

'Tis the Season – Taxes That Is Is Your Business Ready to File?



Greg Nowak, Loren Opper and Jack Van Coevering

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Tis the Season: An Outline of Updates and Tips for Filing in 2010

Introduction

- I. Overview-Introduction
- II. *Kmart v Dept of Treasury* Refunds and the Department's Decision to Retroactively Assess
- III. Michigan Business Tax
 - A. Unitary and Nexus Controversies and the Importance of *KMart*
 - B. Apportionment: Update and the Department Proposal for Sourcing Services and for Sourcing Property
 - C. Modified Gross Receipts: The Department's Proposed Administrative Rule and Other Issues
 - D. Net Operating Losses and FAS 109
- IV. Michigan Business Tax Credits
 - A. Overview
 - B. Proposed Rules
 - C. Thoughts on the Big Three
 - D. Refundable Personal Property Tax
- V. Troubled Companies
 - A. Corporate Officer Liability
 - B. Cancellation of Indebtedness
 - C. Bankruptcy
- VI. Service Tax and Sales Tax Update
- VII. Administrative and Compliance Tips
 - A. Rules, RABs, FAQs and What they Require or Do Not Require You To Do
 - B. Return Positions and Protective Refund Claims
 - C. Compliance Tips

- *Kmart v Dep't of Treasury*
- Refunds, Assessment, What it Means to You

Kmart Decision

- “Person” for SBT purposes does not incorporate the federal check-the-box regulations
- A federally disregarded LLC that had business activity is a “person” and entitled to be separately taxed under the SBT
- The Court did not directly address the treatment of taxpayers that relied on RAB 1999-9 (check-the-box) or 2000-5 (Q Subs)

Kmart Notice

- The Department requires taxpayers to file SBT returns for disregarded entities for all years without regard to the statute of limitations
- Interest due on all tax liabilities
- Taxpayers that included disregarded entities in their returns must amend their returns, subject to the 4 year statute of limitations.
- Interest only payable on refunds from date filed if not paid within 60 days
- No penalties will be assessed if taxpayers comply with the notice by September 30, 2010

Kmart Legislation

- Taxpayer reliance interests create strong equities for legislation to preserve pre-Kmart status quo
- Department willing to support legislation to override Kmart decision if barring both refunds and assessments
- Efforts are under way to pass legislation swiftly – before quarter ending 3/31/2010

Kmart Alternate Arguments

- An entity could be included in an SBT affiliated group if the entity were a “corporation”
- “Corporation” was defined by reference to IRC §7701(a)(3)
- At the time that the SBT reference to “corporation” was enacted, IRC §7701(a)(3) was interpreted by the federal Kintner Regulations

Kmart Alternate Arguments

- The Kintner Regulations provided that an entity was a corporation if it had at least three of the following four corporate characteristics:
 - Continuity of life (created by statute rather than by agreement); centralized management; limited liability; free transferability of interests (transferee may participate in the management of the LLC)

Kmart Alternate Arguments

- See Revenue Ruling 88-76, which applied the Kintner Regulations to a Wyoming limited liability company.
- The ruling found that the LLC was not a corporation.
- Application of the Kintner Regulation may, however, find that an LLC is a corporation depending on the provisions of the state LLC statute.

Kmart Alternate Arguments

- An entity might be a “corporation” for SBT affiliation purposes even if organized as an LLC.
- A review of the LLC statute under which the entity is organized is required.
- As a “corporation,” the entity might be eligible for combination, thus reaching the same result as was reached as a disregarded entity.



Michigan Business Tax

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Michigan Business Tax Unitary Controversies

- 50% “direct or indirect” ownership required by statute. Treasury says indirect = attributional ownership ala IRC 318.
- Plain meaning would suggest a narrower scope – ie, indirect = vertical tiered ownership
- Position may exist for plain meaning interpretation – not attributional – run the numbers, analyze both positions
- Technical corrections could address this

Michigan Business Tax Nexus Controversies

- Economic nexus – nexus exists in absence of physical presence if taxpayer “actively solicits sales” in the state
- Statute sets stage for dot coms or mail order sellers to contest constitutionality – ie, does *Quill* apply outside the context of sales tax to requires a physical presence?
- Note that *Finnegin* rule for unitary groups says if one is in, all are in, so for some taxpayers the nexus issue is irrelevant if a single unitary member has a physical presence



Apportionment: Overview and Update

- When Does a Taxpayer Apportion: The Importance of MBT Nexus
- Apportionment Formula
- Apportionment of Services: Draft RAB
- Alternatives to Statutory Apportionment: MBT

When Can a Taxpayer Apportion?

- For both the business income tax and gross receipts tax, the base is apportioned if the taxpayer has business activities both within and outside Michigan.
- A taxpayer has business activities outside Michigan if it is “subject to tax” (*theoretically*) in another state, including any foreign country (FAQ B13).

The Meaning of “Subject to Tax in Another State”

- Taxpayer is subject to tax in another state if the other state either (1) *has jurisdiction to tax* the taxpayer or (2) subjects the taxpayer to any of the following taxes:
 - Business privilege tax
 - Net income tax
 - Franchise tax measured by net income
 - Franchise tax for the privilege of doing business
 - Corporate stock tax
 - A tax of the type imposed under the MBT Act

The Jurisdiction to Tax (for the Other States) is Determined Under the MBT Nexus Standard

- In determining whether subject to tax in another state, apply MBT nexus rules
- Physical presence in the state for more than one day during the tax year, or
 - For nexus purposes, physical presence does not include professionals providing services in a professional capacity or other service providers if the activity is not associated with establishing a Michigan market.
- Actively solicits sales in the state and has at least \$350,000 gross receipts sourced to the state

Say that again.....

- The lowest nexus standard in the United States benefits Michigan companies that export as it allows the companies to apportion sales to states in which they have no risk of being subject to tax.
 - The other state has a higher nexus standard and likely will not adopt the Michigan nexus standard.

