

Michigan Flow-Through Entity Tax

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- Over 15 years of tax experience
- Works closely with affordable housing, construction, manufacturing, small & midsize businesses, and multi-state issues
- AICPA and MICPA member



Michigan Public Act 135 of 2021

- Flow-Through Entity Tax
 - Signed Into Law December 20, 2021
 - Retroactive for tax years beginning on or after January 1, 2021
 - Cash Basis Tax Payers vs. Accrual Tax Basis Issues
 - Created Immediate Compliance Issue for Taxpayers & Professionals
 - History
 - 3rd time is a charm for the State Legislature (Gov. Snyder vetoed once, Gov. Whitmer vetoed once as well)
 - Tax Cuts & Jobs Act of 2017
 - Created SALT Deduction Limit at Individual Level
 - High tax states looked for ways to work around this limit
 - IRS ruled some of their initial ways were not valid (charitable trusts)
 - IRS has give then green light to pass-through tax deductions
 - CT was the first (over 20 states currently has a work-around, each may be different)

Eligibility

- **Eligible Entities**
 - LLCs that file as partnerships
 - Partnerships (including LP, LLP, GP)
 - S Corporations
- **Ineligible Entities**
 - Publicly Traded Partnerships
 - Flow-Through Entities subject to the financial institutions tax
 - Disregarded entities (Single-member LLCs)
 - LLCs that file federal tax returns as C Corporations
 - C Corporations

Flow Through Entity Tax

- **How Do I elect?**

- Submit an electronic payment to the Michigan Treasury Department through the Michigan Treasury Online (MTO) Website (mto.treasury.Michigan.gov)
- For 2022 tax year & beyond – election must be made by the 15th day of the 3rd month of that tax year (i.e. for 2022 calendar year filers – election must be made by **MARCH 15, 2022**)
- For 2021
 - Election can be made by **APRIL 15, 2022**
 - Pay any unpaid quarterly estimates through MTO could have been paid up to this point
 - If election is made past the due date of the return (March 31, 2022 for calendar year filers) – immediately file the return and pay the full tax due by 4/15 (interest will accrue)

- **Impact of Election**

- Valid for year you make plus the next two years (so 3 total) or Until SALT limit goes away (whichever happens first)
- Note: SALT Limit set to be eliminated for 2026 tax year (expires after 2025)

Flow Through Entity Tax

- **Business Income Tax Base**
 - Generally – start with the amounts of taxable income reported by the entity for federal income tax purposes (Schedule K, or Schedule M-1, Line 8)
 - Adjustments
 - Interest/Dividends derived from obligations/securities of states other than Michigan
 - Income/Losses derived from the sale or exchange of certain obligations of the US Government
 - **Charitable Contributions**
 - Taxes on or measured by net income – including the Michigan flow-through entity tax (note: This includes city income taxes deducted by the business & other state income taxes)
 - Guaranteed payments **for services rendered** by a member who is an individual
 - Tax refunds received under the city income tax & flow-through entity tax
 - Income from & expenses of producing oil & gas, minerals
 - Tax base allocable to those members that are subject to this tax, exclude all others – but there may be a reporting requirement for all members & their allocable share

Flow Through Entity Tax

- **Tiered Structure**
 - Deduct any net positive business income attributable to any flow-through entity that elected to pay the tax for the same tax year
 - Still include any net positive income from non-electing flow-through entities (added back after apportionment)
 - No adjustments if the business income tax base is negative
- **Losses**
 - NOLs do not exist for the FTE Tax
 - Tax will be zero
- **Sales Factor Apportionment**

