Michigan Tax Changes for 2026

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Individual Tax Changes



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No Tax on Tips

2026 – 2028

Federal deduction = Michigan ADJUSTMENT

Non-resident restrictions

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Example: MI Tipped Employee

- Emma is a server at Ya Gotta Love MI Grill
- Her W-2 reports $ 26,000 of tips
- She files a joint tax return with her spouse
- Her Federal Schedule 1-A deduction shows $ 25,000 of Qualified Tips
- $ 25,000 is her eligible MI ADJUSTMENT

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No Tax on Overtime

- 2026 – 2028
- Federal deduction = Michigan SUBTRACTION
- Non-resident restrictions

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Example: MI OT -- Single

- Penelope is an hourly worker at It's Just Parts Inc
- Her W-2 shows Qualified Overtime of $ 15,000
- She files Single
- Her Federal Schedule 1-A Adjustment shows $ 12,500 of Qualified OT
- $ 12,500 is her eligible MI ADJUSTMENT

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Example: MI OT -- MFJ

- Bob is an hourly worker at It's Just Parts Inc
- His W-2 shows Qualified Overtime of $ 15,000
- He files a joint tax return with his spouse
- His Federal Schedule 1-A Adjustment shows $15,000 of Qualified OT
- $ 15,000 is his eligible MI ADJUSTMENT

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MI Residency Restrictions

- Nonresidents: only Michigan-service Tips & OT
- Part-year residents: allocate Michigan-service Tips & OT
- Service location NOT Employer location
- Service location = in-state

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Example: Florida Resident Working in MI

- Carter is a Florida resident who works in MI at his family's hair salon part of the year
- He files Single
- His Federal Schedule 1-A Adjustment shows $10,000 of Qualified Tips
- His tips attributed to MI are $ 5,000
- $ 5,000 is his eligible MI ADJUSTMENT

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Example: Reciprocal State Worker

- Cameron is a Wisconsin resident with a temporary work assignment in MI
- He files Single
- His Federal Schedule 1-A Adjustment shows $ 8,500 of Qualified OT
- His OT attributed to MI are $ 7,500
- He is not eligible MI ADJUSTMENT
- Due to the Reciprocity AgreementCameron does not pay tax in MI

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Social Security Subtraction

2026 – 2028

Taxpayers 67+ AND born after 1952 may claim

Social Security Subtraction AND	Full Standard Deduction

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Retirement Subtraction Changes

- Amended MCL 206.30 (2023 PA 4)
- The Tiered Structure OR
- New Phase-In, "Unified", Approach
- All taxpayers may claim the **full Michigan retirement and pension subtraction**

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…. Retirement Subtraction Changes

- Combined deduction for public retirement under MCL 206.30(1)(f)(i) and (ii)
- Capped at the same inflation-adjusted maximum that applies to private retirement under MCL 206.30(1)(f)(iv)
- Public Safety Retirees -- unchanged

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…. Retirement Subtraction Changes

- Social Security benefits are **fully exempt** (no change needed).
- Military, railroad, and certain public safety pensions remain **fully exempt**.
- Taxpayers "born after 1952" have less restrictions & still choose the standard deduction

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2026 Unified Retirement Subtraction Does NOT Apply to Tier 1

- Qualified Distributions included in Federal AGI
- Maximum subtraction: $ 56,961 single, $ 113,922 MFJ
- Public Pensions
- Private Pensions
- 401(k), 403(b), 457 distributions
- Traditional IRA distributions
- Other qualifying retirement benefits

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Tier	Birth Year	Pre-2026 Rule	Status in 2026
Tier 1	Born before 1946	Full subtraction allowed	Tiered structure OR Unified System
Tier 2	Born 1946–1952	Reduced subtraction until age 67	Unified System
Tier 3	Born after 1952	No subtraction until age 67; limited options	Unified System

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Example: Taxpayer Born 1950 (Tier 2)

$ 40,000 private pension, $ 20,000 IRA distribution, Under 67

Pre-2026 Treatment

- Limited subtraction until age 67
- Private pension partially eligible
- IRA distribution not eligible until age 67
- Limited subtraction: **$20,000**

2026 Treatment

- Full unified subtraction available
- All $60,000 retirement income eligible
- Total subtraction: **$56,961** (single cap)

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Example: Taxpayer Born 1960 (Tier 3)

$ 15,000 private pension, $ 30,000 401(k) distribution

Pre-2026 Treatment

- No subtraction until age 67
- Total subtraction = **$0**
- Eligible standard deduction upon reaching age 67

2026 Treatment

- Full unified subtraction available
- All $45,000 retirement income eligible
- Total subtraction: **$45,000**

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Example: Married Couple (1945 & 1958 birth years)
$ 90,000 pension & IRA distributions