Apportionment Formula

- Single Sales Factor
 - Fraction is equal to Michigan “sales” divided by everywhere “sales”
- “Sales” narrowly defined
 - Consideration received for transfer of title or possession of stock of goods held for sale in the ordinary course of business, performance of services, rental and licensing (if a business activity), any combination.
 - Income from investment assets only if that is the seller’s only business
 - Sales of intangibles limited to gain received – query – what types of intangible sales are included?
 - Occasional sales of assets are excluded from both numerator and denominator.
 - Occasional sale is a sale of an asset that is not stock in trade, inventory, or an asset held for sale to customers in the ordinary course of business. What about intangibles?

Apportionment MBT Changes

- Many MBT sourcing rules are similar to the SBT rules
- Key differences between the MBT and SBT:
 - No longer all or nothing – apportioned to the extent utilized; typically determined by a fraction days in Michigan/days elsewhere
 - New phrase, “ultimate destination at the point the property comes to rest”. When does this allow temporary presence in MI for goods going out (ie dock sales), and look through temporary presence out of state for goods coming in?
 - Performance of services – where the benefit is received (MBT); no longer cost of performance sourcing (SBT) to where the recipient of services receives the benefit under MBT
 - Intangible sales - switch from cost of performance²⁰



Apportionment of Tangible Personal Property

- To Michigan if
 - the property is **shipped or delivered to any purchaser** within Michigan based on the **“ultimate destination at the point the property comes to rest”**
 - FOB or other conditions of the sale are irrelevant
 - For electricity and gas, where the contract requires the property to be shipped or delivered



Apportionment of Tangible Personal Property: Draft RAB

Department presumes that the shipment comes to rest in the shipping state if the goods are not

- Immediately shipped or picked up
- Are warehoused
- Undergo additional value-added services in the shipping state

Ex. Goods warehoused in Michigan for later delivery, might be Michigan sales



Apportionment of Tangible Personal Property: Draft RAB

- “Dock sales”: Purchaser provides the shipping means and picks up the property
- “Drop Shipments”: Seller ships to the purchaser’s customer and the purchaser never takes possession
- For dock sales or drop shipments test is where the goods come to rest, not the method of delivery
 - Not based on the seller’s point of shipment unlike other states

Apportionment of Tangible Personal Property: Draft RAB Summary

- Destination sales assigned to the state where the shipment comes to rest
- Shipment comes to rest upon delivery of the goods where the purchaser ultimately receives the goods...later shipment to the consumer is irrelevant
- Goods come to rest in the shipping state if not immediately shipped or picked up or if the goods undergo value-added services or are warehoused
- Dock sales made in Michigan are presumed to be in Michigan unless the vendor can prove that the property was immediately shipped out and not used in Michigan
 - Records must show actual destination, i.e. purchaser affidavit, bill of lading or shipment document ...at the time of sale
- “Immediate” is determined by “facts and circumstances” considering the nature of the goods and the industry practices



Apportionment of Services: Sec 305 (2) (a)

- To Michigan if
 - the recipient of the services receives “all of the benefit of the services in this state, or
 - in proportion to “the extent the recipient receives benefit of the services in this state”
- How is “benefit” determined?



Apportionment of Services: General Default Rule

Sec. 311

All other receipts not otherwise sourced under this act shall be sourced based on where the benefit to the customer is received or, if where the benefit to the customer received cannot be determined, to the customer's location.

Apportionment of Services: Issues

Key Questions Related to Services

- What is a “service”?
 - Mixed transaction issues.
- Who is the “recipient”?
- What is the benefit?
- Where is benefit received?
- What method to use to apportion a sale between two states?



Apportionment of Services: Other References

- Compare to MTC approach –sourced to where performance occurs
- Compare to Other MBT provisions:
 - To customer's location then to customer's address
 - To domicile, then to primary residence or business address, then to mailing address
 - To the property's location, then to location of the purchaser



Apportionment of Services: Some Answers in the Draft RAB

- Does not define “service” or discussed mixed transactions but see proposed administrative rule regarding “Mixed Transactions”
- Recipient of the services may be someone other than the purchaser
- Does not define the “benefit”
- Does address as to “where the benefit is received”
- Does give some guidance as to how to apportion a service between two states

Draft RAB: The Importance of the Ordering of Defaults

“A taxpayer may not simply use the customer’s location to source a sale of services without first making a reasonable and demonstrable effort, based on its books and records, to determine the location where the recipient of the service received the benefit of that service....

“Sales are not excluded from the apportionment factor if the location of the recipient’s benefit cannot be determined.”

Draft RAB: When a “Benefit is Received” Entirely in Michigan

- The service relates to real property in Michigan
- The service relates to tangible personal property that is in Michigan at the time the service is received or delivered to the purchaser or his designee in Michigan
- Purchaser receives the service in Michigan
- Personal services, typically performed first-hand and direct one-to-one, that are rendered in Michigan: consulting, counseling, training, speaking
- Services provided to a purchaser, whose trade or business is only in Michigan and the service only relates to that business
- Services relate to intangible property used solely in the state
- Professional services that are rendered to an individual in this state or to a purchaser with operations only in Michigan

Draft RAB:

Apportioning the Benefit Received

- Services relate to real estate in multiple states, then it is apportioned to the extent real estate is in Michigan.
[Correct Result?]
- Services relate to personal property owned, leased, delivered to a purchaser or his designee in multiple states, then to the extent the property is located in Michigan or delivered to Michigan.
- Services relate to a trade or business in multiple states, then it is sourced to Michigan to the extent it relates to the trade or business in Michigan.
- Services relate to intangible property in multiple states, then it is sourced to Michigan to the extent the property is used in Michigan.
- Professional services for a purchaser in multiple states, then it is sourced to the extent the services relate to Michigan operations.

Alternatives to Statutory Apportionment

The MBT does not provide much of an alternative.

- May petition the Treasurer for *permission* by showing that the business activity attributed to the taxpayer in Michigan is
 - out of all appropriate proportion to the actual business activity transacted in Michigan and
 - leads to a grossly distorted result or
 - would operate unconstitutionally to tax the extraterritorial activity of the taxpayer.

