A-1155 (Rev. 9-87)

STATE OF MICHIGAN

DEPARTMENT OF TREASURY

TREASURY BUILDING

LANSING, MICHIGAN 48922

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

REVENUE ADMINISTRATIVE BULLETIN 1988-43

Approved: September 26, 1988

INCOME TAX - TAXABILITY OF CAPITAL GAINS AND LOSSES REPORTED ON SCHEDULE D

RAB-88-43. This Bulletin describes the proper application of Michigan's Income Tax Act as applied to determine the taxable portion of a capital gain or loss and the allowable capital loss carryover for Michigan income tax purposes. The statutory provisions governing this determination are MCL 206.103, 206.112(1), (2) and (3), 206.271(1) and (2), and 206.30(1)(c) and (d), respectively.

Law

In determining taxable income under Michigan's Income Tax Act, MCL 206.30(1), a taxpayer may be required or may elect in some cases to make certain adjustments to Federal Schedule D, Capital Gains and Losses, if that taxpayer has income from the sale or exchange of U.S. obligations, and/or has gains or losses from property acquired before October 1, 1967.

Under the Michigan Income Tax Act, MCL 206.30(1)(c) and (d), it is required that a taxpayer add losses from the sale of obligations of the Federal Government, the income this State is prohibited from subjecting to a net income tax, to the extent that these losses have been deducted in determining adjusted gross income.

Conversely, a deduction is allowed to the extent that income from these obligations is included in adjusted gross income. This deduction is reduced by any interest on indebtedness incurred in carrying the obligations and expenses in the production of that income. The deduction is limited to the extent that the expenses, including amortizable bond premiums, were deducted in determining the Federal adjusted gross income.

Under the Michigan Income Tax Act, MCL 206.103, "[a]ny taxpayer having income from business activity which is taxable both within and without this state, other than the rendering of purely personal services by an individual, shall allocate and apportion this net income . . . ."

The Michigan Income Tax Act, MCL 206.112(1), (2) and (3), also allocates gains and losses to Michigan from a sale or exchange if:

1. Real property located in this State, or

2. Tangible personal property is sold and the tangible property had a situs in this State at the time of the sale or the taxpayer was a resident of this State or had a commercial domicile in this State and the sale was not taxable in another State in which the property was located, or

3. Intangible personal property is sold and the taxpayer is a resident of this State.

The State Income Tax Act, MCL 206.271(1), does allow a taxpayer having capital gains and/or losses from the disposition of property taxable to Michigan, to recompute his or her taxable income by excluding all capital gains or losses realized during the taxable year from property acquired before October 1, 1967.

Discussion

When making the adjustments for gains and/or losses based on the Michigan Income Tax Act, a taxpayer may sustain net capital gains and/or losses not identical to the amount computed for Federal income tax purposes.

If the application of the statutory provisions cited above produces a Michigan capital loss unequal to the Federal capital loss, the deduction of a capital loss for the taxpayer's State income tax is computed in the same manner as prescribed in the Internal Revenue Code, Section 1211(b). Any unused portion of the capital loss may be carried over to the next year and applied against any Michigan capital gains and losses computed in that year, if applicable. The Michigan return is then adjusted to include only the Michigan capital loss deduction in the computation of Michigan taxable income.

Consequently, if the application of these statutory provisions produces capital gains unequal to the amount reported for Federal income tax purposes, the Michigan return is adjusted to include only the portion of the capital gain attributable to Michigan.

In both situations cited above, the amount of Federal capital gain and/or loss included in the computation of adjusted gross income is removed from Michigan's taxable base.

Examples

The following examples illustrate these adjustments. For tax years beginning after December 31, 1986, items of income that previously qualified for the capital gain exclusion, pursuant to the Internal Revenue Code Section 1202, will be taxed as ordinary income. These examples are based upon married taxpayers filing jointly.

