The Michigan Business Tax
Compliance Issues and Strategies

A Live Audio Seminar October 2, 2007
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Presented by

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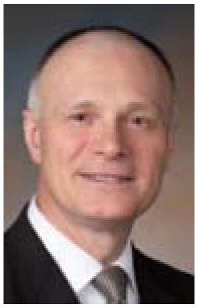
ABOUT THE SPEAKER



Patrick R. Van Tiflin, J.D. is a partner in the Tax Appeals Department of Honigman Miller Schwartz and Cohn LLP and practices in the firm's Lansing, Michigan office. He was selected by his peers nationwide for inclusion in Best Lawyers in America 2007 in recognition of expertise in Michigan taxation. He provides state tax law representation to many Fortune 500 companies in Michigan and throughout the country. His specializations include the Michigan Business Tax, Single Business Tax, Sales Tax, Use Tax, Insurance Company and Retaliatory Tax, investment incentives and tax savings. He is a member of the Editorial Advisory Board for CCH's *State Income Tax Alert* and is a regular contributor to CCH's *State Income Tax Alert* and *Sales & Use Tax Alert*. He is a frequent author and lecturer and has published articles in CCH's *State Tax Review, State Income Tax Alert*, and *Sales & Use Tax Alert*, and the *Real Property Tax Alert*, *The Michigan Tax Lawyer, Journal of Multistate Taxation*, and the *Michigan Bar Journal*.

Mr. Van Tiflin frequently lectures on state tax issues at conferences sponsored by the Council on State Taxation, Tax Executive's Institute, New York University, Michigan Association of Certified Public Accountants, The Chicago Tax Club, Georgetown University Law Center, and the State Bar of Michigan. He is a graduate of the University of Notre Dame Law School and received a Bachelor of Arts Degree in Business Administration and Accounting from Michigan State University, with High Honors. He is admitted to practice in the Michigan state and federal courts, the U.S. Court of Appeals for the Sixth Circuit, and the United States Supreme Court. He is listed in Michigan's Super Lawyers, 2007.

PRESENTATION

The Michigan Business Tax

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October 2, 2007

Presenter:

Patrick R. Van Tiflin

Honigman Miller Schwartz and Cohn LLP

The Michigan Business Tax

What will be covered:

- Who Pays
- Tax Base
- Small Business Rules
- Apportionment
- Unitary Filing

The Michigan Business Tax

What will be covered (cont.):

- Credits and Incentives
- Insurance Company Gross Premiums Tax
- Bank Capital Stock Tax
- Accounting Implications
- Returns, Estimates and Transition Rules
- Potential Litigation and Technical Corrections
- Planning Opportunities

The Michigan Business Tax

- Two Taxes:
  - Modified Gross Receipts Tax
  - Business Income Tax
- Three In Lieu Taxes:
  - Small Business Tax
  - Gross Premiums Tax
  - Bank Capital Tax

Who is Subject to the Tax?

- All persons with nexus conducting business activity
- "Persons" is all inclusive:
  - Any corporation, partnership, limited liability company, receiver, estate, trust, individual or any other group or combination of groups acting as a unit

Nexus

- Any person with physical presence within Michigan for more than one day

  OR

- That "actively solicits" business in the state and has apportioned gross receipts > $350,000

Nexus

- "Physical presence" means any activity by employee, agent or independent contractor acting in a representative capacity
- Physical presence excludes activities of professionals or other service providers if activity does not establish and maintain in-state market
- PL 86-272 does not apply to gross receipts tax

Nexus

- "Actively Solicits" must be defined by the Department in writing and be applied prospectively
- How soon will guidance be issued?
- How far will the active solicitation standard go to a pure economic presence standard?

Modified Gross Receipts Tax

- Modified Gross Receipts Tax
  - Gross receipts
  - Minus purchases from other firms
  - Allocated or apportioned
  - Times .80%
  - Less credits and incentives

Gross Receipts

- Gross Receipts
  - All amounts received unless specifically excluded
- Exclusions
  - Amounts received in an agency capacity
  - Amounts received as agent for another and expended on behalf of the principal

Gross Receipts

- Exclusions
  - Income excluded federal tax base of a foreign air carrier
  - Advertising agency's cost of media time, space, production or talent
  - Real property manager's segregated property maintenance amounts
  - Transfers of accounts receivables

