



Echelbarger, Himebaugh, Tamm & Co., P.C.
STATE AND LOCAL TAX NEWSLETTER

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2008-22

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Single Business Tax (SBT) Small Business Credit for a Controlled Group with a Short Period Tax Year within the Group – Unusual Complications

GRAND RAPIDS, MI – Monday, June 9, 2008 – All fiscal year SBT taxpayers having a tax year ending in 2008 will need to file a short period tax return for the short period starting with the first day of their fiscal tax year and ending on December 31, 2007. Such returns, which were due on April 30, 2008, should have been extended to the last day of the fourth month after the end of the fiscal year ending in 2008. The extension of time to file the short period return will enable the taxpayer to choose to file the tax return based on a prorating of the annual amount (annual method) or the actual amount (actual method) according to guidance provided in Revenue Administrative Bulletin 2007-5 (RAB 07-5). Unusual complications arise when an entity has more than one taxable year, including the short period tax year, within a controlled group year. This newsletter discusses the unusual complications such a situation presents when computing the SBT Small Business Credit.

The Michigan Department of Treasury (Treasury) has provided guidance on these issues in the form of RAB 07-5 and Internal Policy Directive 2008-1 (IPD 08-1). Also see Supplemental Instructions for Final Fiscal SBT Filers and 2007 Additional Instructions Pertaining to Specific Forms. These supplemental or additional instructions correspond to 2007 SBT Instruction Book (Form #3435).

An IPD is an internal document used by Treasury staff to provide guidance and

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standardize policy regarding, in this case, the application of Single Business Tax Act (SBTA) Section 36(7) [MCL 208.36(7)]. IPDs are made available by Treasury on their website in the Reference Library section.

IPD 08-1 addresses the situation where an entity has more than one taxable year in a controlled group year, including a short period tax year. It discusses how the business activities of the entities are combined for purposes of claiming and computing the small business credit. Much of the following is taken from IPD 08-1.

If an entity (hereafter referred to as the "short-year entity") has two taxable years in a controlled group year, the full twelve month fiscal year ending in 2007 and the short year ending December 31, 2007, the two tax years of the short-year entity that end within the same calendar year are not combined on the same C-8009. Instead, two Form C-8009s are filed, each reflecting all other members of the group and one tax period of the short-year entity. [See Plymouth Nursery Inc. v Dep't of Treasury, MTT Docket No 311795 (2006)]

The SBTA specifies "'taxable year' means the calendar year, or the fiscal year ending during the calendar year, upon the basis of which the tax base is computed under this act. When a return is made for a fractional part of a year, tax year means the period for which the return is made. . . ." [MCL 208.10(1)]

The business activities of the affiliates are reported identically on each C-8009 since the two forms represent the same tax year for the affiliates. A controlled group is disqualified from taking a small business credit if combined gross receipts exceed \$10 million, if combined adjusted business income exceeds \$475,000, or if allocated income exceeds \$115,000. SBTA Section 36 [MCL 208.36] authorizes a small business credit available to firms that meet three criteria: (1) gross receipts less than or equal to \$10 million, (2) adjusted business income less than or equal to \$475,000, and (3) owner or officer-allocated income less than or equal to \$115,000.

If a disqualifier exists for any of the affiliates common to both Form C-8009s, then all the affiliates and the short-year entity will be denied the small business credit on both C-8009s. This is because the two forms represent one tax year for the affiliates. If, however, a disqualifier exists only for the short-year entity on only one C-8009 (one tax year) this will not disqualify the short-year entity from taking the small business credit on the other C-8009 (the other tax year). The affiliates, in either case, will be denied the small business credit on both C-8009s. When one member of an affiliated group is allowed the credit, but another is not, the calculation of the credit for the eligible member is still completed on Form C-8009, using the business activity of the entire group.

SBTA Section 36 (7) [MCL 208.36(7)] states: "An affiliated group as defined in this act, a controlled group of corporations as defined in section 1563 of the internal revenue code and further described in 26 C.F.R. 1.414(b)-1 and 1.414(c)-1 to 1.414(c)-5, or an entity under common control as defined by the internal revenue code shall not take the credit allowed by this section unless the business activities of the entities are consolidated."

