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MULTISTATE INCOME/FRANCHISE TAX

Michigan enacts flow-through entity tax election

Tax Alert

Overview

On December 20, 2021, the Michigan governor signed House Bill 5376 (HB 5376) into law. HB 5376 amends the Michigan Income Tax Act to impose a flow-through entity tax on electing flow-through entities with business activity in the state. Flow-through entities may make a three-year binding election to file a return and pay the flow-through entity tax on behalf of their members. This election applies retroactively to tax years beginning on or after January 1, 2021.

This Tax Alert provides a summary of some of the relevant provisions of HB 5376.

Flow-through entity tax election

- HB 5376 provides for a flow-through entity tax on every electing flow-through entity with business activity in the state unless protected from taxation under 15 USC sections 381 to 384 (P.L. 86-272). A flow-through entity is defined as an S corporation or partnership and does not include publicly traded partnerships, disregarded entities, or any person subject to the franchise tax for financial institutions. A partnership means an entity that elects to file as a partnership for federal income tax purposes.

- The election is effective for tax years beginning on or after January 1, 2021.

- The election, once made, is irrevocable and shall continue for the next two subsequent tax years.

- Elections are required to be made on or before the 15th day of the third month of that tax year (elections made for the tax year ending in 2021 would have to be made before the 15th day of the fourth month after the bill's effective date).

- The flow-through entity tax is imposed on positive business income allocated or apportioned to the state at the same rate levied for individual income tax, which is currently 4.25%. For flow-through entities with negative business income, the loss would be includible in the business income tax base of each member of the entity and would not be available to offset the allocated or apportioned business income tax of the entity in any other tax year for which an election was made to pay the flow-through entity tax.

- The flow-through entity tax due is based on only the business income tax base allocable to members that are individuals, flow-through entities, estates, or trusts and excludes the business income tax base allocable to members that are corporations, insurance companies, or financial institutions.

- Electing flow-through entities are required to make quarterly estimated payments if it is reasonably expected the tax liability for the tax year will exceed $800. For a calendar year taxpayer, estimated quarterly tax payments are generally due on April 15, June 15, September 15, and January 15.

- Electing flow-through entities are required to file either an annual or final return by the last day of the third month after the end of the taxpayer's tax year. The Michigan Department of Treasury may extend the date for filing the return upon application of the taxpayer until the last day of the sixth month following the original due date of the return.

Flow-through entity tax credit

- HB 5376 allows members of a flow-through entity that elected to file an entity level return or direct or indirect members of another electing flow-through entity to claim a credit equal to the member's allocated share of the tax as reported to the member by the flow-through entity for the tax year ending on or within the taxpayer's same tax year. If the credit exceeds the tax liability of the member for the tax year, the portion of the credit that exceeded the liability would be refunded.

- For tax year 2021 only, electing flow-through entities will not retain the right to receive interest on a refund from the state related to a flow-through entity tax credit.

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