Michigan Pass-Through Entity Tax Enacted - Quick Action May Be Needed for 2021

December 22, 2021

Michigan Gov. Gretchen Whitmer signed legislation on December 20, 2021, allowing Michigan pass-through entities to elect to pay a newly enacted 4.25% income tax and for the owners of those entities to claim a tax credit against that tax on their Michigan individual income tax returns. The new tax mirrors the so-called State and Local Tax (SALT) cap workaround taxes enacted by several other states that are designed to avoid the $10,000 federal limit on individual itemized deductions for state and local taxes. Importantly, the new tax election is available retroactively for years beginning in 2021, and therefore pass-through entities and their owners may want to consider making this election for tax year 2021.

The bill (H.B. 5376) allows owners of LLCs, S corps and other pass-through entities to pay their state and local taxes at the business-entity level instead of individually. The new tax election is not available to disregarded entities, but only those entities treated as partnerships for federal tax purposes such as S Corporations and multiple-member LLCs, as well as estates and trusts.

The bill is estimated to save the roughly 240,000 pass-through entity owners subject to tax in Michigan about $200 million in federal taxes annually. The law should level the playing field with competing out-of-state businesses because Michigan will join states that have already enacted SALT cap workarounds to benefit local business owners. According to a legislative bill analysis, the new Michigan law will have no impact on state revenue, with the exception of the incremental cost to administer the new tax.

Action to consider for tax year 2021

Because the new tax and related tax credit are effective retroactively for years beginning in 2021, pass-through entities and their owners may wish to consider making the election to pay the new tax for the 2021 tax year. Annual returns are generally due by March 31 unless extended, but the election can be made for 2021 until April 15, 2022. The new law generally requires estimated payments and imposes penalties and interest for the underpayment of those estimated taxes by the pass-through entity, but Treasury has indicated that no penalties will be imposed on pass-through entities that make the election for 2021 and pay the new 4.25% tax when filing their annual return by April 15, 2022. Interest may be assessed for taxes paid after March 31, 2022, but Treasury may also waive interest in the initial year for taxes paid by March 31, 2022.

For further discussion, please contact the authors of this alert or your Miller Canfield attorney.