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December 21, 2023

Michigan Flow-Through Entity Tax Election Deadline Approaching

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Michigan taxpayers with interests in calendar year-end S corporations and partnerships should take note: the deadline to make a new “flow-through” entity tax (“FTE tax”) election for 2024 is approaching, and it occurs prior to the due date of the 2023 FTE tax return. Late filings may result in lost tax savings and administrative complexities, and the Michigan Department of Treasury (the “Department”) has no mechanism by which it will forgive inadvertently missed deadlines. Below, we review the background and benefits of the FTE tax election and provide reminders to help Michigan taxpayers and tax advisors ensure that the proper elections are made in a timely fashion.

Background of the FTE Tax

Effective January 1, 2021, Michigan enacted the FTE tax to allow entities classified as an S corporation or a partnership for federal tax purposes to elect to pay Michigan income tax at the entity level. Without an FTE tax election, the Michigan income of an S corporation or partnership is reported and taxed at the partner level or the member level on a Michigan individual, trust, or estate tax return.

Federal Tax Benefits of the FTE Tax Election

For certain taxpayers, making an FTE tax election can result in considerable federal tax savings because individuals cannot deduct more than \$10,000 of state and local income taxes from their federal taxable income under Section 164(b)(6)(B) of the Internal Revenue Code of 1986, as amended (the “Code”).

The Michigan FTE Tax Election

For taxpayers that file tax returns based on a calendar tax year, the FTE tax election must be made by submitting a payment to the Department by March 15 of the current tax year using the Michigan Treasury Online website. Once the FTE tax has been elected, the FTE tax return is due on March 31 of the year after the close of the prior tax year. Although

deadlines vary by state, Michigan is among a minority of states that require an FTE tax election to be made before the due date or extended due date of the prior year's FTE tax return. Moreover, the FTE tax election is irrevocable and binding on taxpayers for 2 subsequent years after the year of the election (three years in total). Under MCL Section 206.841, the Department should promulgate forms and rules for administration of the FTE tax, but most guidance has only been available in the form of Frequently Asked Questions on the Department's website.

For taxpayers that elected into the FTE tax beginning in 2021, the 2023 tax year will be the last year in which the initial election is valid, and those taxpayers will be required to make a new FTE tax election for 2024. Therefore, with respect to both calendar-year taxpayers who have been paying the Michigan FTE tax since the beginning and calendar-year taxpayers intending to elect into the FTE tax beginning in 2024, March 15, 2024 will be a critically important date.

FTE Tax Election Confusion and Election Problems

Many taxpayers have properly elected to pay the Michigan FTE tax. However, inadvertent errors have also resulted in many taxpayers failing to properly make a timely election, and the Department has indicated that there is no available remedy in many of these cases. Errors have arisen, in part, due to confusing and inconsistent deadlines. For example - the annual FTE tax return is due on the last day of the third month after the end of the tax year (e.g., March 31 for calendar year taxpayers), while the election to pay the FTE tax in a particular year must be made by submitting an electronic payment to the Department by the fifteenth day of the third month of that tax year (e.g., March 15 for calendar year taxpayers), and the individual income tax return for the same taxpayer is generally due April 15.

Although the dates can be confusing, many tax advisors are experienced and can assist in making a timely election. If you have questions regarding the FTE tax election requirements, please contact your Bodman attorney or any of the Bodman tax attorneys listed below. Bodman cannot respond to your questions or receive information from you without establishing an attorney-client relationship and clearing potential conflicts with other clients. Thank you for your patience and understanding.

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