

## INTERNAL POLICY DIRECTIVE 2008-1

April 21, 2008

### **SINGLE BUSINESS TAX SMALL BUSINESS CREDIT AND STATUTORY EXEMPTION FOR A CONTROLLED GROUP – SHORT PERIODS**

The purpose of this IPD is to provide guidance and standardize policy regarding the application of MCL 208.36(7) as it pertains to the Single Business Tax (SBT) small business credit for an entity that has more than one taxable year, including a short period tax year, in a controlled group year. This IPD also addresses the allocation of the statutory exemption under similar circumstances.

#### POLICY ISSUES

1. If an entity has more than one taxable year in a controlled group year, including a short period tax year, how are the business activities of the entities combined for purposes of claiming and computing the small business credit?
2. Under the same circumstances, how is the statutory exemption allocated between members of the group?

#### POLICY DETERMINATIONS

1. If an entity (hereafter, short-year entity) has two taxable years in a controlled group year, the two tax years of the short-year entity that end within the same calendar year are not combined on the same C-8009. Instead, two C-8009s are filed, each reflecting all other members of the group and one tax period of the short-year entity. The business activities of the affiliates are reported identically on each C-8009 since the two forms represent the same tax year for the affiliates.

A controlled group is disqualified from taking a small business credit if combined gross receipts exceed \$10 million, if combined adjusted business income exceeds \$475,000, or if allocated income exceeds \$115,000. If a disqualifier exists for any of the affiliates on either C-8009 then all the affiliates and the short-year entity will be denied the small business credit on both C-8009s. Again, this is because the two forms represent one tax year for the affiliates. If, however, a disqualifier exists only for the short-year entity on only one C-8009 (one tax year) this will not disqualify the short-year entity from taking the small business credit on the other C-8009 (the other tax year). The affiliates, in either case, will be denied the small business credit on both C-8009s. When one member of an affiliated group is allowed the credit, but another is not, the calculation of the credit for the eligible member is still completed on Form C-8009, using the business activity of the entire group. Examples illustrating this treatment are presented at the end of this document.

The adjusted business income, gross receipts, and allocated income to owners or officers for the short period return must be annualized to determine eligibility for that C-8009.

When the short-year entity is claiming the small business credit, the business activity of all members of the controlled group will be combined on each C-8009 with the business activity of the short-year entity in order to calculate the small business credit. When an affiliate is able to take the small business credit, the affiliate will combine its business activity along with that of all other affiliates and the business activity of the short-year entity's last tax year (the second C-8009) in order to calculate the credit.

2. If the short-year entity is allocated any statutory exemption, this allocation is made identically to each taxable year. The statutory exemption must be prorated for the short period return.

## DISCUSSION

Michigan Compiled Law 208.36 authorizes a small business credit available to firms that meet three criteria: (1) gross receipts less than or equal to \$10 million, (2) adjusted business income less than or equal to \$475,000, and (3) owner or officer-allocated income less than or equal to \$115,000.

MCL 208.36(7) states:

An affiliated group as defined in this act, a controlled group of corporations as defined in section 1563 of the internal revenue code and further described in 26 C.F.R. 1.414(b)-1 and 1.414(c)-1 to 1.414(c)-5, or an entity under common control as defined by the internal revenue code shall not take the credit allowed by this section unless the business activities of the entities are consolidated.

In implementing the small business credit for members of a controlled group, the Department has issued administrative guidelines in the form of questions and answers and the forms and instructions put out on an annual basis.

Specifically, Form C-8009, Allocation of Statutory Exemption, Standard Small Business Credit and Alternate Tax for Members of Controlled Groups, must be completed by all controlled groups, including affiliated groups, controlled groups of corporations, and entities under common control, to calculate the standard or alternate small business credit. The gross receipts, adjusted business income and tax base of all members of the group must be combined to determine eligibility and to compute the credit.

Form C-8009 is also used to allocate the statutory exemption among members of the group pursuant to MCL 208.35(2), which states:

An affiliated group, a controlled group of corporations as defined by section 1563 of the internal revenue code, or an entity under common control as defined by the internal revenue code is entitled to only 1 exemption allowed by subsection (1)(a) whether or not a combined or consolidated return is filed.

If the combined gross receipts exceed \$10 million or the combined adjusted business income exceeds \$475,000, or any one individual, partner, officer, or shareholder has allocated income of more than \$115,000 from any one member of the group, the entire group is ineligible for the small business credit.

If a member of the group has a tax year less than twelve months, gross receipts, adjusted business income, and allocated income must be annualized to determine eligibility for the small business credit.

Each member's business activities attributable to its tax year(s) ending within the calendar year are required to be consolidated on Form C-8009.

