compensation credit. The rate of the investment tax credit was also reduced under the new Act to 2.32% for the 2008 tax and will increase back to 2.9%, the original percentage under Public Act 36, for 2009 and thereafter.

Public Act 145 reduced the research and development credit for the 2008 tax year to 1.52%. The rate will increase back to the originally stated 1.9% for the 2009 tax year and thereafter. The Act also reduced the allowable combined credit with the compensation and investment tax credits from 75% of the total tax liability to 65% of the tax liability **before the imposition of the surcharge**.

There has also been added an additional credit against the MBT for those taxpayers that operate a motorsports entertainment complex and modifications made to the credit a new motor vehicle dealer licensed in Michigan may receive, as well as an increase to the rate of credit a Michigan headquartered retailer meeting specific criteria may receive.

Revenue Sharing

The previous Act had a certain amount of MBT that could be collected during each tax year and if the amount generated exceeded the limit a certain amount was to be refunded to the taxpayers and another amount was to be placed in the Budget Stabilization Fund (BSF). The new Act provides for the same effect; however, the amounts have increased to include the amount collected under the MBT and the surcharge and the ratios have changed from 50% refunded and 50% placed in the BSF to 60% refunded and 40% placed in the BSF.

How BDO Seidman Can Help

With the signing of Senate Bill 94 that originally enacted the MBT in Public Act 36 and now with House Bill 5408 that is enacted in Public Act 145 that amends certain provisions of the MBT, Governor Granholm has overhauled the taxing system on business entities, individuals, trust and estates with business activity and/or nexus in Michigan. The new statutes will need to be reviewed to determine their impact on your company or client’s Michigan tax liability. Additionally, since the MBT is considered an income tax for financial statement purposes, and most taxpayers in the past treated the Michigan Single Business Tax as a non-income tax, both FIN 48 and deferred tax assets/liabilities will likely need to be considered for the first time.

BDO Seidman state tax professionals can assist your company in determining the impact of both Public Act 36 and Public Act 145.