

Michigan Department of TREASURY UPDATE

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MICHIGAN ENACTS AN ELECTIVE FLOW-THROUGH ENTITY TAX

States across the country have been enacting flow-through entity taxes which allow flow-through entities to elect into and pay an income tax on business activity within the state. By doing so, flow-through entities can leverage important federal income tax benefits for their owners which, through credits and other complementary adjustments on the members returns, can be captured without an increase or decrease in state tax revenues. Through PA 135 of 2021,¹ signed into law by Governor Gretchen Whitmer on December 20, 2021, Michigan joined at least 22 other states² in enacting a flow-through entity tax. This article provides a broad overview of this new tax in Michigan.

Effective for tax years beginning on or after January 1, 2021, the flow-through entity tax allows flow-through entities — generally, S corporations and other entities taxed federally as partnerships — with business activity in Michigan to elect to pay the tax. The election must be made timely by the 15th day of the third month of the flow-through entity's tax year (March 15 for calendar year filers) and, once made,³ is irrevocable and effective for three tax years. Electing flow-through entities will be required to comply with all applicable flow-through entity tax provisions, including the payment of estimated payments in quarterly installments throughout the year and the filing of an annual return with payment by the last day of the third month after the tax year (March 31 for calendar year filers).

For a flow-through entity that makes the election, tax will be levied annually on its Michigan-sourced "business income tax base." While the "business income tax base" relies upon amounts determined under federal law, it is also subject to special Michigan adjustments. These adjustments generally help align the flow-through entity tax base with that of its individual owners — for example, statutory modifications to the tax base are generally the same as reported by individuals on their Michigan Schedule 1, the tax base is sourced to Michigan using the same sales apportionment rules applicable to business income received by individuals, and even the tax rate is pegged to the same rate for individuals (i.e., 4.25%). Most importantly, only the income allocable to owners or members who are individuals, fiduciaries (i.e., trusts and estates), and other flow-through entities will be subject to the flow-through entity tax.⁴

By paying the tax levied on the applicable business income tax base,

¹ 2021 PA 135.

² For a map of states with a flow-through entity tax, see <https://us.aicpa.org/content/dam/aicpa/advocacy/tax/downloadabledocuments/56175896-pte-map.pdf>

³ For instructions on making this election in 2021 or 2022, please see Treasury's December 22, 2021, Notice linked at the end of this article.

⁴ For technical guidance on the various components of the tax base, flow-through entities should consult Treasury's notice dated January 16, 2022, linked at the end of this article.

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the electing flow-through entity will generate special adjustments that must be reported on its members' returns including, most importantly, a refundable state income tax credit. Members of an electing flow-through entity will receive a refundable tax credit that will generally be equal to their allocable share of flow-through entity tax paid by the 15th day of the third month after the flow-through entity's tax year (March 15 for calendar year filers). Payments made after that date – such as, for example, a late payment of tax – remain eligible for the credit, but only in the member's following tax year. The accurate and timely reporting of the credit and other member information is critical to ensuring the fundamental goal that tax is collected only once on flow-through entity income earned in Michigan.

In this regard, flow-through entities are required to provide certain information to their members. Generally, this includes the flow-through entity tax information that must be reported on the returns, such as the member's share of flow-through entity taxes required to be added back on that return, the member's share of flow-through entity tax refunds required to be subtracted on that return, and the member's share of the refundable flow-through entity tax credit to be claimed on that return. This information must be provided no later than the due date of the flow-through entity tax annual return and can be reported in any reasonable manner by the flow-through entity, including, for example, as notes attached to the Federal Schedule K-1.

Due to the timing of the enactment of this legislation, the Department is currently in the process of developing technical guidance, returns, instructions, frequently asked questions (FAQs), and other explanatory guidance regarding this new tax. The Department encourages taxpayers to review all current guidance, which will provide a more detailed discussion, as well as other special instructions related to the implementation of this tax. This guidance includes the following notices:

1. [Notice Regarding the Implementation of the Michigan Flow-through Entity Tax](#)
2. [Notice: Flow-through Entity Tax Quarterly Estimated Tax Payments for Tax Years Beginning in 2021 Not Subject to Penalty or Interest](#)
3. [Notice: Instructions for Electing and Paying into the Flow-through Entity tax](#)

For future updates on this tax, please visit the new flow-through entity tax webpage, which can be found under the "Business Taxes" banner located at www.michigan.gov/taxes.