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The adjusted business income, gross receipts, and allocated income to owners or officers for the short period return must be annualized to determine eligibility for that C-8009. Annualization is necessary when an amount represents something less than the 12 month annual year. The amount which is less than the 12 month year is required to be annualized to a 12 month year.

When the short-year entity is claiming the small business credit, the business activity of all members of the controlled group will be combined on each C-8009 with the business activity of the short-year entity in order to calculate the small business credit. When an affiliate is able to take the small business credit, the affiliate will combine its business activity along with that of all other affiliates and the business activity of the short-year entity's last tax year (the second C-009) in order to calculate the credit.

The adjusted business income, gross receipts, and allocated income to owners or officers for the affiliate must be prorated to determine eligibility on the Form C-8009. Proration is necessary when a 12 month amount is applied to less than a 12 month tax period.

In implementing the small business credit for members of a controlled group, Treasury has issued administrative guidelines in the form of questions and answers and the forms and instructions put out on an annual basis. Specifically, Form C-8009, Allocation of Statutory exemption, Standard Small Business Credit and Alternate Tax for Members of Controlled Groups, must be completed by all controlled groups, including affiliated groups, controlled groups of corporations, and entities under common control, to calculate the standard or alternate small business credit. The gross receipts, adjusted business income and tax base of all members of the group must be combined to determine eligibility and to compute the credit.

Form C-8009 is also used to allocate the statutory exemption among members of the group pursuant to MCL 208.35(2), which states: "An affiliated group, a controlled group of corporations as defined by section 1563 of the internal revenue code, or an entity under common control as defined by the internal revenue code is entitled to only 1 exemption allowed by subsection (1)(a) whether or not a combined or consolidated return is filed. If the combined gross receipts exceed \$10 million or the combined adjusted business income exceeds \$475,000, or any one individual, partner, officer, or shareholder has allocated income of more than \$115,000 from any one member of the group, the entire group is ineligible for the small business credit.

In the situation where an entity has more than one taxable year in a controlled group year as a result of a short period return, Treasury previously required the controlled group to include both returns ending within the same calendar year on one Form C-8009 to determine eligibility and calculate the small business credit, almost as if they were two different members of the controlled group. In *Plymouth Nursery Inc. v Dep't of Treasury*, [MTT Docket No 311795 (2006)] the Michigan Tax Tribunal allowed the taxpayer's claimed small business credit and denied Treasury's treatment of short period returns, as explained above.

The Tribunal cited the following reasons for its decision:

- Inclusion of more than twelve months of activity is not supported by statute.
- The definition of controlled group does not include multiple tax years for one entity, but rather returns for more than one related entity.
- The definition of tax year precludes consolidation with another tax year of the same entity.
- No promulgated rule or RAB, or any other published position exists.
- The position that a short year must be annualized is inconsistent with including more than twelve months worth of activity.

The Department will acquiesce to the Tax Tribunal's decision in Plymouth. Therefore, if an entity has more than one taxable year in a controlled group year, the two tax years for that entity ending within the same calendar year are not combined on the same C-8009, but are instead each combined separately with its affiliates. If on either C-8009 a disqualifier exists, the entity and its affiliates will be unable to take a small business credit for that tax year. However, a disqualifier for the short-year entity for one tax year will not affect its ability to take a small business credit in the other tax year.

In the calculation of the small business credit, the business activities for all members of the controlled group are combined with the activity of the short-year entity for each tax year separately. If an affiliate(s) claims a small business credit, the last tax year for the short-year entity will be used for purposes of calculating the credit.

If a small business credit is claimed on both of the Form C-8009s, the adjusted business income of the 12 month affiliate which is included in both Form C-8009s, must be prorated in order to avoid computing the alternate tax twice on the same adjusted business income.

Stay tuned for more news and follow the [MichiganStateAndLocalTaxBlog](#) for information as it becomes available. If you have any questions, please go ahead and contact me. I will be happy to be of assistance.

Sincerely,

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