In the situation where an entity has more than one taxable year<sup>1</sup> in a controlled group year as a result of a short period return, the Department previously required the controlled group to include both returns ending within the same calendar year on one Form C-8009 to determine eligibility and calculate the small business credit, almost as if they were two different members of the controlled group.

In *Plymouth Nursery Inc v Dep't of Treasury*,<sup>2</sup> the Michigan Tax Tribunal allowed the taxpayer's claimed small business credit and denied the Department's treatment of short period returns, as explained above. The Tribunal cited the following reasons for its decision:

- Inclusion of more than twelve months of activity is not supported by statute.
- The definition of controlled group does not include multiple tax years for one entity, but rather returns for more than one related entity.<sup>3</sup>
- The definition of tax year precludes consolidation with another tax year of the same entity.<sup>4</sup>
- No promulgated rule or RAB, or any other published position exists.
- The position that a short year must be annualized is inconsistent with including more than twelve months worth of activity.

The Department will acquiesce to the Tax Tribunal's decision in *Plymouth*. Therefore, if an entity has more than one taxable year in a controlled group year, the two tax years for that entity ending within the same calendar year are not combined on the same C-8009, but are instead each combined separately with its affiliates. If on either C-8009 a disqualifier exists, the entity and its affiliates will be unable to take a small business credit for that tax year. However, a disqualifier for the short-year entity for one tax year will not affect its ability to take a small business credit in the other tax year.

In the calculation of the small business credit, the business activities for all members of the controlled group are combined with the activity of the short-year entity for each tax year separately. If an affiliate(s) claims a small business credit, the last tax year for the short-year entity will be used for purposes of calculating the credit.

The attached examples illustrate the filing method required when an entity has more than one taxable year in a controlled group year, the application of disqualifiers, and the calculation of the credit in these circumstances.

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<sup>1</sup> "'taxable year' means the calendar year, or the fiscal year ending during the calendar year, upon the basis of which the tax base is computed under this act. When a return is made for a fractional part of a year, tax year means the period for which the return is made. . . ." MCL 208.10(1) provides:

<sup>2</sup> MTT Docket No 311795 (2006).

<sup>3</sup> MCL 208.36(7); 208.3(1).

<sup>4</sup> MCL 208.10(1).

Example 1: Representing Small Business Credit Adjusted Business Income Disqualifier, Statutory Exemption

A partnership XYZ (Calendar year 2006) and a corporation DEF (Fiscal year ending September 2006) are Brother – Sister. The corporation changes its accounting period to calendar and files a short period return for October – December 2006. The two tax years for DEF ending within the same calendar year are not combined on the same C-8009, but are each combined separately with XYZ. If a disqualifier exists on either C-8009, XYZ will be unable to take a small business credit as the two forms represent one tax year for XYZ. A disqualifier for DEF for one tax year will not affect DEF’s ability to take a small business credit in the other tax year.

	2006 C-8009s					
	C-8009 A			C-8009 B		
	XYZ	DEF	Combined Amount	XYZ	DEF	Combined Amount
Org. Type	Partnership	Corporation			Partnership	
Tax Year	Jan - Dec 2006	Oct 2005 - Sept 2006		Jan - Dec 2006	Oct - Dec 2006	
Statutory Exemption	none	45,000		none	45,000	
Adjusted Business Income	280,000	125,000	405,000	280,000	50,000 (200,000 annualized)	480,000 annualized
Gross Receipts	2,000,000	5,000,000	7,000,000	2,000,000	500,000 (2,000,000 annualized)	4,000,000 annualized
SBC Allowed?	NO	YES		NO	NO	

1. Identical statutory exemptions are allocated to Corporation DEF. If the allocation had been \$30,000 to Partnership XYZ, the remaining \$15,000 would be the identical allocation. Corporation DEF must prorate the \$45,000 when filing their short period return for the tax year Oct – Dec 2006.
2. No adjustment is necessary to the combined adjusted business income or gross receipts of C-8009 A to determine the disqualifiers for that group. The adjusted business income and gross receipts of DEF for Oct- Dec 2006 must be annualized to determine the disqualifiers for C-8009 B. The disqualification of the credit for DEF for Oct- Dec 2006 does not disqualify DEF for Oct 2005-Sept 2006. XYZ is disqualified whenever either tax year ending in 2006 for its affiliate is disqualified.

3. Corporation DEF must annualize allocated income to shareholders in the short period to determine the \$115,000 disqualifier. Although any disqualifier for the short period will also disqualify XYZ, DEF's tax year ending Sept 2006 will not be affected.
4. The business activity for XYZ is combined with the activity of DEF for each tax year separately in the calculation of the small business credit. In this case the calculation of the credit would occur on C-8009 A. If XYZ claims a small business credit, the last tax year for DEF, Oct – Dec 2006, or C-8009 B, will control.

