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STATE AND LOCAL TAX NEWSLETTER

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The New and Expanded Small Business Alternate Tax Credit

GRAND RAPIDS, MI – Monday, July 21, 2008 - The Michigan Business Tax Act (MBTA) contains a credit very similar to the Small Business Credit [MCL 208.36] and alternate tax contained in the Single Business Tax Act (SBTA). The credit is designed to allow eligible businesses to pay a tax on income, defined as adjusted business income, at a 1.8% rate. [MCL 208.1417(4)] To qualify for this special tax treatment, the business must survive three disqualifiers. Like the Single Business Tax (SBT), the three disqualifiers are gross receipts, adjusted business income, and individual income. However, the disqualification amounts have been significantly increased.

The Small Business Credit is available to any taxpayer with gross receipts that do not exceed \$20,000,000 and with adjusted business income minus the loss adjustment that does not exceed \$1,300,000. [MCL 208.1417(1)] The gross receipts and the adjusted business income disqualifiers will be adjusted annually for inflation using the Detroit consumer price index.

The Small Business Credit is taken after the compensation credit, the investment tax credit and the research and development credit, but before all other credits. [MCL 208.1417(1)]

Distributive Share of Adjusted Business Income Disqualifier

An individual, a partnership, a limited liability company, or a subchapter S Corporation is disqualified from taking the Small Business Credit if the individual, any one partner of a partnership, any one member of a limited liability company, or any one shareholder of a subchapter S Corporation receives more than

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\$180,000 as a distributive share of the adjusted business income minus the loss adjustment. [MCL 208.1417(1)(a)]

A Professional Employer Organization (PEO), as defined in Section 113 of the MBTA [MCL 208.1113(4)], determine compensation for the small business credit disqualifier in accordance with Section 417. [MCL 208.1417(8)] Under Section 417, an entity is disqualified from taking the small business credit if more than \$180,000 is paid to an officer, director, shareholder or other defined person. A PEO is disqualified based on amounts paid to its own officers and employees. Individuals leased to a PEO's client are not considered for calculating the PEO's disqualifiers. [Treasury FAQ C2]

For a PEO, the adjusted business income and compensation disqualifiers of the small business credit are determined by Section 417 [MCL 208.1417(8)] which requires a client of a PEO to include compensation paid to the client's officers and employees leased to the client.

For the adjusted business income disqualifier, this means that the client adds compensation and director's fees paid for active shareholders and officers to business income as outlined in Section 417(9). [MCL 208.1417(9)] If the client's adjusted business income exceeds \$1.3 million, the client is disqualified from taking the small business credit. [MCL 208.1417(1)]

Likewise, for the compensation disqualifier, the client will consider all compensation, director's fees and distributive shares paid to its officers, owners and shareholders, even though leased from a PEO. Under Section 417(1)(a and (b) [MCL 208.1417(1)(a) and (b)], the client will be disqualified from taking the small business credit if more than \$180,000 in compensation is allocated or paid to these individuals. While Section 417(8) directs clients of PEOs to consider all compensation of officers and employees; officers/shareholders/owners compensation and distributive shares are included for purposes of the disqualifiers.

Active Shareholder is defined in Section 417(9)(a) as receiving at least \$10,000 in compensation, director's fees or dividends and owning at least 5% of outstanding stock or other ownership interest. [Treasury FAQ C3]

Corporation Shareholder and Officer Disqualifier

If the compensation paid to an individual shareholder of a C

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Corporation or officer of a C Corporation exceed \$180,000, the C Corporation is disqualified from using the Small Business Credit,

or

If the sum of the compensation and directors' fees of a shareholder plus the shareholder's percentage share of the C Corporation's adjusted business income exceeds \$180,000, the C Corporation is disqualified from using the small business credit. [MCL 208.1(417(1)(b))]

Phase Out of the Small Business Credit - Individual

The credit is phased out if the distributive share of adjusted business income for an individual, partner, member, shareholder or officer exceeds \$160,000. [MCL 208.1417(1)(c)]

\$160,000 or less		0.0%
\$160,000	\$165,000	20%
\$165,000	\$170,000	40%
\$170,000	\$175,000	60%
\$175,000	\$180,000	80%
\$180,000 or more		100%

Phase Out of the Small Business Credit – Gross Receipts

If gross receipts exceed \$19,000,000, the credit is reduced by a fraction, the numerator of which is the amount of gross receipts over \$19,000,000 and the denominator of which is \$1,000,000. The credit cannot exceed 100% of the tax liability. [MCL 208.1417(5)]

There is no phase out of the adjusted business income disqualifier of \$1.3 Million.

