



# This Week in State Tax (TWIST)

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## Michigan: 163(j) Legislation Passes; Guidance Issued on Computing Pro Forma Federal Taxable Income

Legislation (Senate Bill 195), which has passed both chambers of the legislature, would address how the 163(j) limitation is computed for Michigan corporate income tax purposes retroactively for tax years beginning on and after January 1, 2022. Under the legislation, a person or a person that is included in a unitary business group that files a federal consolidated return would not have a Michigan business interest expense limitation if the person (1) does not have a federal 163(j) limitation for the tax year, (2) is exempt from the business interest limitation under IRC section 163(j)(3), or is (3) engaged in a trade or business that is excepted under IRC section 163(j)(7). If a corporation is a member of a federal consolidated group that does not have a federal 163(j) limitation for the tax year, that corporation would not have a Michigan business interest expense limitation for that year. The bill would also provide guidance on the tax treatment of any excess business interest, including rules for sharing excess business interest among members of the same unitary business group. It remains to be seen whether Governor Whitmer will sign the legislation.

In other corporate tax news, the Michigan Department of Treasury recently released an 8-page Revenue Administrative Bulletin (RAB 2022-23) addressing the calculation of pro-forma federal taxable income for members of a unitary business group (UBG). For Michigan Corporate Income Tax (CIT) purposes, C corporations engaged in a unitary business file a combined return that is based on a 50 percent common ownership requirement. Federal affiliated groups can make a binding election to file as a Michigan UBG. The election is irrevocable for a 10-year period. Under Michigan law, each UBG member (regardless of whether the state affiliated election is made) is treated as a single person and all the components of a federal return are separately computed to arrive at a UBG member's pro-forma federal taxable income. Each member's separately computed pro-forma federal taxable income is then summed together to determine the UBG's federal taxable income.

The RAB stresses that the composition of a federal consolidated group and a Michigan UBG may differ, even if the affiliated group election is made. For federal purposes, a direct 80 percent or more ownership test applies for inclusion in a federal consolidated return; however, the definitions of "unitary business group" and "affiliated group" in the CIT include persons that are more than 50 percent owned, directly or indirectly, by another member. Also, certain corporations excluded from a federal consolidated return are not excluded from the Michigan return (e.g., REITs). In contrast, foreign operating entities may be included in a federal consolidated return, but are specifically excluded from the definition of UBG. The RAB notes several statutory adjustments are required to be made to pro-forma federal taxable income and the federal consolidated return regulations are not followed for purposes of computing pro-forma federal taxable

income under the Michigan CIT. This results in differences between federal taxable income for federal and Michigan CIT purposes, even when the members of a federal consolidated group and the UBG are the same. The RAB includes examples to illustrate both the difference in composition between a consolidated group and a UBG as well as adjustments that must be made in computing each member's federal taxable income under the CIT. Interestingly, in a footnote to the RAB, the Department refers to the potential law change around the computation of the 163(j) limitation and reminds taxpayers that the amount of interest deducted at the federal level under IRC section 163(j) and under the CIT may be different. The footnote references the Department's Notice *Corporate Income Tax Treatment of the IRC 163(j) Business Interest Limitation* and notes that the Notice is subject to revision pending statutory codification of the IRC 163(j) adjustments required under the CIT that may diverge from current interpretation discussed in the Notice. Please contact [Dan De Jong](#) with questions on RAB 2022-23.



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