## Example 2: Representing Small Business Credit Gross Receipts Disqualifier

Same basic facts as Example 1, although the adjusted business income and gross receipts numbers have been changed to illustrate a disqualification based on excess gross receipts. Partnership XYZ (Calendar year 2006) and Corporation DEF (Fiscal year ending September 2006) are Brother – Sister. DEF changes its accounting period to calendar and files a short period return for October – December 2006. The two tax years for DEF ending within the same calendar year are each combined separately with XYZ.

2006 C-8009s						
	C-8009 A		Combined Amount	C-8009 B		Combined Amount
	XYZ	DEF		XYZ	DEF	
Org. Type	Partnership	Corporation		Partnership	Corporation	
Tax Year	Jan - Dec 2006	Oct 2005 - Sept 2006		Jan - Dec 2006	Oct - Dec 2006	
Adjusted Business Income	280,000	125,000	405,000	280,000	40,000 (160,000 annualized)	440,000 annualized
Gross Receipts	7,000,000	5,000,000	12,000,00 0	7,000,000	500,000 (2,000,000 annualized)	9,000,000 annualized
SBC Allowed?	NO	NO		NO	YES	

1. Identical statutory exemptions are allocated to Corporation DEF.
2. No adjustment is necessary to the combined adjusted business income or gross receipts of C-8009 A to determine the disqualifiers for that group. The adjusted business income and gross receipts of DEF for Oct- Dec 2006 must be annualized to determine the disqualifiers for C-8009 B. The disqualification of the credit for DEF for Oct 2005- Sept 2006 does not disqualify DEF for Oct -Dec 2006. However, because the two forms represent one tax year for XYZ, XYZ is disqualified on both C-8009s.
3. The business activity for XYZ is combined with the activity of DEF for each tax year separately in the calculation of the small business credit. In this case the calculation would occur on C-8009 B. If XYZ could calculate a small business credit, the last tax year for DEF, Oct – Dec 2006, or C-8009 B, would control.

### Example 3: Representing Small Business Credit Partner/Officer/Shareholder Disqualifiers

Same basic facts as in previous examples. Partnership XYZ (Calendar year 2006) and corporation DEF (Fiscal year ending September 2006) are Brother – Sister. DEF changes its accounting period to calendar and files a short period return for October – December 2006. The two tax years for DEF ending within the same calendar year are each combined separately with XYZ. This example addresses four Partner/Officer/Shareholder disqualifier scenarios.

	2006 C-8009s			
	C-8009 A		C-8009-B	
	XYZ	DEF	XYZ	DEF
Org. Type	Partnership	Corporation	Partnership	Corporation
Tax Year	Jan - Dec 2006	Oct 2005 - Sept 2006	Jan - Dec 2006	Oct - Dec 2006
1. Officer/Shareholder Allocated Income	120,000	50,000	120,000	10,000 (40,000 annualized)
SBC Allowed?	NO	NO	NO	NO
2. Officer/Shareholder Allocated Income	50,000	120,000	50,000	10,000 (40,000 annualized)
SBC Allowed?	NO	NO	NO	YES
3. Officer/Shareholder Allocated Income	50,000	50,000	50,000	50,000 (200,000 annualized)
SBC Allowed?	NO	YES	NO	NO
4. Officer/Shareholder Allocated Income	50,000	50,000	50,000	10,000 (40,000 annualized)
SBC Allowed?	YES	YES	YES	YES

1. Identical statutory exemptions are allocated to Corporation DEF.
2. Corporation DEF must annualize allocated income to shareholders in the short period to determine the \$115,000 disqualifier. Although any disqualifier for the short period will also disqualify XYZ, DEF's tax year ending Sept 2006 will not be affected.

Example 3.1 XYZ has one partner with allocated income in excess of \$115,000, which is reported on each C-8009 identically. This disqualifies all affiliates on both C-8009s.

Example 3.2 DEF has one shareholder with allocated income in excess of \$115,000 for the tax year Oct 2005 – Sept 2006. This disqualifies all affiliates on C-8009 A and XYZ on C8009 B. It does not preclude DEF from taking the credit for Oct-Dec 2006.

Example 3.3 DEF has one shareholder with annualized allocated income in excess of \$115,000 for the tax year Oct-Dec 2006. This disqualifies all affiliates on C-8009 B and XYZ on C8009 A. It does not preclude DEF from taking the credit for the tax year Oct 2005 – Sept 2006.

Example 3.4 No disqualifiers exist in this example. The business activity for XYZ is combined with the activity of DEF for each tax year separately in the calculation of the small business credit for DEF. The last tax year for DEF, Oct – Dec 2006, on C-8009 B, will control the calculation of the credit for XYZ.