Alternatives to Statutory Apportionment: the UDITPA Alternative

- Permits taxpayers to elect UDITPA Apportionment: Property, Payroll and Sales; MCL 205.581; Art. III and IV
- For an “income tax”: defined as “ a tax imposed on or measured by net income including any tax imposed on or measured by an amount arrived at by deducting expenses from gross income, 1 or more forms of which expenses are not specifically and directly related to particular transactions.” Art. II (4)

Michigan Business Tax

Modified Gross Receipts: The Proposed “Rule” and Other Issues

- Gross Receipts modified by the deduction for “Purchases from other firms”
 - Statutorily defined phrase, MCL 208.1113 (6) that does not literally mean a purchase from another firm
 - Rules of statutory interpretation apply
 - With two exceptions not similar to the federal cost of goods sold calculation on Schedule A
 - No comparable definition in other states
 - Cannot be referenced by use of federal income tax law as this is not a comparable context. MCL 208.1103
 - Departments FAQs are not binding but are the only source of published guidance.....which has not be uniformly accepted

Modified Gross Receipts: Purchases from Other Firms: Inventory

MCL 208.1113 (6) (a)

Inventory acquired during the tax year, including freight, shipping, delivery, or engineering charges included in the original contract price for that inventory.

Modified Gross Receipts: Purchases from Other Firms: Capital Asset

MCL 208.1113 (6) (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.

Modified Gross Receipts: Purchases from Other Firms: Capital Asset

- Are all assets that are subject to depreciation, amortization and accelerated cost recovery deductible regardless of whether they are intangible?
- If a taxpayer elects to expense the asset, is the asset still eligible for deduction?
- Does the inclusion of the “costs of fabrication and installation” support the inclusion of all capitalized labor and services on self-constructed assets or rebuilt assets?

Modified Gross Receipts:

Purchases from Other Firms: Materials and Supplies

MCL 208.1113 (6) (c)

To the extent not included in inventory or depreciable property, materials and supplies, including repair parts and fuel.

Modified Gross Receipts:

Purchases from Other Firms: Materials and Supplies

- What is the meaning of the phrase, “To the extent not included in inventory or depreciable property” (MCL 208.1113 (6) (c))?
- Do materials and supplies used in the production of income also qualify as deductible “material and supplies,” i.e. paper, computers, software, etc.?
- Does electricity, steam, water, alternative fuel qualify as a “material and supplies” or as “fuel?”

Michigan Business Tax Net Operating Losses

- Statute creates 10 year income tax loss carry-forward
- Do losses survive ownership change events like SBT losses did (RAB 1992-3)? Should MBT conform to IRC 381 carryover rules? And IRC 382 limitation provisions?
- Possible subject of technical correction

Michigan Business Tax

FAS 109

- Statute permits future deduction in 2015-2029 to offset book hit from enactment of MBT
- Equal to amount of income tax deductions to offset net deferred tax liability otherwise recorded on books
- Needed to report amount of deduction on first tax return due after enactment
- Form unclear regarding level of detail required
- Unclear whether amount disclosed can be amended – Treasury says no
- Treasury has not yet disclosed total amount of future deductions reported by taxpayers

Michigan Business Tax Credits Overview

- Similar Treatment to the SBT
 - Same ordering
 - No or few changes to many credits, i.e. charitable credits
- Changes from the SBT? Double the credits; more than twice as complicated
 - More than 40 credits, constituting the bulk of MBTA statutes
 - Of the 20 Forms for Standard MBT Taxpayers, 15 are for credits
 - Calculated on a unitary basis unless specifically exempted
- Substantial Unwritten Administrative Practice
 - Proposed Rule on Industrial Personal Property Credit, FAQs
 - Credit Ordering: Proposed Rule on Ordering, FAQ C26
- But only a few credits will apply to most standard Michigan-based taxpayers
 - Note: While 40% of MBT Taxpayers were projected to have the same or lower tax liability, the estimate is based on the use of credits

I. Overview (cont.)

- Types of Credits:
 - Refundable v Nonrefundable v Hybrid
 - Sun-setting or Disappearing
 - Recaptured
 - Discretionary Credits: MEGA, DELEG, Local Units

- Limited and Different Credit Scheme for Insurance Companies and Financial Institutions
 - Compensation Credit, Renaissance Zone Credit, Historic Preservation Credit, Brownfield Rehabilitation Credit
 - Other industry specific credits
 - Insurance Companies must take Premiums Tax Credit before other credits

Ordering of MBT Credits: Meaning of Ordering

- Each credit is calculated using the tax liability determined after the deduction of previously ordered credits
 - For nonrefundable credits, this may mean that subsequent credits may not be available for use. Some planning might be useful
- No change from the general calculation of credits in the SBT C-8000 Form
- Generally no statute (aside from a few nonrefundable credits) requiring ordering but practical and administrative policies apply (i.e. taxpayers would want nonrefundable credits exhausted first)
 - Order is largely what the Department says on the tax forms and in Frequently Asked Question C26
 - Order makes sense

Ordering of MBT Credits: Calculation of Credits

- Credits are factored **after** calculation of the apportioned Business Income Tax, the apportioned Modified Gross Receipts Tax and the Surcharge

BIT @ 4.95%

+ MGRT @ 0.80%

Total MBT Before Surcharge and Credits

x 21.99% Surcharge

Total Liability Before Credits

Ordering of MBT Credits

Proposed Rule R208.1237-1241.

