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REVENUE ADMINISTRATIVE BULLETIN 1988-44

Approved: September 26, 1988

TAXABILITY OF INCOME UNDER THE CLAIM OF RIGHT DOCTRINE

RAB-88-44. This Bulletin announces the Michigan income tax treatment of amounts repaid and deducted under the "claim of right" doctrine. The claim of right doctrine, Section 1341 of the Internal Revenue Code (IRC), is used to recompute tax liability when a taxpayer has previously included in gross income, under a claim of right, consideration that later must be repaid because the taxpayer did not in fact have a right to the income.

Federal Income Tax Treatment

Pursuant to Section 1341, if an item of income was included in gross income in a prior year because it appeared that the taxpayer had an unrestricted right to the income when in fact the taxpayer did not, the taxpayer is entitled to claim a deduction of the amount repaid in the year of repayment.

To ensure that a taxpayer is adequately compensated for an amount repaid that exceeds \$3,000, a taxpayer may compute his or her tax liability in the year of repayment by either:

1. Claiming the amount repaid in the year of repayment as an itemized deduction, or
2. Reducing the tax liability due in the year of repayment by the amount of tax attributable to the income in the prior tax year.

Michigan Income Tax Treatment

A tax liability recomputed under the claim or right doctrine, IRC Section 1341, is not permitted as an adjustment in the calculation of Michigan Income Tax liability to the extent this adjustment was not allowed in the computation of Federal adjusted gross income.

Michigan taxable income is defined pursuant to MCL 206.30(1) as adjusted gross income as defined in the Internal Revenue Code, subject to certain adjustments.

Under Section 67 of the IRC, an adjustment pursuant to Section 1341 is classified as a miscellaneous itemized deduction. There is no provision under the Michigan Income Tax Act to allow an adjustment of a Federal itemized deduction in the computation of Michigan taxable income.

For purposes of computing a Michigan Homestead Property Tax Credit, Farmland Preservation Tax Credit or a Home Heating Tax Credit, a claimant may not deduct from household income an amount repaid under the claim of right doctrine.