Example 1: Taxpayer A has included in his Federal Schedule D out-of-state short-term capital gains and Michigan long-term capital losses for property acquired <u>after</u> September 30, 1967.

	Federal	Michigan	Out-of-State
Short-term capital gain	$ 40,000	$ --	$40,000
Long-term capital loss	(260,000)	(260,000)	--
Balance	(220,000)	(260,000)	40,000
Less 50% deduction	110,000	130,000	--
Taxable balance	($110,000)	($130,000)	$40,000
Capital loss deduction	($ 3,000)	($ 3,000)	

For carryover purposes, Taxpayer A will have a Federal long-term capital loss carryover of $214,000 ($220,000 less $6,000), and a Michigan long-term capital loss carryover of $254,000 ($260,000 less $6,000).

Example 2: Taxpayer B has both Michigan and out-of-state long-term capital losses included in his Federal Schedule D.

	Federal	Michigan	Out-of-state
Short-term capital gain/loss	$ --	$ --	$ --
Long-term capital loss	(20,000)	(10,000)	(10,000)
Balance	(20,000)	(10,000)	(10,000)
Less 50% deduction	10,000	5,000	5,000
Taxable balance	($10,000)	($ 5,000)	($ 5,000)
Federal capital loss deduction	($ 3,000)	($ 3,000)	

For capital loss carryover purposes, Taxpayer B will have a Federal long-term capital loss carryover of $14,000 ($20,000 less $6,000), and a Michigan long-term capital loss carryover of $4,000 ($10,000 less $6,000). No adjustment is required in the first year on the Michigan income tax return because the taxpayer has Federal and Michigan capital loss deductions in the same amount.

Example 3: Taxpayer C has included in his Federal Schedule D a portion of his capital gains realized <u>prior</u> to October 1, 1967.

	Federal	Michigan
Short-term capital loss	($20,000)	($20,000)
Long-term capital gain	30,000	10,950*
Balance	10,000	($9,050)
Less 60% capital gain exclusion	6,000	--
Federal taxable amount	$ 4,000	--
Michigan capital loss deduction	--	($ 3,000)

* The property in this example was acquired on October 1, 1940, and sold on September 30, 1986. Under Michigan Income Tax Act, MCL 206.271, 63.5% of capital gains were realized prior to October 1, 1967 and may be excluded.

Furthermore, Taxpayer C may reduce his Michigan taxable income by $4,000 of the capital gain included in his Federal adjusted gross income and claim a short-term capital loss deduction of $3,000 in computing his Michigan taxable income. The unused short-term capital loss of $6,050 may be carried forward to the next tax year.

Example 4: Taxpayer D has included long-term capital gains and losses from the sale of obligations of the United States in his Federal Schedule D. The taxpayer has also included short-term capital gain from the sale of real estate located in Michigan.

	Federal	Michigan
Short-term capital gains	$ 32,000	$32,000
Long-term capital gains	30,000	--
Long-term capital losses	(50,000)	--
Net long-term gain	12,000	32,000
Less 60% capital gain exclusion	7,200	--
Taxable balance	$ 4,800	$32,000

Taxpayer D must increase his Michigan taxable income by $27,200 (the difference between $32,000 and $4,800).

Example 5: Taxpayer E has short-term capital losses from the sale of corporate securities. He has incurred long-term capital gains of $50,000 from the sale of obligations of the United States.

	Federal	Michigan
Short-term capital losses	($32,000)	($32,000)
Long-term capital gain	50,000	--
Net long-term gains/losses	18,000	(32,000)
Less 60% capital gain exclusion	10,800	--
Balance	$7,200	($32,000)
Capital gain/loss deduction	$7,200	($3,000)

Taxpayer E will subtract the Federal capital gain of $7,200 and further subtract Michigan's capital loss of $3,000 from adjusted gross income. For the subsequent taxable year, the taxpayer will have a Michigan capital loss carryover deduction of $29,000.