Pre-2026 Treatment
- Older spouse: Tier 1 = full subtraction
- Younger spouse: no subtraction until age 67
- Combined subtraction $ 56,961 = older spouse's portion

2026 Treatment
- Full unified subtraction available
- All $ 90,000 retirement income eligible
- Total subtraction: $ 90,000

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…. Retirement Subtraction Changes

- **Younger retirees (born after 1952) benefit the most:** They no longer need to wait until age 67 to claim a meaningful subtraction.
- **Mixed-income households gain flexibility:** Couples with different birth years no longer need to prorate or track separate limits.
- **Preparers avoid the "birth-year matrix":** No more:
  - Age-67 crossover rules
  - Pension-only vs. pension-plus-other-income distinctions
  - Tier-specific caps
- **Planning becomes easier:** Taxpayers can time distributions (IRA, 401(k), lump sums) knowing the subtraction applies uniformly.

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Feature	Pre-2026 rules (tiered system)	2026 and forward (unified system)	Practitioner impact
Eligibility Based On Birth Year	Yes — Tier 1 (before 1946), Tier 2 (1946–1952), Tier 3 (after 1952)	No — birth year eliminated	Simplifies eligibility; no more birth-year matrix
Age Requirement	Often required to be age 67 for Tier 2 and Tier 3	No age requirement	Younger retirees gain access to subtraction
Maximum Subtraction Amounts	Tier-dependent; lower for younger cohorts	Unified maximum: • $56,961 (single) • $113,922 (MFJ) (indexed)	All taxpayers receive the same cap
Types Of Income Eligible	Public pensions always favored; private pensions and IRA/401(k) limited for younger cohorts	All retirement income types treated uniformly (pensions, IRA, 401(k), 403(b), 457, annuities)	Eliminates complex source-based distinctions
Social Security	Fully exempt	Fully exempt	No change
Military, Railroad, Public Safety Pensions	Fully exempt	Fully exempt	No change
Coordination Rules	Complex: age 67 crossover, pension-only vs. pension-plus-other-income rules	Eliminated	Dramatically reduces preparer error risk
Married Couples With Different Birth Years	Required proration and tier-mixing	Unified treatment	Simplifies MFJ returns
Interaction With Federal Agi	Subtraction applied after federal AGI	Same	No change
Overall Complexity	High	Low	Major simplification for practitioners

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Business Tax Changes



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Bonus Depreciation Decoupling (Nonconforming)

IRC §168(k): Federal 100%	MCL 206.607(1)(b) MI adjustment – beginning 2025	Individuals
Pass-through entities	Flow-through entity tax calculations	Separate adjusted basis tracking

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Bonus Depreciation Workflow

- Prepare Federal depreciation schedule
- Recompute each asset's MI depreciation pre-OBBBA (§168(k) prior to January 1, 2025)
- Compare
- Report difference:
  - Add-back federal bonus depreciation
  - Subtract MI allowable depreciation
- Carry forward MI basis & future depreciation separate from federal

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MI Bonus Depreciation Problem

- Federal basis reduced quicker
- MI basis higher after the year placed in service
- MI allows additional depreciation after year placed in service
- Federal depreciation may be exhausted after year placed in service
- Gain or Loss at time of sale different in MI because MI basis differs from Federal basis
- Pass-Through Entities – provide a statement with K-1

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Bonus Depreciation Comparison Federal & MI

Placed in Service Dates	Federal Bonus Depreciation	Michigan Bonus Depreciation
After Sept 27, 2017, and before Jan 1, 2023	100%	100%
After Dec 31, 2022, and before Jan 1, 2024	80%	80%
After Dec 31, 2023, and before Jan 1, 2025	60%	60%
After Dec 31, 2024, and before Jan 19, 2025	40%	40%
After Jan 20, 2025 and before Jan 1, 2026	*100% restored under OBBBA*	*40% continues*
Jan 1, 2026 thru December 31, 2026	100%	20%
On or after Jan 1, 2027	*100%*	*0%*

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Example: Pete's Excavating LLC, March 1, 2026, purchases a piece of equipment for $ 500,000, 5-year MACRS

Federal Treatment

- 100% Bonus Depreciation
- May elect out but doesn't
- Federal deduction = $ 500,000

MI Treatment

- Add back $ 500,000 bonus taken on federal
- 20% Bonus Depreciation
- MI subtraction = $ 100,000
- Remaining basis = $ 400,000
  - MI MACRS for remaining class life

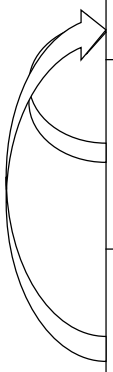
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Other Decoupling (Nonconforming)