ABOUT TREASURY UPDATE

Treasury Update is a periodic publication of the Tax Policy Division of the Michigan Department of Treasury.

It is distributed for general information purposes only and discusses topics of broad applicability. It is not intended to constitute legal, tax or other advice. For information or advice regarding your specific tax situation, contact your tax professional.

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NEW INCOME TAX DEDUCTION FOR WAGERING LOSSES FOR CASUAL GAMBLERS

At the close of 2021, PA 168 was signed into law creating a new individual income tax deduction for wagering losses sustained by casual gamblers, for tax years beginning in 2021. Since Michigan taxable income begins with federal adjusted gross income (AGI), it includes the wagering gains of both professional and casual gamblers. However, prior to PA 168 due to the differing manner in which wagering losses are reported at the federal level for professional and casual gamblers, only the professional gambler's losses were captured in Michigan taxable income. Since casual gamblers report their wagering losses as an itemized deduction on Schedule A at the federal level, which is not a component of AGI, the casual gambler's losses were not captured on the Michigan return.

PA 168 amended the Michigan Income Tax Act to allow a separate deduction for casual gamblers who elect to itemize deductions federally rather than take the standard deduction. The deduction equals the wagering losses a taxpayer claims as an itemized deduction on their federal income tax return for the same tax year. As before, a gambler cannot reduce taxable gambling winnings below zero. For nonresidents, only wagering losses attributable to wagering transactions placed at or through a casino or licensed race meeting located in Michigan may be deducted and only to the extent of the gains on those transactions allocated to Michigan.

PA 168 did not create a separate deduction for purposes of the City Income Tax Act and does not affect the tax calculation of city income tax liability.

COURT OF APPEALS AFFIRMS THAT CHARGES FOR THE DELIVERY OF AGGREGATE WERE TAXABLE UNDER THE SALES TAX ACT

In a published decision issued January 13, 2022, in the matter of *Brusky Construction v Dep't of Treasury*, the Michigan Court of Appeals affirmed the Court of Claims' grant of summary disposition in favor of Treasury related to assessments for the taxpayer's failure to pay sales tax on delivery charges for aggregate it sold at retail. The Court of Claims' Opinion and Order in this matter (Docket No. 19-000017-MT) is discussed in the November 2020 issue of the *Treasury Update*.

On appeal, the taxpayer argued that the Court of Claims erred in finding that it made retail sales because the court disregarded the taxpayer's asserted status as a "purchasing agent" under an alleged agency relationship that the taxpayer had with its customers. The taxpayer also argued that the Court of Claims failed to follow *Midwest Power Line, Inc v Dep't of Treasury*, 324 Mich App 444 (2018), which interprets the statutory phrase "persons engaged in the business of" under the Use Tax Act to mean that a taxpayer must be "primarily engaged" in a particular type of business to qualify for the rolling stock exemption from use tax. The taxpayer argued that the Court of Claims erred by not ruling that retail sales must be a person's "primarily engaged" business purpose in order to be subject to sales tax, since the Sales Tax Act contains that the same statutory phrase, and that because taxpayer characterized its primary business as transportation services, it was not "primarily engaged" in making retail sales. Finally, the taxpayer asserted that application of the "incidental to services" test of *Catalina Marketing Sales Corp v Dep't of Treasury*, 470 Mich 13 (2004) required a finding that it engaged in the provision of a service (delivery of aggregate) and not sales of tangible personal property, and thus its sales were not subject to sales tax.

In response to the taxpayer's agency argument, the Court of Appeals determined that even assuming that a purchasing agent is not liable for sales tax (a legal question the court did not rule on), the record did not support the taxpayer's agency argument. For example, the taxpayer failed to demonstrate that its customers had any control over where the taxpayer purchased aggregate or the delivery routes that it chose to deliver the materials. Also, the Court of Appeals found that there was no evidence that the taxpayer represented any of its customers as an agent in its transactions with aggregate suppliers. The taxpayer's position that it was a purchasing agent, since it did not "agree" to be a seller, was also rejected by the Court of Appeals. The court determined that the taxpayer's position does not comport with either the plain language of the Sales Tax Act (e.g., the Act does not require mutual assent between buyer and seller as the seller is liable for the tax when making taxable sales) or the taxpayer's own business model (e.g., the taxpayer purchased aggregate for the purpose of selling it as evidenced by its use of "resale" exemption certificates and the fact that it remitted sales tax on those purchases).