- SBT Credits are taken before MBT Credits
- Nonrefundable MBT Credits are taken before Refundable MBT Credits
- Nonrefundable MBT Credits for Compensation, Investment, Research and Development and Small Business Credits are taken before all other Nonrefundable MBT Credits
- Unless the statute directs differently, credits are taken in the order they appear in the MBTA
- Hybrid (electable) credits are calculated first as nonrefundable. If the taxpayers elects for the refund, the credit would be *taken* as a refundable credit
- If a group of credits is required to be taken *before* other credits, order within the group is determined by taking the oldest credits first
- If a group of credits is required to be taken *after* other credits, order within the group is determined by taking the newest credits first

Ordering of MBT Credits: Nonrefundable Credits

The following Nonrefundable Credits are taken before all other Nonrefundable Credits and are taken in the order specified by statute, which is:

- Unused Carry-Forwards from SBT (§ 401)
- Compensation Credit (§ 403(2))
- Investment Tax Credit (§ 403(3))
- Research and Development Credit (§ 405)
- Alternate/Small Business Credit (§ 417)

Nonrefundable Credits: SBT Carryforwards

- 8 SBT Credit Carryforwards, Form 4569
 - SBT Investment Tax Credit
 - SBT Historic Preservation Credit
 - SBT Low-Grade Hematite Pellet Credit
 - SBT Pharmaceutical Credit
 - SBT Created Jobs Credit
 - SBT “Old” Brownfield Credit
 - SBT “New” Brownfield Credit
 - SBT MEGA Business Activity Credit

Nonrefundable Credits: SBT Carryforwards

- In tax years 2008 and 2009, unused SBT Credit Carryforwards may be used against MBT liability, even if the credit is not continued under the MBT.
- Credit Carryforwards are “ordered.” That is, if the tax liability is reduced to zero, subsequent Credit Carryforwards cannot be used and may be lost.
- On the other hand, the MBTA does not extend the term of the SBT Carryforwards. FAQ C37
- Unitary Business Groups combine SBT Credit Carryforwards of each member but are advised to use the oldest credit first.
- The unused Brownfield and Historic Credits are not limited to 2008 and 2009, but can be carried forward for same period as approved for under SBT (10-year period).

Ordering of MBT Credits: Nonrefundable Credits

The remaining **Nonrefundable Credits** are taken in the following order as provided on Forms 4571, 4572 and 4573 (see also FAQ C26)

- Community or Education Foundation Credit (§ 425)
- Homeless Shelter/Food Bank Credit (§ 427)
- NASCAR Speedway Credit (§ 409(1))
- Stadium Credit (§ 410)
- Start-Up Business Credit (§ 415)
- Public Contribution Credit (§ 421)
- Arts and Culture Credit (§ 422)
- Next Energy Business Activity Credits (§ 429)
- Renaissance Zone Credit (§ 433)
- Historic Preservation Credit (§ 435)
- Low Grade Hematite Credit (§ 439)
- Entrepreneurial Credit (§ 441)
- New Dealer Motor Vehicle Inventory Credit (§ 445)
- Large Food Retailer Credit (§ 447)
- Mid Size Food Retailer Credit (§ 449)
- Bottle Deposit Administration Credit (§ 451)
- Brownfield Rehabilitation Credit (§ 437)
- Private Equity Fund Credit (§ 453)

The Simplified Return: A Practical Ordering Tip

- Allows taxpayers to claim the **Small Business Credit** and to file and pay the MBT without computing the Business Income Tax or the Modified Gross Receipts Tax.
- To qualify, taxpayers must not exceed \$19 Million in gross receipts and \$1.3 Million in adjusted business income, **no recapture credits**, no apportionment, not part of unitary business group. [Statutory?]
- Only two credit are allowed:
 - The **Gross Receipts Filing Threshold Credit** (the phase in credit).
 - **Refundable Credits**

Nonrefundable Credits: The Big Three Credits

- Combined, **the Compensation and Investment Credits**, cannot exceed 50% of a taxpayer's liability in 2008 and 52% in 2009 and beyond.
- Combined with **the Compensation and Investment Credits**, the **R & D Credit** cannot exceed 65% of a taxpayer's annual liability.
- All three credits must be taken before any other Nonrefundable Credits.



Nonrefundable Credits: The Compensation Credit, 403 (2).


- Equal to 0.370% (except in 2008 it was 0.296%) of compensation for services performed entirely or primarily in Michigan.
- Compensation includes: Wages, salaries, fees, bonuses, commissions, or other payments for the benefit of employees, officers or directors, including payments to pension, retirement and profit-sharing plans, net earnings from self-employment, payments on W-2 that are subject to or exempt from federal income tax withholding.
- Excludes: Payments made *by* Professional Employer Organizations, Independent Contractors, FICA, FUTA, employee discounts.

Compensation Credit

- FAQ C28: Compensation is in this state if it is performed in Michigan or if services performed out of Michigan are “incidental” to the services performed in Michigan.
- FAQ C32, C39: Compensation calculated on a basis consistent with the taxpayer’s federal reporting. This may depend on the kind of compensation, i.e. wages must be reported on a cash basis where as payments to a pension are reported on an accrual basis.
- FAQ C32: Expenses incurred for the benefit of the taxpayer and not the employee are excluded, i.e. rent or interest expense.

Investment Tax Credit, 403(3), (4), (5).

- Equal to 2.9% (except in 2008 it was 2.32%) of the cost
 - “including fabrication and installation
 - **paid or accrued** in the taxable year
 - of tangible assets of a type that are, or under the internal revenue code will become **eligible for depreciation, amortization ...for federal income tax purposes**
 - provided the assets are **physically located in this state for use in a business activity in this state**”
 - For **mobile tangible assets**, multiple the cost by the apportionment factor
 - For **assets transferred to Michigan** after 12/31/07, the cost is the federal basis as of the date of transfer plus the cost of fabrication and installation in Michigan
- Minus recapture



The Net Investment Tax Credit, 403(3), (4), (5): Recapture.

- For fixed and mobile tangible personal property, the recapture is based on the rate the credit was used, times the gross proceeds at disposition, minus any gain, multiplied by the apportionment factor, plus the loss, multiplied by the apportionment factor.
- For mobile assets, the recapture amount is apportioned.
- For assets transferred out of Michigan, the recapture is the federal tax basis at the date of transfer.
- The credit is a negative amount, the amount is added to the tax liability.

