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Michigan Flow-Through Entity (FTE) Tax Overview

<https://www.michigan.gov/taxes/business-taxes/flowthrough-entity-tax/frequently-asked-questions> (visited 7/29/23)

2021 PA 135 introduces Chapter 20 within Part 4 of the [Michigan Income Tax Act](#). Effective January 1, 2021, the Michigan flow-through entity (FTE) tax is levied on certain electing entities with business activity in Michigan.

The Michigan FTE tax:

- is elected and levied on the Michigan portion of the positive business income tax base of a flow-through entity. This amount generally correlates to the business income attributed to members who will be taxed in Michigan.
- allows a flow-through entity to elect to pay tax on certain income at the individual income tax rate. If this election is made and the tax is paid by the entity, members of the entity are eligible to receive a refundable income tax credit. Although the flow-through entity effectively pays the income tax, members must comply with reporting or return filing requirements under Part 1 or Part 2 of the Income Tax Act.
- requires the reporting of complementary entity-level and member-level adjustments. The electing flow-through entity, based on the calculation and payment of the Michigan FTE tax, must communicate certain credits and adjustments to members, providing for proper reporting on Michigan individual income tax returns.
- is designed to fulfill the scope and intended purpose of ensuring that tax on income is paid only once—collecting the same amount of income tax from the business entity as would otherwise be collected from the entity's members. Generally, the tax is designed to benefit members of the flow-through entity that are individuals, trusts, or estates.

Flow-Through Entity Tax FAQ

- **What tax year is the Michigan FTE tax effective?**
The flow-through entity tax is retroactive to tax years beginning on and after January 1, 2021. The continued levy of the tax is contingent upon the existence of the federal state and local tax (SALT) deduction limitation codified within IRC 164(b)(6)(B).
- **What is a flow-through entity and which business entities are eligible to pay the Michigan FTE tax?**

A flow-through entity is defined as an S corporation or a partnership under the internal revenue code for federal income tax purposes.

The Michigan FTE tax is levied and imposed on certain electing flow-through entities with business activity in Michigan.

The following types of common flow-through entities may elect to pay the Michigan FTE tax:

1. Limited liability companies (LLCs) that file federal income tax returns as partnerships.
 2. Partnerships (including limited partnerships, limited liability partnerships, and general partnerships).
 3. S Corporations.
- **Which business entities are not eligible to pay the Michigan FTE tax?**

Businesses that are not flow-through entities — such as sole proprietorships or C corporations — are not eligible to pay the Michigan FTE tax.

Certain types of flow-through entities are specifically excluded from paying the Michigan FTE tax:

1. Publicly traded partnerships as defined under IRC 7704.
 2. Flow-through entities subject to the financial institutions tax under [Chapter 13 of Part 2 of the Income Tax Act](#).
 3. Entities that are disregarded for federal income tax purposes, such as single member LLCs.
 4. LLCs that file federal income tax returns as corporations.
- **How do flow-through entities make an election into the Michigan FTE tax?**

The election must be made by submitting an electronic payment to the Treasury through Michigan Treasury Online ([MTO](#)). Any other manner of making the election (e.g., submitting a written election statement or making a payment outside of MTO) is not a valid election.

The election is effective for three years: the tax year in which the payment is made and the next two successive years. The election payment must be directed to the initial year of the election. Once the election is made it is irrevocable.

A timely election payment must be received by the fifteenth day of the third month of the flow-through entity's tax year. Although special rules apply for the initial implementation year, calendar year filers will ordinarily be required to make an election by March 15 of the tax year.

- **How is the Michigan FTE tax calculated?**

For the same tax year under Section 51 of the Income Tax Act, the Michigan FTE tax is levied on qualifying/electing entities at the same rate as Michigan individual

income tax (IIT) is levied on individuals. For example, the tax year 2021 tax rate for Michigan FTE tax and IIT is 4.25%.

The Michigan FTE tax is levied only on the Michigan portion of the positive “business income tax base” attributable to direct members of an electing flow-through entity that are individuals, fiduciaries (i.e., estates or trusts), or other flow-through entities. Any portion of the business income tax base attributable to direct members that are insurance companies, financial institutions, or C corporations is not subject to the Michigan FTE tax.

