



JAMES J. BLANCHARD, Governor
ROBERT A. BOWMAN, State Treasurer

STATE OF MICHIGAN
DEPARTMENT OF TREASURY
TREASURY BUILDING
LANSING, MICHIGAN 48922

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**INDIVIDUAL INCOME TAX - PROPERTY TAX CREDIT
PARTIAL USE OF HOMESTEAD FOR BUSINESS PURPOSES**

RAB-88-23. This Bulletin describes the Michigan income tax treatment applicable to a homestead property tax credit claimant using his or her homestead as a principal residence, and as a site for a trade or business.

Michigan Income Tax

General Rule

MCL 206.520(1),(2) provide that a claimant who owns a homestead may claim a credit against the state income tax otherwise due for the tax year for the property taxes levied on a homestead that would have been deductible for Federal income tax purposes pursuant to Section 164 of the Internal Revenue Code of 1986, or the property taxes that would have been deductible if the taxpayer had elected to itemize his or her deductions. The property taxes used for the credit may not be greater than 1 tax year. A renter or lessee who is renting a home may claim a similar credit based on 17 percent of the gross rent paid. To qualify for credit, a claimant must be an individual who was domiciled in Michigan for at least 6 months of the calendar year in which the claim is filed. (See MCL 206.504(2))

The property taxes used for the credit computation are subject to further adjustment if more than one homestead is occupied during the tax year. A claimant shall not occupy more than one homestead at one time.

Homestead Used Partially for Business or Income Purposes

Department of Treasury Rule, 1979 AC, R 206.25(2) provides that "[t]he taxes on a homestead, which is an integral part of a larger unit of assessment, shall be the proportion of the total property tax that the value of the homestead is to the total value of the assessed property."

This Rule, in essence, provides that the property taxes claimable for a homestead property tax credit must be prorated when a claimant used a portion of his or her homestead for business purposes or to produce income during the year. A claimant may not include the portion of property taxes or property taxes paid in rent that is attributable to the trade or business conducted in the home.

Generally, there are two situations where a homestead may be used for purposes other than as the sole principal residence of the claimant. First, a claimant may conduct a business in the home. The property taxes attributable to the business may be deductible as business expenses for Federal income tax purposes. Secondly, a portion of the homestead may be rented to another person as his or her principal residence. The methods used to prorate the property taxes in these situations are discussed below:

Situation 1:

If a contractual agreement or an arm's length transaction exists between an owner and renter or lessee, the renter or lessee is entitled to claim a credit on property rented or leased as a homestead based upon 17 percent of the gross rent paid if it was used as a principal residence. The owner-occupant must determine his or her share of property taxes on the same dwelling by reducing property taxes levied on the entire homestead by the greater of: (1) 17 percent of the rent collected, or (2) property taxes deducted on a Federal business schedule.

Example 1:

Property taxes of \$1,500.00 are levied on a homestead occupied by two eligible claimants: the owner-occupant and renter. Of the \$1,500.00, 50 percent (\$750.00) of the taxes are claimed as a business expense deduction on Federal Schedule E. The owner-occupant of the homestead collected rent of \$6,000.00 in 1986. The renter is entitled to claim as his share of the property taxes, 17 percent of rent paid (\$1,020.00). The owner-occupant must reduce total taxes levied on the dwelling by the greater of the amount of property taxes deducted on Schedule E (\$750.00) or the amount claimed by the renter (\$1,020.00) to determine his or her share of property taxes for the credit. In this example, the owner may claim \$480.00 (\$1,500.00 - \$1,020.00) as taxes paid on the property.

Situation 2:

A taxpayer who deducted, or would have deducted except for Section 280A(c) of the Internal Revenue Code of 1986, part of his or her homestead for business purposes (other than for rental housing income) must reduce total property taxes levied on the homestead by the percentage of the home designated for business purposes. This includes persons who regularly use parts of their home to provide day care services for children, for persons 65 or older, or for persons who are physically or mentally unable to care for themselves. The occupants of the facility are entitled to a prorata share of the property taxes allocable to the business based on the number of occupants designated by the license or permit.

Example 2:

A taxpayer uses 20 percent of his homestead for business purposes. In 1986, property taxes of \$2,000.00 were levied on the homestead. The taxpayer deducted \$400.00 on Federal Schedule C. The amount of property taxes eligible for the homestead property tax credit is \$1,600.00 (\$2,000.00 - \$400.00).

Example 3:

A taxpayer derived gross income of \$1,000.00 from a business conducted within his home. For Federal income tax purposes, 20 percent of the home is designated for business purposes. To arrive at net business income, gross income is first reduced by mortgage interest and real estate taxes paid on the business portion of the home. Although property taxes totalled \$8,000.00, the taxpayer may not deduct more than \$1,000.00 on Federal Schedule C. Section 280A(c) of the Internal Revenue Code of 1986 allows business deductions only to the extent of gross income.

Therefore, the taxpayer may claim 80 percent of the property taxes for the credit regardless of the fact he effectively received a tax benefit of only 13 percent of the property taxes deducted on Schedule C.

Example 4:

A taxpayer is licensed for 12 adult foster care (AFC) residents in his home. The homestead is occupied by the owner as well as the AFC residents. For business purposes, one-half (or \$1,500.00) of the property taxes are deducted on Federal Schedule C. Each AFC resident is entitled to 1/12 (\$125.00) of the property taxes deducted on Schedule C for claiming a property tax credit. The balance of the property taxes are claimable by the owner for his credit, providing there are not other business activities conducted in the home.