

The New Michigan Business Tax Analysis for Real Estate Companies

The New Michigan Business Tax will affect every business operating in Michigan. It is important to examine your business structure before the end of this year to take appropriate planning steps to minimize tax liability and avoid compliance pitfalls.

The new Michigan Business Tax package replaces the Single Business Tax with two basic, broadly applicable taxes: 1) a modified gross receipts tax and 2) a business income tax. The gross receipts tax rate is 0.8% which is applied to all gross receipts minus purchases from other firms. The business income tax is imposed at a rate of 4.95% on federal adjusted business income (with adjustments).

Impact on the Real Estate Sector

Generally, the new Michigan tax regime favors manufacturing companies at the expense of certain others. According to the Department of Treasury, one of the categories of businesses that will pay more tax under the new regime is real estate firms. However, for purposes of the Department of Treasury's analysis, real estate firms are lumped together with insurance companies and banks. Given that it is clear the new tax system increases liability for banks and insurance companies, it is unclear how much of the category's increased tax liability is attributable to real estate firms.

Key Credits

One of the key changes included in the new tax is a significant reduction in the personal property tax. There is a tax rate reduction for both commercial and industrial personal property, with a 35% refundable credit for the remaining industrial personal property taxes paid. To the extent that real estate firms have little personal property (especially industrial), these provisions offer little relief. Since the new tax is revenue neutral, most firms with relatively little personal property will likely pay more under the new system. The new tax system does not include any tax relief for property taxes paid on real property.

Real estate firms will benefit from an investment tax credit (ITC) equal to 2.9% of the net investment in Michigan. However, the combined ITC and a separate credit equal to 0.37% of compensation paid may not exceed 65% of the taxpayer's liability.

Also, any ITC taken under the Single Business Tax is subject to recapture under the MBT if the property for which the credit was claimed is disposed of. However, property for which a capital acquisition deduction was taken under the SBT (property acquired in 1999 and earlier) will not be subject to MBT recapture when the property is sold.

Tax Base Calculations

The calculation of gross receipts under the new tax is important to real estate firms. Gross receipts include all amounts received unless specifically excluded. Relevant exclusions include amounts received in an agency capacity, real property managers' segregated property maintenance amounts, security deposits, principal payments on loans, and the value of property acquired in like-kind

exchanges. Also, proceeds from the sale of depreciable property used in the trade or business are deducted from gross receipts. However, the gain on the sale of this property is not deducted. Purchases from other firms are subtracted from gross receipts to determine net gross receipts (the tax base). Acquisition of any depreciable asset qualifies as a purchase from other firms. However, the acquisition of raw land would not qualify as a deductible purchase unless the land was held for resale and could be considered inventory.

Tax Incentives

From a real estate development perspective, it is important to note that all of the important development incentives that had been part of the Single Business Tax have been preserved. Brownfield Redevelopment Credits, Historical Preservation Credits and Renaissance Zone benefits will all continue under the new tax.

Potential Tax Rebate

If net cash revenues collected under the SBT and MBT exceed estimates for revenue neutrality by 5% or more for 2008 and 2009, the revenues in excess of \$5 million will be rebated pro rata to net cash taxpayers.

Honigman's MBT Services

As you analyze the impact of the new Michigan Business Tax on your business, Honigman can assist by providing the following critical services:

- Estimate of tax liability under different scenarios using Honigman's MBT Tax Calculator
- Analysis of components of tax bases, especially gross receipts
- Identification of strategies to reduce gross receipts and expand deductions for purchases from other firms
- Assistance in maximizing property tax credits
- Identification of new credits and incentives available to your business
- Analysis of unitary filing group and identification of strategies to reorganize tax filings to minimize taxes
- Assistance with key tax classification issues
- Evaluation of steps to take to ensure qualification for any tax rebate
- Updates on technical corrections and interpretations

For more information, please contact:

June Summers Haas (517-377-0734 or jhaas@honigman.com)

Mark A. Hilpert (517-377-0727 or mhilpert@honigman.com)

Stewart L. Mandell (313-465-7420 or smandell@honigman.com)

Alan M. Valade (313-465-7636 or avalade@honigman.com)

Patrick R. Van Tiflin (517-377-0702 or pvantiflin@honigman.com)