



38800 Country Club Dr.
Farmington Hills, MI
48331

248-848-3714
info@bomadet.org

www.bomadet.org



MICHIGAN BUSINESS TAX GOES TO THE EXTREME ON FORECLOSURE

Background

The Michigan Business Tax (MBT), which was signed into law July 12, 2007, imposes a 4.95% business income tax and a modified gross receipts tax at the rate of 0.8% (plus a 21.99% surcharge which is currently under review). Against the backdrop of the nation's highest unemployment rate, plummeting commercial real estate and home values and stagnant per-capita income growth, the Michigan Business Tax increases have had a staggering impact on commercial real estate throughout the State of Michigan. The MBT presents a grossly unfair result for sponsors of real estate partnerships by imposing the MBT on officers, members, and managers of business entities who are charged with the responsibility of tax issues, and who sign returns or checks in payment of Michigan taxes. Unlike income taxes, MBT tax is not imposed on the owners of an LLC, who may have the funds to pay the tax, but is instead imposed directly on the LLC (or corporation, partnership, etc). Since the LLC has no funds to pay the tax, **Michigan law imposes responsibility for 100% of the tax on the LLC officer (or corporate officer, general partner, etc.) who is in charge of signing tax returns and paying taxes. Thus, if a 10% owner of the LLC supervises tax reporting for the company, that 10% owner would have to pay 100% of the amount due.** The 10% owner would have no legal right to seek reimbursement from the other 90% owners, since only the 10% owner is liable for the tax. For example, if there is a \$5 million capital gain, the MBT tax would be about 7% of that or \$350,000, all of which would be payable by the one LLC officer with tax supervision responsibility.

BOMA proposes the following to mitigate the negative effects of the MBT in foreclosures on real estate partnerships and LLC's.

1. Exempt income and gains related to foreclosure from the gross receipts tax.
2. Make the corrections retroactive to passage of the MBT (1/1/08) on theory this was unintended from outset.
3. To the extent included in federal taxable income, deduct any income derived from the cancellation of debt, or gain realized from the disposition of real property, to the extent such income or gain related to the foreclosure of a loan secured by real property owned by the taxpayer and used in the taxpayer's regular business activity, regardless whether such foreclosure occurred by means of a judicial foreclosure, deed in lieu of foreclosure, sale by a court-appointed receiver entered into under the threat of foreclosure, or equivalent transaction treated for federal income tax purposes as a foreclosure.

THE SAD REALITY, a real life example: Doug Levine related the impact on his business and on him personally—

An affiliate of his company Levine Property Management owns properties in Livonia. Due to the high unemployment rate and the downsizing of many Michigan companies over the last several years, vacancies have been mounting. Coupled with the meltdown in the mortgage industry, he has lost another 12 mortgage companies and/or title companies as tenants in his properties over the last year.

For example, 3 years ago, he leased 83,000 s.f. of office space to Quicken Loans at the 17187 N. Laurel Park Dr. building in Livonia, MI. Due to the meltdown in the residential real estate market and mortgage industry, Quicken Loans has moved out of the building. When they stop paying rent, the affiliate will no longer be able to pay the debt service and operating expenses. As a result, the mortgage company has indicated that they will foreclose. Efforts to work something out with the mortgage company have failed because it is a securitized loan (CMBS) and they will not even consider modifying the terms of the loan because he has not defaulted, however, the funds, once available in the bank, are no longer available because they were used for TIs (tenant improvements), lease commissions and to carry the property before Quicken Loans moved in. Efforts have also been made to refinance but due to the current credit crisis and a loss of a major tenant, refinancing is not an option.

(A side note- Quicken Loans was given a MEGA Grant by the State of Michigan so they would stay in Michigan.)

His accountants informed him of the tax impact if the bank foreclosed; he was shocked at the amount of MBT that would be due. For this property alone, he would owe \$435,000! The accountants explained that the new MBT includes forgiveness of debt, a phantom income, in foreclosure as part of the gross income for the purpose of calculating the MBT, (the SBT provided exclusion for properties that had been foreclosed on.) Doug laments, "If we don't have the dollars to pay our debt service and operating expenses, how can the state of Michigan expect us to pay the MBT? Where are the dollars going to come from?" Since the entity has no funds to pay the tax, Michigan law imposes responsibility for 100% of the tax on the manager or officer who is in charge of signing tax returns and paying taxes, that would be the individual, Doug Levine who became the manager when his father passed away in June, 2007. **Doug only owns a small percentage, less than 10%, of the building, but is left on the hook for paying the \$435,000 in MBT.** So the entity loses its building to foreclosure and then he personally has to pay a huge MBT tax, not to mention the federal and state income taxes on the depreciation recapture. LLC's, Limited Partnerships and corporations are supposed to shield the owners from personal liability, rather than this awful and unintended result!

In another building in the same complex, Ford Motor Credit is moving out after 17 years, Levine must decide to continuing to carry the property in hopes of leasing the space or give it back to the lender in an effort to preserve enough cash to pay the MBT. In frustration Mr. Levine adds, "**The MBT is supposed to be a business tax not a going-out-of-business tax!**"

How do we attract real estate investment in the State of Michigan that leaves an LLC partner potentially holding the bag?!? Simple answer, WE WON'T, because most significant to businesses in the location hunt is the state's tax structure.

For more information on BOMA, its members or issue positions please contact:

Gregg McDuffee, Government Affairs Committee, Co-Chair
John Sier, Government Affairs Committee, Co-Chair
Janet Langlois, BOMA Metropolitan Detroit, Executive Director
Dan Gustafson, Scofes & Associates Consulting

gregory_mcduffee@dwjba.com
john.sier@kitch.com
jlanglois@bomadet.org
dan@scofesconsulting.com

Prepared with assistance of Maddin, Hauser, Wartell, Roth & Heller, P.C.