Governor Proposes Michigan Tax Reform

Joel C. Farrar & Nicholas M. Oertel
Foster Swift Business & Corporate Law Report
Winter 2011

AUTHORS/ CONTRIBUTORS
Joel C. Farrar
Nicholas M. Oertel

PRACTICE AREAS
Business Law
Family Owned Businesses
Tax Law

On February 17, 2011, Governor Rick Snyder proposed restructuring Michigan's tax system. The Governor's proposal would eliminate the complex and unpopular Michigan Business Tax (MBT) and replace it with a much simpler flat 6% Michigan Corporate Income Tax (CIT). The CIT would apply to businesses that are taxed as "C" corporations for federal income tax purposes, but would exempt "pass-through" businesses that are taxed as "S" corporations or partnerships (including most limited liability companies) and trusts, since owners of "pass-through" entities already pay individual taxes on business profits. The exemption from the CIT for "pass-through" entities is estimated to relieve 95,000 Michigan companies from the burden of filing a Michigan business income tax return.

The Governor's proposal would also eliminate most of the MBT's tax credits and deductions, retaining only the MBT Small Business Alternative Credit. The CIT would, however, retain the MBT's broad nexus standards, pursuant to which an out-of-state taxpayer would be subject to the CIT if it has a physical presence in Michigan or actively solicits sales in Michigan and has Michigan sales of at least $350,000, subject to certain federal restrictions on Michigan's taxing authority.

The CIT would tax insurance companies and financial institutions differently from other businesses. Insurance companies would be subject to a tax equal to 1.25% of gross direct premiums written on property or risk located or residing in Michigan. Financial institutions would be subject to a franchise tax equal to 0.29% of the financial institution's net capital, where net capital is based on a 5-year average of equity capital as computed in accordance with GAAP less the average daily book value of U.S. and Michigan obligations.

The Governor also proposed significant changes to the Michigan income tax for individuals, partly to offset the loss of approximately $1.8 billion in annual revenue that would result from the adoption of the CIT. The Governor's proposal would retain the reduction in the individual income tax rate from 4.35% to 4.25% that is scheduled for October 1, 2011, but would then freeze the rate at 4.25%. Most credits and deductions currently allowed against the individual income tax would be eliminated, with the exception of the personal exemption (fixed at the 2011 level of $3,700 and subject to a phase-out for higher income individuals), the homestead property tax credit (generally fixed at 80% and subject to a reduced phase-out), the exemption for disabled persons, certain provisions for military personnel and veterans, and a few others. In addition, with the exception of Social Security income, all public and private pensions would be subject to the revamped tax, as would senior dividends and interest and political contributions.