



The New Michigan Corporate Income Tax

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On May 25, 2011, Governor Rick Snyder signed legislation that repeals the complex and unpopular Michigan Business Tax (MBT) and replaces it with the new Michigan Corporate Income Tax (CIT) effective as of January 1, 2012. The new tax package also makes major changes to Michigan's individual income tax law.

Effective January 1, 2012, the CIT will impose a flat 6% tax on the Michigan apportioned income of businesses that are taxed as C corporations for federal income tax purposes. Unlike the MBT, the CIT will not apply to "pass-through" entities such as S corporations and most limited liability companies. Moreover, a C corporation will be exempt from the CIT if its Michigan-apportioned annual gross receipts are less than \$350,000 or its CIT liability is less than \$100. Gross receipts will be apportioned based on the ratio of Michigan sales to total sales, as is currently done under the MBT. Ultimately, the replacement of the MBT with the CIT is estimated to relieve 95,000 Michigan businesses from the burden of filing a Michigan business income tax return and paying business taxes.

Since the CIT will apply only to C corporations, businesses that are taxed as C corporations may want to consider converting to an S corporation or another type of "pass-through" entity. This conversion could help reduce the business's effective income tax rate, and it might also help to reduce the owners' payroll or self-employment taxes. However, several tax and business issues should be considered before pursuing such a conversion.

A downside of the CIT is that it will not retain most of the tax credits and deductions that are available under the MBT. One exception is the small business alternative tax credit, which will provide a credit to small businesses with gross receipts of less than \$20 million and adjusted business income of \$1.3 million or less, subject to certain limitations on the amount of compensation that may be paid to shareholders and officers. If a taxpayer qualifies for the credit, the taxpayer will receive a credit for the difference between the taxpayer's CIT liability and 1.8% of the taxpayer's adjusted gross income.

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Transitional relief may also allow taxpayers to continue to claim select credits under the MBT if they continue to file under the MBT, rather than the CIT.

The CIT will tax insurance companies and financial institutions differently from other businesses. The CIT's tax on insurance companies is identical to the tax such business pay under the MBT. Financial institutions would also be subject to the same net capital tax imposed under the MBT, and the 0.29% net capital tax rate approximately equals the rate paid under the MBT, although the CIT will no longer allow financial institutions a deduction for goodwill.

If you have questions regarding the CIT, the changes made to the Michigan individual income tax law, or Michigan taxes generally, please contact us.