Concerning the application of *Midwest Power Line*, the Court of Appeals explained that even if that decision created a "primary purpose" test for rolling stock when interpreting the phrase "engaged in the business of" in the definition of an interstate fleet motor carrier, it is "improper" to import that interpretation when construing the persons

subject to the imposition of sales tax because the context of the Sales Tax Act "evidences no intent that only persons who engage primarily in retail sales are subject to sales tax." The court declared that to hold otherwise would render MCL 205.52(3) and MCL 205.54(d)(i) of the Sales Tax Act meaningless.

Finally, the Court of Appeals dispensed with the taxpayer's argument regarding the application of the "incidental to services" test under *Catalina Marketing Sales Corp*, affirming the Court of Claims' reasoning that this test was irrelevant to the facts in *Brusky* because the decision in *Catalina Marketing Sales Corp* establishes only a "general rule" which does not apply where the statute explicitly governs the sales tax treatment. The court stated that because the Legislature "expressed a clear intent" to subject delivery charges that fall within the definition of "sales price" to taxation, the "incidental to services" test is "not applicable."

As of this publication, the taxpayer has not filed an application for leave to appeal this decision to the Michigan Supreme Court.

MICHIGAN LEGISLATURE AMENDS TRANSFORMATIONAL BROWNFIELD STATUTE

Enacted on December 29, 2021, PA 138 amended the Brownfield Redevelopment Financing Act (Act) to make several material changes regarding how transformational brownfield plans are evaluated and how tax capture for those plans is calculated. For example, PA 138 eliminated provisions requiring a determination by the Michigan Strategic Fund that a proposed transformational brownfield plan will result in an overall positive fiscal impact to the state.

Also, the Act now requires that separate calculations for income tax capture revenues and withholding tax capture revenues, which are transmitted to the owner or developer of the transformational project site, be established for each eligible property. Formerly, this tax capture was calculated at the plan level, based on all eligible properties within a transformational brownfield plan. Income tax capture revenues are the amounts attributable to the income tax from individuals residing within the eligible property subject to the transformation brownfield plan for the tax year that exceed the initial income tax for individuals residing in for the tax year the plan was adopted. Withholding tax capture revenues are the amount by which Michigan income tax withheld from individuals employed within the eligible property for each calendar year exceeds the initial withholding tax value for the calendar year in which the plan was approved.

The Act also now allows the owner or developer of a transformational brownfield project site to elect to utilize a new "safe harbor" method of calculating tax capture based on amounts established by the Michigan Strategic Fund, based on the size and use of the eligible property and the average annual wage for individuals employed within the property. The Michigan Strategic Fund may adjust the "safe harbor" for an eligible property or portion of that property after the original approval of the plan that may be required to reflect changes in the plan for the transformation project site. In addition, the Act now allows the Michigan Strategic Fund to waive certain requirements under certain circumstances, including the mixed-use development requirement and the percentage cap on the use of income tax capture revenues.

Finally, PA 138 extends the sunset provisions for approving transformational brownfield plans from December 31, 2022, to December 31, 2027.

RECENTLY ISSUED GUIDANCE FROM TREASURY

Revenue Administrative Bulletins

RAB 2021-21 Sales and Use Tax – Sales and Use Nexus Standards for Remote Sellers (Issued: December 21, 2021)

RAB 2021-22 Sales and Use Tax – Marketplace Facilitators and Sellers (Issued December 21, 2021)

RAB 2021-23 Individual Income Tax Treatment of Motor Vehicle Insurance Premium Refunds (Issued December 21, 2021)

RAB 2021-24 Part 1 of the Michigan Income Tax Act: The Retirement and Pension Benefits Deduction for a Surviving Spouse (Issued December 21, 2021)

RAB 2021-25 Individual Income Tax Homestead Property Tax Credit Calculation When Prior Year Property Taxes are Adjusted (Issued December 22, 2021)

RAB 2021-26 Individual Income Tax and Michigan Business Tax Farmland Preservation Tax Credit Eligibility (Issued December 29, 2021)