Gross Receipts

- Exclusions
  - OID
  - Refunds
  - Discounts, whether cash or in-kind
  - Tax refunds
  - Security deposits
  - Principal repayments
  - Like-kind exchanges

Gross Receipts

- Exclusions
  - Return of basis on property that is a capital asset under 1221(a) and 1231(b) property
  - Insurance or civil judgment unless included in federal taxable income
  - Sales finance company repayment of principal

Gross Receipts

- Exclusions
  - Motor vehicle sales finance company principal
  - Mortgage company sale of loans
  - PEO reimbursement for wages and benefits
  - Motor vehicle floor plan interest credit

Gross Receipts – Purchases From Other Firms

- Inventory acquired during the year at cost – not cost of goods sold – including shipping, delivery or engineering costs in invoice
- Assets subject to depreciation, amortization or accelerated cost recovery
- Materials and supplies, including repair parts and fuel

Gross Receipts – Purchases From Other Firms

- "Staffing company" compensation of personnel
- General contractors' cost of subcontractors
- No deduction for labor costs

Gross Receipts - Inventory

- Inventory
  - Stock of goods for resale
  - Finished goods, goods in process, raw materials
  - Motor vehicle floor plan interest
- Does Not Include
  - Personal property for lease
  - Depreciable or depletion property

Modified Gross Receipts Tax

- Imposed on unitary business group's sum of modified gross receipts
  - less foreign operating entity
  - less intercompany transactions
- For 2008, deduct 65% of SBT loss carryforward incurred in 2006 and 2007
- Unitary group SBT loss carryforward only allowed against tax base of company that incurred the loss

Modified Gross Receipts Tax

- Tax is not prohibited from being collected from customers by vehicle or boat dealers
- Can others collect and pass on the gross receipts tax?
- Gross receipts tax is imposed on privilege of doing business and not on income or property

Business Income Tax

- Business Income
  - Plus adjustments
  - Allocated or apportioned
  - Times 4.95%
  - Less credits and tax incentives

Business Income Tax

- Business Income
  - Federal taxable income
  - Partnerships and S Corporation means income and expenses separately reported to partners or shareholders
  - Tax Exempt person means unrelated business taxable income
- Unitary Business Group Income
  - Sum of each member's income less intercompany transactions

Business Income Tax

- Additions
  - Other state obligations interest and dividends deducted from FTI
  - Other net income taxes deducted from FTI
  - Federal NOL

Business Income Tax

- Subtractions
  - Foreign source dividends including foreign operating entities
  - Income from pass-through entities subject to tax

Business Income Tax

- Related Entity Expense
  - If taxpayer deducted from FTI royalty, interest or other expense
  - Paid to a person outside the unitary business group related by Ownership or Control to the taxpayer
  - For use of intangible asset
- Then expense must be added back

Business Income Tax

- Related Entity Expense Addback required unless demonstrate:
  - Nontax business purpose other than avoidance of MBT,
  - Arm's length pricing and rates under 482 and 1274(d), and
  - One of the following three:
    - Pass-through of third-party transaction,
    - Results in double taxation, or
    - Unreasonable to addback as determined by Treasurer and agreed to by taxpayer

Business Income Tax

- Subtractions
  - Interest from U.S. obligations
  - Earnings from self-employment under 1402 except to the extent earnings represent reasonable return on capital
- Business loss incurred after 12/31/2007
- Business loss carryforward ten years

Small Business Treatment

- Filing threshold remains at $350,000 gross receipts (partial credit up to $700,000)
- Small business-low profit credit is expanded
- Unincorporated credit is eliminated

Small Business Credit Comparison

	SBT	MBT
Tax Cap (% of ABI)	2%	1.8%
Gross Receipts Limit	$10 M	$20 M
ABI Limit	$475,000	$1.3 M
Officer Income Limit	$115,000	$180,000

(Adjusted Business Income = Federal Taxable Income plus compensation and director's fees of active shareholders and officers, plus loss carry-forwards/backs)

Exempt Entities

- Entities exempt from both modified gross receipts tax and business income tax are unchanged from the SBT
  - U.S. government, this state, other states and their political subdivision
  - Tax exempts and 501(c)(12) and (16)
  - Certain 501(c)(4)s
  - Nonprofit housing corporation
  - Production of agricultural goods
  - Farmer's cooperative
  - Reciprocal insurer's attorney-in-fact
  - Multiple employer welfare arrangement

Apportionment

- 100% Sales Factor
- Apportioned if taxed in another state or would be taxable in another state if state imposed tax similar to Michigan
- No separate apportionment formulas

Apportionment

- Finnegan Rule -- Sales of unitary business group is all sales in Michigan regardless of whether the person has nexus with Michigan. Intercompany sales are eliminated.