Electing flow-through entities must calculate the Michigan portion of the business income tax base before adjusting for the portion that is taxable or nontaxable based on attribution to their members.

- **How is the business income tax base determined for the Michigan FTE tax?**

The business income tax base refers to the flow-through entity’s federal taxable income and any payments and items of income and expense that are attributable to the business activity of the flow-through entity and separately reported to its members less specific statutory adjustments and/or special additional adjustments for a tiered structure.

The Michigan FTE tax is only levied on the positive business income tax base of an electing entity. If the business income tax base is less than zero, then no tax is due in that year.

The specific statutory adjustments include:

1. Interest income and dividends derived from obligations or securities of states other than Michigan.
2. Income and losses derived from the sale or exchange of certain obligations of the US government.
3. Charitable contributions.
4. Taxes on or measured by net income, including the Michigan FTE tax.
5. Guaranteed payments for services rendered by a member who is an individual.
6. Tax refunds received under the city income tax and flow-through entity tax.
7. Income from and expenses of producing oil and gas.

- **How is the business income tax base apportioned for the Michigan FTE tax?**

The business income tax base of the flow-through entity is apportioned to Michigan using a sales factor that is based on the ratio of sales sourced to Michigan to total sales everywhere.

In determining the sales factor, sales of tangible personal property are typically sourced to the state where the transfer of ownership occurs (i.e., where the purchaser takes possession of property or where the property is delivered to the purchaser). Sales other than sales of tangible personal property are sourced based on the location of the relevant income-producing activity.

Most importantly, the apportionment rules for flow-through entities are the same rules that apply to business income reported by individual members under Part 1 of the Michigan Income Tax Act. The information used to apportion the business income tax base under the Michigan FTE tax should therefore be the same information reported by many flow-through entities to its individual members to determine business income taxable in Michigan.

- **Is a flow-through entity required to pay the Michigan FTE tax on income attributable to direct members that are exempt from tax?**

In some cases, yes. The Michigan FTE tax is levied on the portion of the “business income tax base” attributable to any direct member that is an individual, fiduciary (i.e., trust or estate), or another flow-through entity. There is no special adjustment if such a direct member is exempt from tax by operation of federal or state law.

For example, an electing flow-through entity may have a member that is an Employee Stock Option Plan (ESOP), which is a trust that is generally exempt from tax under the Internal Revenue Code. The flow-through entity is required to pay the Michigan FTE tax on the share of the business income tax base attributable to the ESOP. In turn, the ESOP will receive a refundable Michigan FTE tax credit for its allocated share of the Michigan FTE taxes levied and paid - and will be able to file an income tax return in order to claim it.

- **What are the relevant reporting requirements for flow-through entities that have elected into the Michigan FTE tax?**

Each tax year, on or before the Michigan FTE annual tax return due date, the flow-through entity must separately report the following information to each member:

1. Information regarding the allocation and apportionment of the business income tax base and the allocation and apportionment of income subject to tax under Part 1 (i.e., the individual income tax) or Part 2 (i.e., the corporate income tax), as applicable, of the Income Tax Act.
2. The member's allocable share of the reporting entity's taxes on or measured by net income, including the Michigan FTE tax, that was required to be added back in computing the flow-through entity's business income tax base.
3. The member's share of the reporting flow-through entity's refund of Michigan FTE tax received during the tax year, if applicable.
4. The member's share of the following tax amounts, reported separately:
 1. The tax imposed under the Michigan FTE tax for the tax year and paid by the fifteenth day of the third month after the end of the tax year.
 2. The Michigan FTE tax imposed for any prior tax year that was paid in the current tax year excluding any amount reported under 4i for the previous tax year.
 3. The Michigan FTE tax allocated to the reporting flow-through entity under either 4i or 4ii by other flow-through entities with tax years ending on or within the reporting flow-through entity's tax year.

In determining a member's share of the tax items in #4 above, a flow-through entity must base those amounts on the member's share of the income or gain generating

the flow-through entity tax that are included in the member's business income. For example, if a member recognizes income, expenses, gains, or losses in proportions other than pro rata based on ownership percentage, the tax allocated to that member must be equal to that percentage.

- **How does a flow-through entity provide information to members?**

There are no statutory requirements related to how information must be communicated to members of the flow-through entity. Flow-through entities may provide the required information to its members in any reasonable manner, including as separate statements or as notes attached to the Federal Schedule K-1.