Notices

- Instructions for Electing Into and Paying the Flow-Through Entity Tax (Issued: December 22, 2021)
- New Tax Treatment of Wagering Losses for Casual Gamblers Under the Michigan Income Tax Act (Issued January 13, 2022)
- Notice Regarding the Implementation of the Michigan Flow-Through Entity Tax (Issued January 14, 2022)
- Flow-Through Entity Tax Quarterly Estimated Tax Payments for Tax Years Beginning in 2021 Not Subject to Penalty or Interest (Issued January 18, 2022)
- Notice Regarding the Michigan Catastrophic Claims Association Surplus for Insurers Subject to the Premiums Tax (Issued February 17, 2022)

Statement of Acquiescence/Non-Acquiescence Regarding Certain Court Decisions

In each issue of the quarterly Treasury Update, Treasury will publish a list of final (unappealed), non-binding, adverse decisions issued by the Court of Appeals, the Court of Claims and the Michigan Tax Tribunal, and state its acquiescence or non-acquiescence with respect to each. "Acquiescence" means that Treasury accepts the holding of the court in that case and will follow it in similar cases with the same controlling facts. However, "acquiescence" does not necessarily indicate Treasury's approval of the reasoning used by the court in that decision. "Non-acquiescence" means that Treasury disagrees with the holding of the court and will not follow the decision in similar matters involving other taxpayers.

ACQUIESCENCE: No cases this quarter.

NON-ACQUIESCENCE: No cases this quarter.

FIRST-TIME HOME BUYER SAVINGS PROGRAM ESTABLISHED

On February 9, 2022, Governor Gretchen Whitmer signed into law PA 5 and PA 6, legislation which is intended to assist Michigan residents in purchasing their first homes. PA 6 establishes the First-Time Home Buyer Savings Program Act which provides for the creation of first-time home buyer savings accounts to be used to pay for or reimburse a qualified beneficiary's eligible costs for the purchase of a single-family residence in Michigan. Beginning on January 1, 2022, through December 31, 2026, any individual may open an account with a financial institution and designate the account as a first-time home buyer savings account. The maximum account balance limit for a first-time home buyer savings account is \$50,000.

PA 5 amended the Income Tax Act to provide a deduction for certain contributions to a first-time home buyer savings program account, qualified withdrawal distributions to a qualified beneficiary, and interest earned on the account. Specifically, to the extent not deducted in determining adjusted gross income (AGI), taxpayers may deduct contributions to a first-time home buyer savings program account less qualified withdrawals for a total deduction up to \$5,000 for a single return or \$10,000 for a joint return each tax year. To the extent not deducted in determining AGI, interest earned from these accounts may also be deducted from income in determining income tax liability. Finally, to the extent included in AGI, distributions that are qualified withdrawals to the qualified beneficiary may be deducted. The deductions for contributions are in effect only through December 31, 2026.

A first-time home buyer may be a qualified beneficiary of a first-time home buyer savings account. A qualified beneficiary is a Michigan resident who has not previously owned or purchased a single-family residence during the three (3) years prior to the date of purchase of a single-family residence. The qualified beneficiary must own and occupy the single-family residence as his or her principal residence. First-time home buyer savings accounts must be used to pay eligible costs, such as the down payment and other allowable closing costs for the purchase of a single-family residence.

The account holder is the individual who establishes the account with a financial institution for which that account holder may claim a first-time home buyer savings account status on their income tax return. The account holder is responsible for the use or application of funds in a first-time home buyer savings account. An individual may individually or jointly be the account holder of a single first-time home buyer savings account or multiple accounts; however, multiple accounts created by a single account holder may not designate the same qualified beneficiary. An individual, however, may be designated as the qualified beneficiary on more than one first-time home buyer's savings account created by multiple account holders.

An account holder is required to submit certain documents with his or her income tax return for each first-time home buyer savings account and must keep records and documentation for a minimum of four years for each first-time home buyer savings account.

There is a 10% penalty for funds withdrawn from a first-time home buyer's savings account for any purpose other than the payment of eligible costs for the purchase of a single-family residence by the qualified beneficiary.

Treasury will soon be issuing additional guidance on the requirements for participation in this program and its administration.



Archives of Treasury Update can be found on the website at Michigan.gov/Treasury under the Reports and Legal Resources tab.