The Net Investment Tax Credit, 403(3), (4), (5).

- Michigan has decoupled from bonus depreciation, thus, if bonus depreciation was used on the federal return, the MBT taxpayer must calculate a separate MBT tax base for assets subject to the credit. FAQ C51
- Unused Net Investment Tax Credits are not carried forward. FAQ C47
- Land does not qualify for the Net Investment Tax Credit. FAQ C45
- Though some tangible personal property will qualify under the Net Investment Tax Credit and the Research and Development Credit, it may not be used in both. Note: the practice opportunity

Nonrefundable Credits: The Research and Development Credit, 405.

- 1.9% (except in 2008 it was 1.52%) of a taxpayer's research and development expenses in Michigan in the tax year
- Credit ceiling...the total **combined** credit in **403** (Compensation and Net Investment Tax Credit) **and in 405** cannot exceed 65% of the tax liability *before the surcharge*

Nonrefundable Credits: The Research and Development Credit, 405.

- Compare to **Net Investment Tax Credit**
 - Higher ceiling, 65%
 - **No Recapture required**
- Compare to the R&D Motor Vehicle Credit, 450- 450a
 - Refundable, no recapture
- Compare to the **MEGA Contribution to Research and Development Credit, 407**
 - Permits a credit for contributions to MEGA approved “eligible business”
 - If the taxpayer does not comply with the terms of the MEGA agreement within 5 years, the taxpayer is liable for 125% of the credit received in each year
- Compare to the **Start-Up Business Credit, 415**, for businesses for which research and development expenses constitutes 15% of its total expenses
 - Permits a credit when MBT tax liability exceeds business income.
 - Requires recapture

Nonrefundable Credits: The Research and Development Credit, 405.

- R & D expenses defined in IRC as “the sum of in-house research expenses and contract research expenses
- In-house research defined as:
 - Any wages paid or incurred to an employee for qualified services performed by such employee
 - Any amount paid or incurred for supplies used in the conduct of qualified research
 - Under regulations prescribed by the Secretary, any amount paid or incurred to another person for the right to use computers in the conduct of qualified research
- Contract research expenses defined as:
 - 65% of any amount paid or incurred by the taxpayer to any person (other than an employee of the taxpayer (for qualified research)

Ordering of MBT Credits: Refundable Credits

Refundable Credits

- Sec. 407 - MEGA Research and Development Credit
- Sec. 413 - Personal Property Tax Credits
- Sec. 423 - Worker's Disability Supplemental Benefit Credit
- Sec. 429 - Next Energy Payroll Credit
- Sec. 431 - MEGA Employment Tax Credit
- Sec. 409(2) - NASCAR Safety Credit
- Sec. 450 - Hybrid Technology Research and Development Credit
- And, Farmland Preservation Credit.

There is no ordering of Refundable Credits for the purpose of calculating the deduction on the Annual Return. Each credit is separately calculated and totaled, the sum of which is entered on the Annual Return. See Form 4574

Personal Property Tax Credits, 413

- Refundable credit for personal property taxes paid in the tax year
 - Industrial personal property – 35%
 - Telephone personal property -- 23% for 2008, and 13.5% for subsequent years
 - Natural gas pipeline property – 10%
- In addition to millage reduction, that began in 2008
 - 24 mill reduction for industrial personal property (includes property under IFT), the amount as the residential principle residence millage reduction
 - 12 mill reduction for commercial personal property
- Total reduction for industrial personal property is 65% of taxes personal property taxes assessed in 2007



Personal Property Tax Credits, 413

Qualifications: Classification

- Must meet General Property Tax Act definition of eligible “personal property”
- Industrial personal property is “classified as personal property under section 34c [MCL 211.34c (3)(c)] or in the case of [IFT personal property] is situated on land classified as industrial real property under section 34c...”
 - Note: There is no requirement that an assessor’s determination under MCL 211.34c is binding
 - Note: There is no requirement that the personal property be owned by a manufacturer, i.e. leased industrial personal property
 - Note: There is no requirement that the personal property is evaluated separately from the parcel on which it found, i.e. office desk on an industrial parcel



Personal Property Tax Credits, 413

Qualifications: Filing

- File Personal Property Tax Statement on or by February 20
- Pay the personal property tax before the end of the tax year
- To support the credit/refund MBT file copies of :
 - The timely filed Personal Property Tax Statement
 - The assessments or bills for which taxes were paid
 - Proof of payment

Personal Property Tax Credits, 413: The Department of Treasury's Proposed Administrative Rule AC R208.2-7

- Rule 4 To obtain the credit, taxpayers must file with the return, the assessment and proof of payment
- Rule 5 “In addition ... the department may also require a taxpayer claiming the credit to file...
 - documentation that the property is classified as industrial...
 - documentation that the real property upon which [IFT personal property] is located is classified as industrial
 - documentation that the [Property Tax Statement was] timely filed”

Personal Property Tax Credits, 413: The Department of Treasury's Proposed Administrative Rule AC R208.2-7

- Rule 6: Appeal process for incorrect classification of personal property; board of review
 - Contains a “legal argument” that sections 19 and 34c of the General Property Tax Act give discretion to the assessor to determine local property classifications, and that, “these determinations by the local taxing unit will control.”
 - Contains a shorter explanation that appeals are exclusively to the March Board of Review and to the State Tax Commission but that “The department does not provide an alternative appeal process”
- Rule 6 conflicts with 413 and it is a process that has been held unconstitutional

Personal Property Tax Credits, 413: The Department of Treasury's Proposed Administrative Rule AC R208.2-7

- Rule 7 Leasing of personal property; documentation in support of qualification
 - Requires that in addition to statutorily required information the taxpayer provide proof “showing to whom the property was assessed; and proof of payment by the taxpayer. It is the person the local taxing jurisdiction has named in the bill as liable for the tax who may claim the credit”
 - And, “A lessee of property may not claim credit for taxes it is paying on behalf of the owner/lessor”
 - And, leasing companies are “classified as a commercial *business*. ... Personal property of a leasing company is classified as commercial personal; and that classification is not related to the classification of the real property...it is possible that neither the lessor nor the lessee will be eligible for the credit”