Apportionment

- General apportionment rule is destination or where the customer receives the benefit
- Rules are NOT the same as under SBT
- Cost of Performance Test for Intangibles and Services is Gone

Apportionment – Real and Personal Property

- Sales of tangible personal property sourced to destination
- Rental real property sourced to property location
- Rental tangible property receipts sourced based on days in-state to everywhere
- Rental mobile transportation property receipts based on in-state use

Apportionment – Financial Receipts

- In general, law codifies Michigan's version of the MTC's financial apportionment sourcing rules previously contained in RAB 2002-14
- Royalties and income from using intangibles sourced to state of property use
- Interest from loans secured by real property looks to location of real property

Apportionment – Financial Receipts

- Interest from loans not secured by real property looks to location of the borrower
- Transportation company services sourced based on revenue miles in-state to everywhere
- Spun-off company provisions maintained

Apportionment

- Sales of services sourced to where customer receives the benefit of the services. If more than one state, then receipts included in proportion to in-state benefit.
  - No definition yet of "where customer receives benefit"
  - Language based on Ohio, but unclear if Michigan will follow Ohio's many regulations or provide separate rules

Apportionment

- Alternative Apportionment Rule
- May petition for
  - Separate accounting
  - Inclusion of one or more factors
  - Other method
- Apportionment provisions presumed to fairly attribute
- Must show business activity attributed to state is out of all appropriate proportion and leads to grossly distorted result

Mandatory Unitary Filing

- Purpose of mandatory unitary filing is to prevent tax planning and subject as many companies as possible to the new tax
- Revenue estimates attributed no new income to move from elective consolidation to mandatory unitary filing
- Water's edge

Unitary Business Group

- U.S. persons, other than foreign operating entity
- One of which
  - Owns or controls >50% ownership interest with voting rights
  - And flow of value or contribution and dependency between or among the persons in the unitary business group

80/20 Companies

- Foreign Operating Entity
- Would otherwise be part of unitary group – U.S. person
- Substantial operations outside U.S., Puerto Rico and any territory of U.S.
- At least 80% of income is active foreign income under 861(c)(1)(B)

Unitary Business Filing Implications

- Foreign entities with nexus file on a stand-alone basis
- No special rules for non-PE foreign companies under the gross receipts tax
- Foreign dividends eliminated

Unitary Business Filing Implications

- Intercompany transactions eliminated
- Deductions denied to nonunitary affiliates
- Finnegan taxes the non-nexus members of the group

Compensation Deduction and Investment Tax Credit

- Investment Tax Credit: 2.9% of net new capital assets in Michigan
- Compensation Credit: 0.37% of compensation paid in Michigan
- These credits are taken first and together are capped at 65% of tax liability

Economic Development Credits Retained

- Michigan Economic Growth Authority (Section 431/SBT MCL 208.37c)
- Renaissance Zones (Section 433/SBT MCL 208.39b)
- Historic Preservation (Section 435/SBT MCL 208.39c)
- Brownfield Development (Section 437/SBT MCL 208.38g)

Retained Credits (cont.)

- Venture Capital Investment (Section 419/SBT MCL 208.37e)
- Charitable Contributions (Section 421/SBT MCL 208.38)
- Start-up Business (Section 415/SBT MCL 208.31)
- Homeless Shelters / Food Banks (Section 427/SBT MCL 208.38f)

Retained Credits (cont.)

- Alternative Energy (Section 429/SBT MCL 208.39e)
- Worker's Compensation (Section 423/SBT MCL 208.38b)
- Community Foundations (Section 425/SBT MCL 208.38c) - Now includes educational foundations
- Low-grade Hematite (Section 439/SBT MCL 208.39d)

To the extent provided by the SBT, existing credits under these sections may be carried forward against the new tax, but recapture provisions also apply.

