

Small Business Credit

The small business credit was first enacted in 1977 (PA 273 of 1977) to provide qualified small business entities relief from the harsh effects of the Single Business Tax. The first step in determining the small business credit is to determine whether the taxpayer is eligible. To become eligible for the small business credit, the taxpayer must survive a series of disqualifiers.

Eligibility for Small Business Credit

Any taxpayer who is not disqualified by any of the following qualifies for the credit.

1. Gross receipts do not exceed \$10,000,000 (MCL 208.36(2))
2. Adjusted business income minus loss adjustment does not exceed \$475,000 (MCL 208.36(2))
3. The distributive share of the adjusted business income minus the loss adjustment of an individual, partner or "S" corporation shareholder does not exceed \$115,000. (MCL 208.36(2)(a))
4. The compensation and director's fees of a shareholder or officer of a corporation other than an "S" corporation do not exceed \$115,000. (MCL 208.36(2)(b))

The small business credit shall be taken before any other credit. (MCL 208.36(2))

Corporations

A corporation whose adjusted business income is less than 45% of tax base is entitled to the small business credit if all of the following conditions exist: (MCL 208.36(2)(b))

1. Corporation's gross receipts do not exceed \$10 million, **and**
2. Corporation's adjusted business income does not exceed \$475,000, **and**
3. No shareholder or officer has allocated income in excess of \$115,000 **or**
4. The sum of compensation and director's fees of a shareholder (except "S" corporations), plus the sum of business income, net operating loss carryover, and capital loss carryover used to arrive at business income, times the percentage of outstanding stock owned by that shareholder, does not exceed \$95,000.

Individuals

An individual whose business income is less than 45% of tax base is entitled to the small business credit if both of the following conditions exist: (MCL 208.36(2)(a))

1. Gross receipts do not exceed \$10 million, **and**
2. Business income does not exceed \$95,000.

Partnerships

A partnership whose business income is less than 45% of tax base is entitled to a small business credit if all of the conditions exist: (MCL 208.36(2)(a))

1. Partnership's gross receipts do not exceed \$10 million, **and**
2. Partnership's business income does not exceed \$475,000, **and**
3. No partner has a distributive share of business income in excess of \$115,000.

In all cases, if a return covers a period of less than 12 months, then gross receipts, adjusted business income, compensation and director's fees, and sum of business income and loss carry-overs must be annualized.

Section 36(2)(c) (MCL 208.36 (2)(c)) of the Single Business Tax Act provides a phase out of the small business credit when compensation or the distributive share of adjusted business income exceeds \$95,000.

Adjusted Business Income	Credit is Reduced By
\$95,000 or less	0%
More than \$95,000-Less than \$100,000	20%
More than \$100,000-Less than \$105,000	40%
More than \$105,000-Less than \$110,000	60%
More than \$110,000-Less than \$115,000	80%
More than \$115,000	100%

Small Business Credit - Loss Adjustment

Act 257 of 1990 (MCL 208.36(1)(e)) provides for a "loss adjustment" which is used to reduce adjusted business income to determine the business income (\$475,000) disqualifier and Individual, Partner, Shareholder (\$95,000) disqualifier used in determining eligibility for the Small Business Credit or Alternate Tax. The loss adjustment is only used to determine whether or not a taxpayer is eligible to claim either the small business credit or the alternate tax. The calculation of the credit % or alternate tax is based on adjusted business income before the loss adjustment.

"Loss Adjustment" means the amount by which adjusted business income was less than zero in any of the 5 years immediately preceding the tax year for which the eligibility for this credit is being determined. In determining the loss adjustment in a previous year, a negative adjusted business income amount can not be carried from a year in which the taxpayer did not receive a small business credit. (MCL 208.36(1)(e))

Definitions

Adjusted Business Income

Total Adjusted Business Income is: (MCL 208.36(1)(c))

- Business Income, plus
- Compensation and director's fees of an "Active Shareholder", plus a
- Net Operating Loss (NOL) carry-over included in business income, plus a
- Capital loss carry-over included in business income, plus the
- Compensation and director's fees of a corporate officer.

Adjusted Business Income

Adjusted Business Income of an individual shareholder equals the sum of:

Compensation and director's fees, plus

(Business income + NOL carryover + capital loss carryovers) times the shareholder's % of stock.

Active Shareholder

An "active shareholder" is one who meets all of the following conditions: (MCL 208.36(1)(a))

1. Is a shareholder of the corporation, **and**
2. Owns at least 5% of outstanding stock, **and**
3. Who receives at least \$10,000 in compensation, director fees or dividends from the business.

Qualified Shareholder

A qualified shareholder must meet all of the following conditions:

1. Is a shareholder of an S corporation **or** professional corporation, and
2. Is a full-time employee of the taxpayer or devotes at least 51% of his or her time to the business, **and**
3. Owns at least 10% of the business, **and**
4. Whose share of business income is at least \$12,000

Note: A person cannot serve as a qualified shareholder in more than one business.

Officer Defined (MCL 208.36(1)(b))

"Officer" means an officer of a corporation other than a subchapter S corporation including the chairperson of the board, president, vice-president, secretary, and treasurer, or persons performing similar duties.

Credit Calculation (MCL 208.36(5))

The percentage reduction in tax liability is calculated as follows:

$$(1.0 - \text{Adjusted Business Income}) \times \text{Tax} \\ (.45 \text{ Tax Base})$$

If Gross receipts are between 9 million and 10 million.

$$(1.0 - \text{Gross Receipts} - \$9,000,000) \\ (\$1,000,000) \\ (1.0 - \text{Adjusted Business Income}) \times \text{Tax} \\ (.45 \text{ Tax Base}) \\ (\text{MCL } 208.36(6))$$

Maximum credit allowed is 100% of the tax otherwise due, before other credits.

Affiliated Group of Corporations, Controlled Group

No credit shall be allowed to an affiliated group of corporations, a controlled group of corporations, an entity under common control, unless the business activities of these entities are combined. (MCL 208.36(7))

Attribution of Stock Ownership

Attribution of stock ownership from family members per IRC Section 328(a)(1) applies for determination of the small business credit (IRC Section 318 - constructive ownership of stock) for tax years ending prior to December 31, 1988. (MCL 208.36((3))

Alternative Tax Computation

Section 36(4) (MCL 208.35(4)) provides an alternative tax computation for persons qualifying for small business credit equal to 2% of that persons adjusted business income.

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