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Return of the Capital Acquisition Deduction? Michigan Business Tax Provisions Look Similar

GRAND RAPIDS, MI – Monday, December 17, 2007 – Two provisions in the Michigan Business Tax (MBT) relating to the Modified Gross Receipts Tax Base look a lot like the former Capital Acquisition Deduction (CAD) in the Single Business Tax (SBT) prior to year 2000. The following information on the old CAD is provided because of its potential relevance to the MBT.

The Capital Acquisition Deduction (CAD) in Section 23 of the Single Business Tax Act (SBTA) provided an adjustment to recognize the consumption of capital assets. The CAD was repealed effective for tax years starting after December 31, 1999. The CAD was replaced by the Investment Tax Credit.

The Single Business Tax Capital Acquisition Deduction

The CAD, is a deduction of the entire cost of certain tangible assets in the year of acquisition. This is contrasted with the cost recovery under the Internal Revenue Code that allocates deductions over the "useful life" of an asset by means of depreciation or amortization. The tangible asset must be an asset of a type that is or will become eligible for depreciation or amortization for federal income tax. However, the CAD may be allowed in years where no depreciation is allowed for federal income tax purposes. Cost of an asset to be deducted as CAD is the amount paid or accrued during the taxable year. (MCL 208.23)

CAD: Qualifying Tangible Assets

In general, any tangible asset of a type that is eligible or will become eligible for the federal income tax allowance for depreciation or amortization qualified for CAD subject to recapture. Type of assets subject to depreciation are those assets defined as tangible property in U.S. Department of Treasury Regulation 1.167(a)-2, which includes such property as buildings, machinery, trucks, and office furniture. However, it does not include tangible property, land or property subject to the federal income tax depletion allowance. Type of assets subject to amortization include such property as leasehold improvements, certain facilities, but does not include intangible property or certain organization costs.

Cost and Method of Accounting

Cost is the amount paid or accrued for the acquisition of a qualifying tangible asset. This cost usually equals the basis of property that will be recovered through depreciation, amortization, or other means of write-off. In general, the cost of qualifying tangible assets (property) is deducted in the taxable year that such costs are recorded in the taxpayer's books and records. Permissible methods of accounting are the cash receipts and disbursements method and/or accrual methods consistent with the taxpayer's method of accounting used for federal income tax purposes.

Under the cash disbursement method, cost of property is deducted in the taxable year in which such cost, in part or total, is paid. Under the accrual method, the cost of property is deducted in the taxable year that all of the events have occurred which establish the fact of the liability giving rise to such cost (in part or total), and the cost can be determined with reasonable accuracy.

Recapture of Capital Acquisition Deduction

In general, the gross proceeds or other benefit derived from the sale or other disposition of qualifying tangible assets is added to the allocated or apportioned tax base. This adjustment is decreased by the gain (increased by the loss) from the disposition of such property that is reported in federal taxable income.

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A disposition means any disposition or conversion of qualifying tangible assets. This includes sales, exchanges, abandonment's, retirements, trade-ins, involuntary conversions, property converted to non-qualifying property and any other event in which such property ceases to be qualifying property in the hands of the taxpayer.

Michigan Business Tax Provisions

The MBT in Section 203 imposes a modified gross receipts tax at the rate of 0.8% of the "modified gross receipts tax base". [MCL 208.1203(1)] The modified gross receipts tax base means a taxpayer's gross receipts less purchases from other firms. [MCL 208.1203(3)]

"Purchases from other firms", as is defined in Section 113(6), includes the following subtraction:

(b) Assets, including the costs of fabrication and installation, acquired during the tax year of a type that are, or under the internal revenue code will become, eligible for depreciation, amortization, or accelerated capital cost recovery for federal income tax purposes. [MCL 208.1113(6)(b)]

Please note the similarity between the MBT subtraction and the SBT deduction. Like the SBT deduction, the MBT subtraction includes assets that will become eligible for depreciation, amortization, or ACRS. However, the MBT subtraction is not limited to only tangible assets. The MBT subtraction can also include intangible assets as long as they can be amortized.

What method of accounting is used to determine the MBT subtraction? Like the CAD, the deduction for the purchase of assets from other firms would be based on the method of accounting used by the taxpayer for federal income tax purposes. The subtraction would be allowed in the taxable year that such costs are recorded in the taxpayer's books and records. This means construction in progress would be deducted in the year paid or accrued and recorded on the taxpayer's books and records.

The subtraction would not have to wait until the assets is placed in service and depreciated or amortized. Section 113(6)(b) includes the phrase "that are, or under the internal revenue code will become" which suggests the taxpayer does not have to wait until the assets is placed in service. The asset merely has to be "acquired during the year".

Sale or Disposition of Business Assets

Amounts received from the sale, transaction, exchange, involuntary conversion, or other disposition of assets used in a trade or business (Section 1231 type assets), except land, will be included in "gross receipts" as broadly defined in Section 111(1). These assets are of a type that would qualify for depreciation, amortization or ACRS. Unlike the CAD recapture in the SBT, the MBT requires inclusion of the total gross proceeds in gross receipts when the assets are sold or otherwise disposed of.

It is very important to monitor the acquisition and disposition of assets used in a trade or business. The MBT ramifications are significant.

Please stay tuned for more news and follow the [MichiganStateAndLocalTax Blog](#) for information as it becomes available.

If you have questions please feel free to contact me. I would be happy to be of assistance.

Sincerely,

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