Terminated Tax Credits

- Unincorporated Business Credit (MCL 208.37)
- MEGA Business Activity Credit (MCL 208.37d)
- Transferred Jobs Credit (MCL 208.35i and MCL 208.35j)
- Minority Venture Capital Company Credit (MCL 208.36b)
- High Technology Activity Credit (MCL 208.37b) -no new certificates were issued after 1991
- Created Jobs Credit (MCL 208.37f) - only applied to the 2005 tax year

Terminated Tax Credits (cont.)

- Donated Automobile Credit (MCL 208.37g)
- Apprenticeship Credit (MCL 208.38e)
- Pharmaceutical Research Credit (MCL 208.39f)
- Enterprise Zone Credit (MCL 208.37a)
- These credits may be carried forward for the 2008 and 2009 tax years (to the extent the credit could be carried forward under the SBT)

New Credits

- Research and Development Credit
  - 1.9% of R&D expenditures
  - 30% of contributions to small business for R&D, capped at $300,000
- Entrepreneurial Credit (2008-2010)
  - If: - gross receipts < $25 million
    - created 20 new jobs in MI
    - $1.25 million in capex

    Credit equals marginal tax resulting from added employment.

Special Sector and Arts Credits

- Motor Sports Complex Credit
- Sports/Entertainment Facility
- Motor Vehicle Dealer
- Special Compensation Credit for large retail establishments
- Culture Credit: 50% of contribution over $50,000 to municipal or non-profit art, historical or zoological inst.

Personal Property Tax Relief

Starting in 2008:

- 24 mill Reduction for Industrial personal property (includes property under IFT)
- 12 mill reduction for Commercial personal property
- 35% refundable MBT credit for taxes paid on Industrial personal property (replaces 15% credit in SBT)
- 23% refundable MBT credit utility property taxes paid by telephone companies (13.5% in subsequent years)
- 10% refundable credit for personal property taxes on natural gas pipelines.

Personal Property Tax Relief Example

	Industrial	Commercial
Assessed Value (50% of Market)	$100,000	$100,000
Current Average Tax Rate	52 mills	52 mills
Tax under old system	$5,200	$5,200
New Tax Rate	28 mills	40 mills
New Tax	$2,800	$4,000
MBT Credit Amount	$980	$0
Effective Tax	$1,820	$4,000
Effective Tax Cut	$3,380 (65%)	$1,200 (23%)

Personal Property Relief

- Classification of property as real or personal becomes more important
- Classification of personal property as "industrial" is usually tied to the classification of the real property where the personal property is located
- Wrong classification must be addressed early in the process

Insurance Company Gross Premiums Tax

- Gross premiums tax at 1.25% rather than 1.07% under SBT
- Retaliatory tax applicable
- Retains industry specific credits
- Exempt first $190 million disability insurance premiums

Insurance Company Gross Premiums Tax

- In lieu of all other taxes except real and personal property tax, sales tax and use tax
- Compensation credit and investment tax credit are denied

Bank Capital Stock Tax

- Tax on average net capital over last five years times .235%
- In lieu of modified gross receipts and business income tax
- Net capital = equity capital under GAAP less cost of goodwill and U.S. and MI obligations
- Tax base is apportioned based on gross business
- Gross business same as under SBT

Return Filing and Transition Rules

- Effective 1/1/2008
- Fiscal year taxpayers use short year or months in year/12
- Estimated returns due 4/15 while annuals due 4/30

Return Filing and Transition Rules

- No penalty transition rule
- Revenue Act controls administration by Department of Treasury
- Bill appropriates $1 million to Treasury for implementation

Refund Provision

- If net cash revenues exceed
  - Revenue estimate plus 1% and
  - Amount is more than $5,000,000
- Then 50% of excess refunded to taxpayers making net cash payments
- Net cash is annual and estimated payments during fiscal year less refunds

Controversy

- Credits
- Denial of credits
- Personal property tax classification
- Refund mechanism
- Finnegan
- Definition of Unitary Business
- Taxation of other states' interest and dividend payments
- Geoffrey

Possible Areas for Technical Corrections

- FAS 109 requirement to book deferred income tax liability
- Assignability of brownfield credits
- Reporting/payment dates
- Gross receipts tax base
- Treatment of foreign taxpayers
- Finnegan/Joyce
- Penalty transition

Planning Opportunities

- New tax is not a value-added tax
- Accelerate items not taxable under SBT into 2007
- Defer items that increase the base under SBT
- Re-evaluate existing Michigan tax strategies

Accelerate Items Not Taxable Under SBT

- Interest income
- Dividend income
- Royalty income except franchise royalties
- Use SBT loss carryforward