- **What is a tiered or indirect credit?**

These terms can be used to describe a credit generated by an FTE taxpayer for another flow-through entity, which is listed as a direct member on Form 5774, Part 2. That credit is passed through to the member flow-through entity's owners and each respective share is ultimately claimed by taxpayers subject to Michigan individual income tax or corporate income tax (Part 1 or Part 2 of the Michigan Income Tax Act). Those taxpayers own the credit-generating flow-through entity indirectly, which is why their credits may be referred to as indirect credits. In addition, this ownership structure is often referred to as a tiered structure and therefore, creates what may be referred to as tiered credits.

- **What support must be provided to a member to support their claim of an indirect or tiered credit?**

Documentation provided to a member to report that member's share of FTE tax credit and tax base adjustments must include the name and FEIN of the credit-generating flow-through entity, and have credits and adjustments separately stated by flow-through entity. For more information about the required reporting to members, see Section I.E. of [Treasury's Notice Regarding the Implementation of the Michigan Flow-Through Entity Tax](#). Importantly, these specific reporting requirements apply to both electing and non-electing flow-through entities within a tiered structure in order to allow the ultimate member to claim the credit and make any return adjustments as necessary.

- **What are the filing and payment due dates for the Michigan FTE tax?**

Annual Returns

The annual 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 filers).

A flow-through entity must pay, by the initial due date of the annual return, its estimated unpaid tax liability for the tax year covered by an extension. Interest and, if applicable, penalty, will accrue from the initial due date of the return until the tax is paid.

An annual return must be filed by all electing flow-through entities. There are no de minimis liability thresholds for return filing purposes (i.e., an annual liability of \$100 or less), and an annual return is required even if liability was paid in full through estimated payments.

Any payments toward a tax year's Michigan FTE tax liability made after the 15th day of the third month after the tax year, will not qualify for a member credit for that same tax year. Instead, those payments will be reported as credits eligible to be claimed for members' immediately succeeding tax year.

Estimated Tax Payments

Flow-through entities that elect to pay the Michigan FTE tax are required to make estimated payments each year that their annual tax liability is reasonably expected to exceed \$800.

For calendar year filers, the estimates must generally be made in equal installments on or before April 15, June 15, September 15, and January 15. For fiscal year filers, the estimates must be made in equal installments on dates that correspond to the due dates for calendar year filers.

- **What formats can an electing flow-through entity use to file its Michigan Flow-Through Entity Tax Annual Return (Form 5772)?**

All Michigan FTE returns, including Form 5772, must be submitted electronically through Michigan Treasury Online ([MTO](#)). Michigan FTE tax returns submitted outside MTO will not be accepted.

- **Can an electing flow-through entity amend its Michigan FTE tax annual return?**

Amended annual return functionality for Michigan FTE tax is scheduled to be available on Michigan Treasury Online (MTO) in mid-December 2022. No additional returns for the tax year should be submitted until that time, even if you discover an issue with the original filing. All Michigan amended annual FTE tax returns will be submitted electronically through MTO.

- **What is entered on the Michigan Sales (line 1a) and Total Sales (line 1b) of the Michigan Flow-Through Entity Tax Annual Return (Form 5772) if the flow-through entity had no sales, only income derived from interest and/or dividends?**

For apportionment purposes, the interest is considered a "sale". The source of the sale is where the decision-making activities of the flow-through entity occur. If a flow-through entity is managed from an office in Michigan, the interest would be treated as a Michigan sale. If management of a flow-through entity occurs out of state, then the interest would be sourced as an out-of-state sale.

- **What methods can be used to make election, estimated, or annual Michigan FTE tax payments?**

All Michigan FTE tax payments must be submitted electronically through Michigan Treasury Online ([MTO](#)).

Payments submitted outside MTO will not be considered for valid election into the Michigan FTE tax.

Michigan FTE payments submitted outside MTO will not be accepted for estimated or annual tax obligations.

- **Is there a payment limit for electronic Michigan FTE tax payments?**

All Michigan FTE tax payments are submitted electronically through Michigan Treasury Online ([MTO](#)). ACH payments are limited to \$99,999,999 per transaction. Debit card payments are limited to \$999,999 per transaction.