- Rule 7 lacks statutory authority with 413 and is contrary to the General Property Tax Act which would assess lessee the personal property tax

Troubled Companies

Bankruptcy Tax Issues

- **Chapter 11 allows you to do things you cannot otherwise do, including:**
 - Expedite resolution of current state/local audit and administrative appeals
 - Opportunity to quickly resolve potential exposures not currently under audit
 - Reduce the dollar value of potential liabilities
 - Categorize liabilities as unsecured claims, particularly in the income and use tax areas
 - Negotiate secured claims with taxing authorities for virtually any tax and generally eliminate all penalty
 - Shelter corporate officers and employees from state/local personal liability statutes for "responsible" officers/employees

Opportunities – Claims Management

- **Up-front cataloging and prioritization of claims**
 - Confirm whether taxing authorities have properly allocated claims between secured and unsecured
 - Identify other exposures that may be worthwhile to settle during Chapter 11 (e.g., FIN 48 or FAS 5 exposures unknown to the taxing authority)
 - Determine which claims or other issues dictate special handling (e.g., large dollar claims that should be negotiated)
 - Overall claims strategy development

Opportunities – Claims Management

(cont.)

- **Development of negotiating strategy**
 - Coordinate with overall Chapter 11 plan – important to coordinate between tax advisors and bankruptcy counsel
 - Develop settlement ranges based on financial condition, including what secured and unsecured creditors are expected to receive
 - States will often agree from 20% to 50% discounts on secured claims



Opportunities – Claims Management

(cont.)

■ Execution of negotiating strategy

- Generally deals with bankruptcy units in state tax/revenue agencies, but Attorney General or gubernatorial approval may sometimes be required

Negotiation leverage is that payment of secured claims post-emergence is not guaranteed so why not take a lump sum payment now?

- However, in exchange for a lump sum payment, we expect a reasonable discount on the secured claim
- Generally receive state approval to forego unsecured claims

Opportunities – Claims Management

(cont.)

- **Continuous process coordination**
 - Planning up-front is important to develop the strategy and select the right matters to settle with taxing authorities
 - Development of tracking report to show current status of all claims, including next steps and needed approvals
 - At least weekly coordination meetings on the status of negotiations and to plan ongoing strategy and tactics

- **Computing cash tax liabilities projected post-Bankruptcy**
 - Application of state treatment of IRC Sec. 381, 382 and 108 provisions can be complex and may provide for positions
 - Impact of fresh start accounting upon net worth taxes and property factors needs to be analyzed
 - Opportunities to limit reduction to tax attributes may exist based on post-emergence structuring as well as positions available where law is grey



Opportunities – Modeling & Structuring (cont.)

- **Identify potential structures to emerge from bankruptcy**
 - **Potential Opportunities**
 - Eliminate unnecessary legal entities and streamline org chart
 - Maximize utilization of surviving tax attributes
 - Structure external and intercompany debt in a tax efficient manner
 - Improve alignment of legal and operating structure
 - Provide future flexibility via check the box entities
 - Facilitate future dispositions of business units
 - **Implement restructuring plan**
 - Determine work plan and responsibilities among team members

Opportunities – Property Tax

- Reduction to property tax assessments
- Appeals may be filed in bankruptcy court
- Negotiation of settlements are accelerated by urgency of bankruptcy proceedings

Officer Liability

- WHO? officers, members, managers, or partners may be liable for their entities' taxes
- IF: they have control or supervision of, or responsibility for, making the returns or payments

Officer Liability

- BUT personal tax liability will not attach to corporate officers who simply have significant involvement in the financial affairs of a corporation. The involvement must be tax specific.

Officer Liability

- AND...IF their corporation, limited liability company, limited liability partnership, partnership, or limited partnership fails for any reason to file the required returns or to pay the tax due.

Officer Liability

- WHO IS RESPONSIBLE: The signature of any corporate officers , members, managers, or partners on returns or negotiable instruments submitted in payment of taxes is prima facie evidence of their responsibility for making the returns and payments.

Officer Liability

- **DISSOLUTION?** Dissolution does not discharge an officer's, member's, manager's, or partner's liability for the prior entity's failure to make a return or remit the tax due.

Officer Liability

- **COLLECTION:** The assessment and collection provisions of the Revenue Act apply for the purposes of collecting the tax, interest, and penalties from the officer, member, manager, or partner.

Officer Liability – RAB 1989-38

- RAB sets forth the statutory requirements and the evidence of officer responsibility that the Department of Treasury on which the Department will reply.

Officer Liability – RAB 1989-38

- The Department considers certain documents that would further its ability to present facts regarding officer standing and officer responsibility. Any of the following documents may be utilized to support or demonstrate the facts necessary to assert officer liability:
 - Application for registration
 - Returns filed by the corporation during the period noted on the proposed assessment
 - Michigan Annual Reports which include the period assessed

Officer Liability – RAB 1989-38

- Audit or collection reports that identify an individual officer as responsible for payment and reporting of taxes
- Correspondence from the taxpayer that identifies an officer as responsible for payment or reporting of taxes
- Collector reports establishing regular contact with a corporate officer regarding unpaid taxes

Officer Liability – RAB 1989-38

- Sales, use and withholding returns that identify corporate officers
- Payment plan agreements signed by corporate officers
- Checks in payment of taxes signed by an officer, or subpoenaed bank signature cards for the periods in question
- Any other documents that would tend to prove or disprove corporate officer liability

Officer Liability – Protective Actions

- File the entity's returns and pay the taxes
- Challenge notice of assessments timely
- Ensure that notices sent to the entity's address are forwarded to the responsible officer

Officer Liability – Right to Contest

- If:
 - the assessment of tax against the entity becomes final without contest, and
 - if the Department of Treasury asserts the liability against the responsible officer
 - May the responsible officer then contest the validity of the final assessment against the entity?