Defer Items That Increase SBT Base

- Compensation
- Interest expense
- Dividend expense
- Royalty expense

Defer Items That Increase SBT Base

- CAD recapture transactions
- Other state net income tax
- Capital loss carryover or carryback
- Losses from partnerships

Exemptions, Reductions and Credits that Go Away

- Alternative gross receipts reduction
- Compensation reduction
- Unincorporated Taxpayer Credit

Look at Sales Factor and Gross Receipts

- Plan for Mandatory Unitary filing
- Sales Factor
  - Will be 100%
  - May include interest, dividends and other income from investments
- Gross Receipts – Not Federal Gross Receipts
- Excludes:
  - Amounts received in agency capacity
  - Refunds, returns
  - Cash and trade discounts
  - Like-kind exchanges
  - Transfers of accounts receivable

Industry Specific Concerns

- Insurance
  - Slightly worse treatment – 1.25 vs. 1.07
  - Retaliatory tax may go down
  - "In Lieu" use tax exemption – purchase out-of-state in 2007 – watch out for transition issues – possible assessments for exempt year purchases
- Financials
  - No more benefit of interest income deduction for nonfinancial mortgage companies
  - May need to re-think intercompany financing strategies
  - Sourcing of financial receipts will be based on MTC financial apportionment sourcing regulations

Industry Specific Concerns

- Consolidated Return Filers
  - Now mandatory unitary filing
  - Includes entities other than corporations
  - Finnegan Rule
- Real Estate Management
  - Form of contract will dictate what is in gross receipts
- Franchisors/Trademark Licensors
  - Royalty company strategy needs to be rethought

This presentation is intended to provide general information regarding the Michigan Business Tax. It is not intended to be an all encompassing treatment of the subject matter and does not purport to offer legal advice.

Questions?

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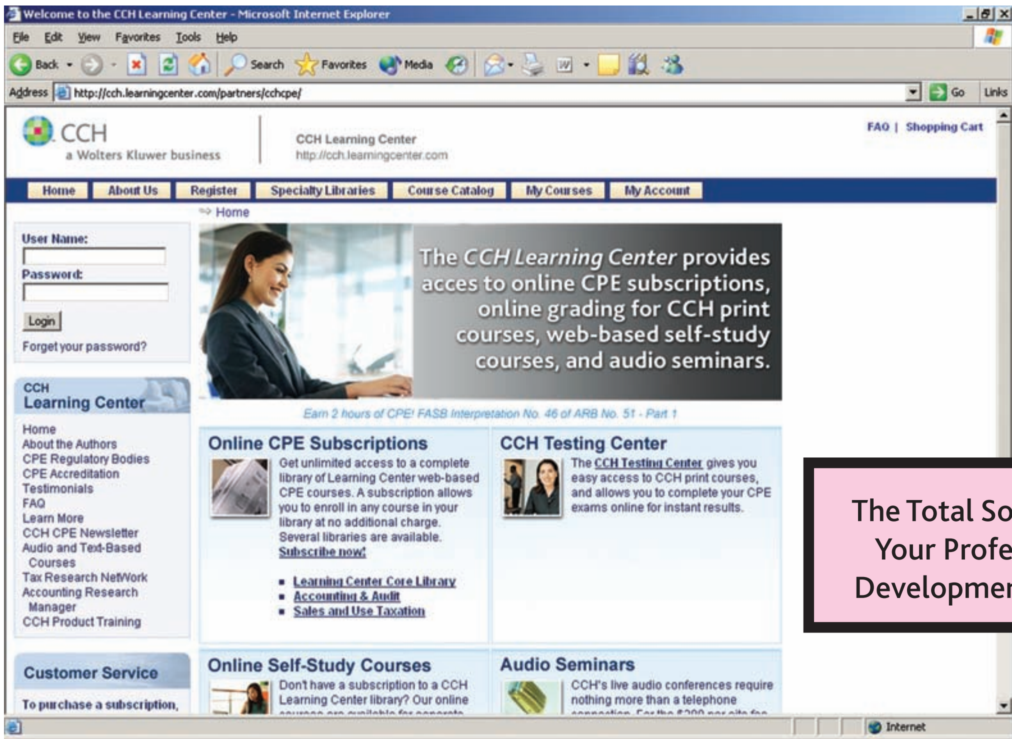

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