The Small Business Credit Calculation

A taxpayer that qualifies for the Small Business Credit is allowed a

credit against the MBT equal to the amount by which the tax imposed exceeds 1.8% of adjusted business income. [MCL 208.1(417(4))]

Adjusted business income is business income plus the following:

(i) Compensation and director's fees of active shareholders of a corporation

(ii) Carry back or carry forward of a net operating loss

(iii) Capital losses, and

(iv) Compensation and director's fees of officers of a corporation.

MCL 208.1417(9)(b)]

The Small Business Credit for a "unitary business group" is calculated on a combined basis. The MBTA defines a taxpayer as a person or a unitary business group. [MCL 208.1117(5)] Therefore, the Small Business Credit and all three disqualifiers is computed on a combined as if all of the separate entities were one. The Small Business Credit "is available to any *taxpayer* with gross receipts that do not exceed \$20,000,000.00 and with adjusted business income minus the loss adjustment that does not exceed \$1,300,000.00 as adjusted annually for inflation using the Detroit consumer price index" and subject to certain additional disqualifiers. MCL 208.1417(1)

Since "taxpayer" is "a person or a unitary business group" [MCL 208.1117(5)], the gross receipts and adjusted business income thresholds under Section 417(1) apply to taxpayers. Thus, for a unitary business group, the gross receipts and adjusted business income thresholds must be calculated by the unitary business group by combining the gross receipts and adjusted business incomes of its members. [Treasury FAQ C5]

The disqualifiers under Section 417 (1) (a) and (b) [MCL 208.1417(1)(a) and (b)] apply to a taxpayer that is a unitary business group if such disqualifiers apply to any member of that unitary business group. For example, a taxpayer that is a unitary business group is disqualified from taking the Small Business Credit if that unitary business group includes a member that is a partnership and any one partner of that partnership receives more

than \$180,000.00 as a distributive share of the adjusted business income minus loss adjustment of the partnership. [Treasury FAQ C5]

Similarly, the reduction percentages in Section 417(1)(c) [MCL 208.1417(1)(c)] apply to a taxpayer that is a unitary business group if such reduction percentages apply to any member of that unitary business group. For example, the Small Business Credit of a taxpayer is reduced by 20% if the taxpayer is a unitary business group that includes a member that is a corporation and the compensation and directors' fees of an officer of that member corporation exceed \$160,000.00 but are less than \$165,000.00. [Treasury FAQ C5]

Tax Year Less Than Twelve Months

If the tax year is less than twelve months, the gross receipts disqualifier, the adjusted business income, and share of business income disqualifiers shall be prorated. [MCL 208.1417(6)] The amount is multiplied by a fraction, the numerator of which is the number of months in the tax year and the denominator is 12.

Short Form Filing Option

If the taxpayer qualifies for the Small Business Credit without any of the reductions, they may file a short form return without a computation of the Michigan Business Tax. [MCL 208.1417(7)]

Professional Employer Organization (PEO)

If the taxpayer leases its officers and employees from a PEO, the compensation paid by the PEO to the taxpayer's officers and employees is included in the taxpayer's (client) tax return for Small Business Credit disqualification purposes. [MCL 208.1417(8)]

Loss Adjustment

A loss adjustment is used to reduce adjusted business income for the adjusted business income disqualifier (\$1,300,000) and the individual, partner, and shareholder disqualifier (\$180,000). The loss adjustment is used only to determine if the taxpayer is eligible for the Small Business Credit alternate tax calculation. The credit calculation or alternate tax is based on adjusted business income before the loss adjustment. [MCL 208.1417(9)(d)]

The loss adjustment is the amount by which adjusted business income was less than zero in any of the five years immediately preceding the tax year. The negative adjusted business income is used only to the extent needed to qualify for the credit. The taxpayer may not reuse negative adjusted business income. The negative adjusted business income cannot be carried from a year in which no small business tax credit was claimed.

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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