Officer Liability – Right to Contest

- **NO!**
- But it does not hurt to try to work out the issue with the Department
- The Department might recognize that no tax was due



Officer Liability – Bankruptcy of the Officer

- Laurence Gregory COLLER (Court of Appeals 2004)
- If the officer files for bankruptcy, is the tax discharged?



Officer Liability - Bankruptcy of the Officer

- The Federal Bankruptcy Code provides that an individual debtor is not discharged from any debt for a tax duty where he fails to file a required return.
11 USC 523(a)(1)(B)



Officer Liability - Bankruptcy of the Officer

- Officer's argument: He is not a "debtor" for purposes of the federal statute because he was not personally required to file the corporation's amended tax return.
- The corporation had federal changes and should have filed amended Michigan returns but did not do so.



Officer Liability - Bankruptcy of the Officer

- The Court of Appeals decided:
- A debtor's failure to file an amended state tax return to reflect federal adjustments creates a non-dischargeable debt under § 523(a)(1)(B)(i).
- To hold otherwise, “would be to reward the debtor-taxpayer in bankruptcy court for failing to comply with state tax law requirements.”



Officer Liability – Bankruptcy of the Entity

- RAB 1989-38 provides that the officer liability is derivative of that of the corporation, and any corporate consent, **waiver**, etc., of the statute of limitations is **also effective** against the responsible corporate officer. In cases of failure to file by the corporation, the statute would remain open with respect to a responsible corporate officer.



Officer Liability – Bankruptcy of the Entity

- Elsheick (Court of Appeals 1997)
- If the tax debt of the entity is not dischargeable in the bankruptcy proceeding of the entity
 - is the officer liable for interest and penalties that accrue after the entity files a bankruptcy petition?



Officer Liability – Bankruptcy of the Entity

- General rule: Interest on prepetition claims ceases to accrue upon the filing for bankruptcy
- BUT post-petition interest and penalties can be imposed in connection with non-dischargeable tax debts
- Because the tax debt was non-dischargeable, post-petition interest and penalties may be assessed...the officer remains derivatively liable for those penalties



Officer Liability – For a Post-Petition Assessment

- **RAB 1989-38** provides Corporate officers may be assessed for tax liability incurred by the corporation prior to the date the corporation filed under Chapter XI of the United State's Bankruptcy Code.



Officer Liability – For a Post-Petition Assessment

- RAB 1989-38: Taxes incurred subsequent to filing under the bankruptcy code are the responsibility of the debtor in possession or trustee in bankruptcy. If the corporation is the debtor-in-possession and no bankruptcy trustee is appointed, then the corporate officer(s) retains control of the filing of tax returns and payment of taxes.



Officer Liability – For a Post-Petition Assessment

- RAB 1989-38: Officer liability will attach to any unpaid corporate taxes while the corporation is the debtor-in-possession and no bankruptcy trustee has been appointed. Issuance of an officer liability Intent to Assess may be desirable to preclude the running of the statute of limitations for a particular taxable period, and assure collection.



Officer Liability – For a Post-Petition Assessment

- RAB 1989-38: In those cases where a corporation files a petition in bankruptcy, the Department would issue an officer liability assessment at approximately the same time it prepares a bankruptcy claim to be filed through the Attorney General's office. This would place the individual officer on notice that he or she has a potential liability.



Officer Liability – For a Post-Petition Assessment

- **Stackpoole** (Court of Appeals 1992)
- The entity filed a petition in bankruptcy
- Prepetition taxes had not been paid by the entity
- The Department issued an assessment against the entity after the petition was filed



Officer Liability – For a Post-Petition Assessment

- A petition for bankruptcy stays commencement or continuation of proceedings against the debtor; the enforcement of a judgment obtained before the commencement of the case in bankruptcy; any acts to obtain possession of property of the estate; any acts to create, perfect, or enforce a lien against property of the estate; and any act to collect, assess, or recover a claim against the debtor that arose before the commencement of the bankruptcy case.



Officer Liability – For a Post-Petition Assessment

- Despite the stay, a bankruptcy filing under chapter 11 “does not operate as a stay ... of the issuance to the debtor by a governmental unit of a NOTICE of tax deficiency.”



Officer Liability – For a Post-Petition Assessment

- Issuance of the amended “notice of final assessment” was not in violation of the bankruptcy stay.



Officer Liability – For a Post-Petition Assessment

- The post-petition issuance of “notice of final assessment” for debtor's unpaid prepetition sales taxes did not violate the automatic stay
- The debtor's officer became personally liable for the taxes when the debtor failed to pay the taxes after receiving notice of the tax deficiency



Officer Liability – Statute of Limitations

- Livingstone (Supreme Court 1990)
- The Department asserted a tax liability against the entity timely
- The Department of Treasury asserted officer liability after the statute of limitations to assess the entity had expired



Officer Liability – Statute of Limitations

- The officer argued that the statute of limitations expired before the Department issued the notice of officer responsibility to him
- The Court held that the statute of limitations that applied to the entity did not limit collection procedures of the Department against the officer

Officer Liability - Delegation

- Sol CICUREL (Court of Appeals 1998)
- To avoid bankruptcy, officer contracted with liquidation sales specialist to conduct a liquidation sale in the entity's stores

Officer Liability - Notice

- Keith (Court of Appeals 1989)
- Notice to the entity's last known address of the final assessment is sufficient notice to the corporate officer

Officer Liability - Delegation

- After approximately six months, the liquidation sales specialist unexpectedly pulled its personnel and merchandise out of the entity, leaving the officer with unpaid employee payroll and unpaid withholding and sales tax.

Officer Liability - Delegation

- The officer said, I DID NOT HAVE CONTROL OF THE RETURNS AND TAXES
- The Court of Appeals said: An officer cannot shield himself from tax liability by relying on the self-imposed provisions of their private agreement with the liquidation company.