Due Dates

- **Tax Return**
 - Last Day of 3rd month
 - For Calendar Year Fliers for 2021 only – April 15th, 2022
 - 6 month extension to last day of 9th month are possible (Apply for or valid federal extension NOTE: THIS DOES NOT DELAY THE TIME TO PAY!)
- **Election to Pay**
 - 15th Day of the 3rd month of the tax year you want it to go into effect (Note for 2022 – 3/15/22)
 - 4th Qtr. Estimate for 2021 (1/18/22 – 3 qtrs. should have been made)
 - After 1/18/22 – target 100% of the tax due
- **Estimates**
 - Follows Individual Estimate Due Dates
 - April 15, June 15, September 15, January 15
 - No penalties for underpayment for 2021 only (interest may apply)

Federal Tax Impact

- **Deductibility Issues**
 - IRS Notice 2020-75
 - A specified income tax payment is one the flow through entity “makes...during a taxable year” in computing its taxable income “for the taxable year in which the payment is made” (Notice 2020-75, Section 3.02(2))
 - IRC Section 164(a) provides that the SALT deduction is for the tax year in which taxes are “paid or accrued”
 - Method of Accounting
 - Cash Basis – this appears to be pretty clear, year paid = expense
 - Accrual Basis – some concern that the notice restricts it to “paid” but is there an argument to be made that the tax was accruable as of 12/31 since the election retroactively applies to 2021 even if made in 2022 by April 15th.

Reporting Concerns

- Reporting to Shareholders/Partners

- Federal K-1
- State does not have a specific method required – only that all appropriate info gets reported to each owner with their federal k-1
 - Compliance Needs
 - Info Regarding Apportionment
 - Members' allocable share of reporting entity taxes including the MI FTE Tax that was added back to determine income tax base
 - Member's share of reporting FTE refund received during the year (if applicable)
 - Member's share of the following tax amounts, reported separately;
 - Tax imposed under the MI FTE tax for the year & paid by the initial due date
 - MI FTE Tax imposed for any prior year that was paid in the current tax year
 - MI FTE Tax allocated to the reporting FTE under the two items above by other FTEs

Reporting Concerns

- **Forms to file**
 - Return/Payments filed through MTO
 - No forms will be filed separately to the state of Michigan through your business income tax return
 - Payments made outside of the MTO website are not considered a valid election
- **Tax Reporting**
 - Federal Taxable Income is reduced by the owner's allocable share of the expense
 - Tax expense is an add-back on the state return (no deduction for it on the MI return)
 - Tax paid is a credit on your personal MI-1040

Other Concerns/Complications

- **Tax Planning is a must!** Contact your tax advisor for assistance.
 - Multi-state issues may limit impact
 - 199A limits impact
 - Multiple owners/k-1s spreads out benefit
- Election Concern – 2022 deadline is before 2021 deadline!
- Refunds will likely be taxable on your 2022 return (Federal Tax Benefit Rule)
- Entities effectively double pay the tax for 2021
 - Cash Flow issues? Refunds aren't exactly speedy right now!
 - Increase state tax refund?
 - Distribution issues possible at the entity level

Other Concerns/Complications

- **Multi-state issues**
 - What if one owner isn't subject to MI Tax?
 - What if you have activity sourced outside of Michigan?
- **199A issues & Tax bracket issues**
 - 199A may lessen the impact of the expense (by 20%)
 - What if one owner is at 37% and the other owner is at a lower bracket (say 22%)
- **Personal Estimates**
 - May still be needed
 - What other income do you have?
 - This credit under the FTE is only for income earned by the electing entity
- **Need to consider shareholder agreement/partnership agreements**

Example

- Federal Tax Savings

- S Corporation has 1 owner (100%)
- Individual Itemizes their personal taxes, and has \$12,000 of property taxes paid during 2021
- S Corporation earns 700,000 of income (subject to no state adjustments)
- MFJ Return, no 199A limits & S Corp gets the 199A deduction
- Individual is in the 37% bracket
- S Corp is 100% in Michigan

- Tax = $700,000 \times 4.25\% = 29,750$
- Federal Projected Savings = $29,750 \times 37\% \times 80\%$ (199A impact) = 8,806
- If No 199A, Federal Savings = $29,750 \times 37\% = 11,008$

Tax Planning is key!

Questions?

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