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Michigan's New Corporate Income Tax – Planning Opportunities for Partnerships, S Corporations and LLCs

On May 25, 2011, Governor Rick Snyder signed into law the Tax Reform Plan (HB 4361 and HB 4362), which replaces the Michigan Business Tax (MBT) with a new "Corporate Income Tax" (CIT). The CIT will only apply to entities characterized as "C" corporations under the Internal Revenue Code (the Code). Sole proprietorships and pass-through entities, which were subject to the MBT, will not pay taxes or file returns under the CIT (except to the extent that they may have to withhold tax on behalf of corporate members). This means that the vast majority of small to medium-sized businesses will no longer be subject to an entity level Michigan income or franchise tax.

If you own or manage a partnership, S corporation, or single-member LLC, you should evaluate the 2011 year-end planning opportunities that arise from the repeal of the MBT:

Deferring Gain Recognition: If you expect to have a significant amount of income from a transaction scheduled for the last few months of 2011, the repeal of the MBT should be a factor in structuring the transaction. For example:

- **Sale of Business:** If you plan on selling a business before the end of 2011 in a transaction that would otherwise be subject to the MBT, you should consider (i) deferring closing until 2012, or (ii) closing an installment sale in 2011 with all or most of the proceeds received and recognized in 2012.
- **Sale of Real Property:** If you plan on selling real property and you must close before the end of 2011, you may be able to avoid paying MBT on the proceeds by initially structuring the transaction as a like-kind exchange under Section 1031 of the Code, and subsequently, after December 31, 2011, making a nonqualifying disposition of the replacement property.
- **Foreclosure:** If you are considering relinquishing property to a nonrecourse lender, you should consider whether the transaction can be structured so that gain from the foreclosure transaction is deferred to 2012.

Avoiding Recapture: If you intend to sell assets that previously received Investment Tax Credits under the MBT — which are subject to recapture upon sale — it would be wise to defer the realization of gain until 2012, when the recapture provisions are no longer in effect.

Accelerating Deductions: Consideration should be given to accelerating into 2011 deductible expenditures that would otherwise be made after 2011. This could be particularly beneficial in the case of inventory, depreciable assets, and materials and supplies, 100% of the cost of which are deductible in the year such items are acquired in computing the modified gross receipts tax component of the MBT. Similarly, by purchasing certain machinery or equipment that, under the Tax Relief Act of 2010 (P.L. 111-312), qualify for 100% bonus depreciation for federal income tax purposes if placed in service before January 1, 2012, you may significantly minimize the business income tax component of your MBT liability. For an accrual method taxpayer, a fixed commitment in 2011 to make such expenditures may suffice to allow a 2011 deduction, even though the expenditures are not made until after 2011.