The Service Tax and Other Sales Tax Issues

- Service tax proposed by Business Leaders For Michigan – 5.5% tax exempts business to business transactions, health care, education, housing and nonprofits
- Entire revenue dedicated to MBT relief – immediate surcharge repeal and reduction in gross receipts tax rate to 0.45%
- Governor’s proposal covers virtually the same scope and same tax rate, but dedicates substantial revenue to school aid fund in addition to delayed 2 year phase out of surcharge and 3 year reduction in gross receipts tax rate to 0.6%

Sales Tax: Proposed Administrative Rules on Mixed Transaction

- If a transaction is “principally” the transfer of *taxable* sales or services, it is taxable
- If a transaction is “principally” the transfer of *exempt* sales or services, it is exempt
- If a Mixed Transaction is not subject to tax, the seller is subject to a use tax on its consumption of property or services
 - But Note, MCL 205.94 (2) as it apportions an exemption by exempt use to total use or other reasonable method approved by the Department
- 6 factor test to determine whether a transaction is principally a sale of personal property or of a service
 - The primary factor is what the buyer sought as the object of the transaction; other factors bear less weight
- Defines “Bundled Transaction” determined under a different test, MCL 205.93 a or 93b



Sales Tax: Proposed Administrative Rules on Mixed Transaction

6 Factor Test

1. What the buyer sought as the object of the transaction
2. What the seller or service provider is in the business of doing
3. Whether the taxable item was provided as a retail enterprise with a profit making motive
4. Whether the taxable item was available for sale without the exempt item
5. The extent to which the exempt item has contributed to the value of the taxable item transferred
6. Any other factors relevant to the particular transaction

Sales Tax: Proposed Administrative Rules on Mixed Transactions and Bundled Transactions

- “Bundled Transactions:” a retail sale of two or more products that are “distinct and identifiable” but sold for a single “non-itemized” price
 - Does not include packaging that is incidental
 - Product provide free with the purchase
 - Items included in the definition of the purchased price
 - De minimus taxable products of 10 cents or less
 - Michigan would tax this under the 6-Factor Incidental Test
- Taxed only if Seller can establish what is nontaxable

Administrative and Compliance Tips

- What documentation is needed to support the use, benefit and location standards for apportioning sales?
 - Contracts with customers and sales invoices
 - Purchase invoices for supplies
 - Capital asset invoices and journals
 - Resale and exemption certificates
 - General ledgers, subsidiary ledgers and journals and supporting books and records
 - Tax returns, 1099s
 - Bank statements
 - Working papers and accounting data used to prepare tax return
 - Computer and EDP records
 - Documents supporting determination where benefit of service is received
 - Documents supporting determination of portion of service received in Michigan vs. another state

Credit Practice Tips

- **If you are a manufacturer, pay attention to property tax notices.** Classification changes should be appealed. With the millage reduction, property tax relief for industrial personal property amounts to 65% of the personal property tax assessed and paid. Appeal to the March Board of Review.
- **Prepay personal property taxes** by the end of the tax year, not when last due, if you want to claim them on an annual MBT return.
- **File Timely.** File the Personal Property Statement no later than February 20. Better to file timely than to be accurate. You can correct later, but you cannot file later.
- **Think Small Business.** If the taxpayer is a small business, with gross receipts less than \$20 million and low officer/shareholder comp, calculate the Small Business Alternative Credit first. You will not be using most of the other nonrefundable credits, except the Phase-In and the Personal Property Tax Credit.

Credit Practice Tips (cont.)

- **Pay attention to sunsets:** A number of credits exist for a limited time period. They generally do not affect standard MBT taxpayers.
 - 2008-2010
 - MEGA R&D, 407
 - Entrepreneurial Credit, 441
 - 2008-2013
 - NASCAR Speedway Credit, 409
 - Stadium Credit, 410
 - 2008-2015
 - Qualified Film Infrastructure, 457
 - Qualified Film Job Training, 458
 - 2008-2016
 - R &D for Hybrid Vehicles, 450

Credit Practice Tips (cont.)

- **SBT Credit Carryforwards: use it now or lose it forever.** One more year for SBT Credit Carryforwards.
- **Review Past SBT Credits for Open Years.** You may need to file an amended return for open years to increase the SBT credit carryforwards in 2008 and 2009.
- **It's all about Research and Development.** Take as much as you can and claim the rest as a Net Investment Credit.
- **Watch out for Recaptures.** For failing businesses, recaptures trigger a new liability in later years. If the entity cannot pay the liability, it will be assessed to the successor or the entity's former corporate officers!!
- **Know the Big Three Credits.** Most credits are NOT available to most taxpayers as they are sector-specific.

Credit Practice Tips (cont.)

- **The Order matters.** In most instances, the ordering of credits permit taxpayer to take the most useful credits first and get the most out of refundable or carryforward credits.
- **Think Multiformity.** It is worth determining whether the entities are really a unitary group or if they can be broken into separate entities for the purpose of claiming the small business credit.
- **Ignorance of the law is no excuse.** While many of the Department's informal statements are helpful to understand the Department's position, they are not always based in the statute, i.e. the Simplified return.
- **Think Twice Before NOT Appealing.** Chances are there will be other taxpayers appealing the same issue. A favorable result only assist you if you have an appeal filed. Legislation may also modify many of the Department's aggressive positions.

Assessment Change Notices

- Assessment Change Notices will be issued in mid-February with the single largest increase in taxable value, 4.4%
 - Tribunal appeals for commercial and industrial property filed by May 31
- Personal Property Tax Bills will show a decline in the millage rate due to the MBT
 - A decline of 24 mills for industrial personal property and 12 mills for commercial personal property
- In 2010, property tax revenue will dramatically decline
 - Lower projected CPI
 - Cumulative effect of foreclosures, business failures and lower property values

Greg Nowak
313.496.7963
nowak@millercanfield.com

Loren Opper
313.496.7858
opper@millercanfield.com

Jack Van Coevering
616.776.6319
vancoevering@millercanfield.com



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