

AN ALERT FROM THE BDO STATE AND LOCAL TAX PRACTICE

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SUBJECT

MICHIGAN ELIMINATES FLOW-THROUGH ENTITY WITHHOLDING REQUIREMENT

SUMMARY

On June 8, 2016, Michigan Governor Rick Snyder (R) signed into law H.B. 5131, 98th Leg., Reg. Sess. (Mich. 2016), which eliminates the requirement for an entity classified as a partnership or S corporation for federal income tax purposes (“FTE”) to withhold income tax on an owner’s distributive share of Michigan income. Elimination of this withholding requirement is effective for taxable years beginning on or after July 1, 2016.

DETAILS

For taxable years beginning before July 1, 2016, Michigan requires an FTE to withhold income tax on the distributive share of Michigan income of an owner that is an FTE or a corporation, if the FTE’s Michigan apportioned business income for the taxable year exceeded \$200,000. FTE and corporate owners may make an election to “opt out” of such withholding requirement if they meet certain documentation and notification requirements.

Also for taxable years beginning before July 1, 2016, Michigan requires an FTE to withhold income tax on a nonresident individual owner’s distributive share of Michigan income. No minimum income threshold for the withholding requirement, or option to make an election to “opt out” of withholding, exists for a nonresident individual.

H.B. 5131 eliminates the requirement imposed on an FTE to withhold income tax on the distributive share of Michigan income of all owners, nonresident individuals included, for taxable years beginning on or after July 1, 2016. H.B. 5131 does not modify the option to file a composite return on behalf of qualifying owners, or impose any new filing requirements on FTEs.

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BDO INSIGHTS

- ▶ For taxable years beginning before July 1, 2016, an FTE should continue to follow the “old” withholding requirements. This includes filing the quarterly withholding form (Form 4917) and annual reconciliation form (Form 4918) when required.
- ▶ Since Michigan does not require an FTE to file an annual income tax return, and H.B. 5131 eliminates the withholding requirement for taxable years beginning on or after July 1, 2016, an FTE will have no required filings for income tax purposes. FTEs still should consider providing their owners with a statement or Michigan K-1 equivalent with sufficient information for their owners to determine their Michigan source income.
- ▶ The elimination of the withholding requirement shifts the responsibility and liability for making estimated income tax payments from the FTE to the FTE’s owners. An FTE owner is still liable for income taxes due on Michigan source income, and should consider whether estimated income tax payments are required.
- ▶ An FTE may still file a composite tax return (Form 807) on behalf of qualifying owners. If a composite tax return is filed, then Michigan requires the FTE to make estimated tax payments on behalf of its owners included in the composite filing. If a nonresident individual is not included in a composite filing, then Michigan requires the individual to file his or her own individual income tax return (MI-1040) to report their Michigan source income.

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