IRC §179 expensing limitations	IRC §163(j) business interest limitation
IRC §174 & §174A research expenditure treatment	IRC §168(n) qualified production property

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§179 Comparison Federal & MI



Tax Year	Federal §179	Michigan §179
2023	Limit: **$ 1,160,000** Phase-out: $2,890,000	Same as federal
2024	Limit: **$ 1,220,000** Phase-out: $3,050,000	Same as federal
2025	Limit: **$ 2,500,000** Phase-out: **$ 4,000,000**	**2024 Limit** Limit: **$ 1,220,000** Phase-out: **$ 3,050,000**
2026+	Limit: **$ 2,560,000** Phase-out: **$ 4,090,000**	Limit: **$ 1,220,000** Phase-out: **$ 3,130,000**

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Example: Pete's Excavating LLC places in service $ 1,500,000 equipment on March 1, 2026, 5-year MACRS

Federal Treatment

- 179 allowed = $ 1,290,000
- Remaining basis: $ 210,000
- Bonus Depreciation = $ 210,000
- Total Federal Deduction = $ 1,500,000

MI Treatment

- 179 allowed = $ 1,220,000
- Remaining basis: $ 280,000
- Bonus Depreciation (20%) = $ 56,000
- Remaining Basis = $ 224,000
  - MI MACRS class life
  - 1st year depreciation = $ 44,800
- Total MI Deduction = $ 1,320,800

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…. Example: Mechanics of MI Adjustment

- Add back Federal 179 = 1,290,000
- Add back Federal Bonus = 210,000
- Subtract MI 179 = 1,220,000
- Subtract MI Bonus = 56,000
- Subtract MI 1st year MACRS = $ 44,800
- NET MI Add-Back = $ 179,200

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…. Example Federal & Michigan

Category	Federal	Michigan
Asset Cost	$1,500,000	$1,500,000
§179 Limit	$1,290,000	$1,220,000
§179 Taken	$1,290,000	$1,220,000
Remaining Basis	$210,000	$280,000
Bonus Depreciation Rate	100%	20%
Bonus Depreciation Allowed	$210,000	$56,000
Remaining Basis After Bonus	$0	$224,000
MACRS Depreciation (Year 1)	$0	~$44,800
Total Deduction (Year 1)	**$1,500,000**	**$1,320,800**

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What if Pete's Excavating was taxed as an S Corporation?

- Attach a statement to the Schedule K-1
- Pro-rata share of MI Add-back
- Pro-rata share of MI Subtraction
- Net MI Adjustment

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What if Pete's Excavating was a C Corporation?

- Recompute Federal Income without:
- §168(k) (bonus depreciation)
- §168(n) (special expensing)
- §174A (OBBBA amortization rules)
- OBBBA §179 increases

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What if Pete's Excavating was a C Corporation?

- Remove federal 100% bonus depreciation (OBBBA)
- Remove federal §179 increases (OBBBA)
- Apply Michigan's **pre-OBBBA bonus schedule** (40% in 2025, 0% in 2026+)
- Apply Michigan's **pre-OBBBA §179 limits** ($1.22M / $3.05M)
- Recompute MACRS using pre-OBBBA rules

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Comparison: C Corp & Flow-Through Entity Treatment

Category	Federal (OBBBA)	Michigan – Individual & Flow-Through	Michigan – C Corporation (CIT)
§179 Limit	$1,290,000	$1,220,000	$1,220,000
§179 Taken	$1,290,000	$1,220,000	$1,220,000
Remaining Basis	$210,000	$280,000	$280,000
Bonus Rate	100%	20%	20%
Bonus Allowed	$210,000	$56,000	$56,000
Remaining Basis After Bonus	$0	$224,000	$224,000
MACRS (Year 1)	$0	~$44,800	~$44,800
Total Deduction	**$1,500,000**	**$1,320,800**	**$1,320,800**
Yr-End Basis	$ 0	$ 179,200	$ 179,200

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Key Differences: C Corp & Flow-Through Entity Treatment

Step	Flow-Through (MI-1040/FTE)	C Corporation (CIT)
Starting point	Federal AGI	Federal taxable income
Adjustment method	Add-back federal bonus/§179 → subtract Michigan amounts	Recompute federal taxable income as if IRC = 12/31/2024
Bonus depreciation	Michigan 20% (2026)	Michigan 20% (2026)
§179	Michigan $1.22M limit	Michigan $1.22M limit
MACRS	MACRS on remaining MI Basis	MACRS on remaining MI Basis
Separate MI Basis Schedule?	Yes	Yes
Mechanics	Adjustment lines on MI-1040/FTE	Recomputed federal taxable income for CIT base

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Pass-Through Entity Recordkeeping

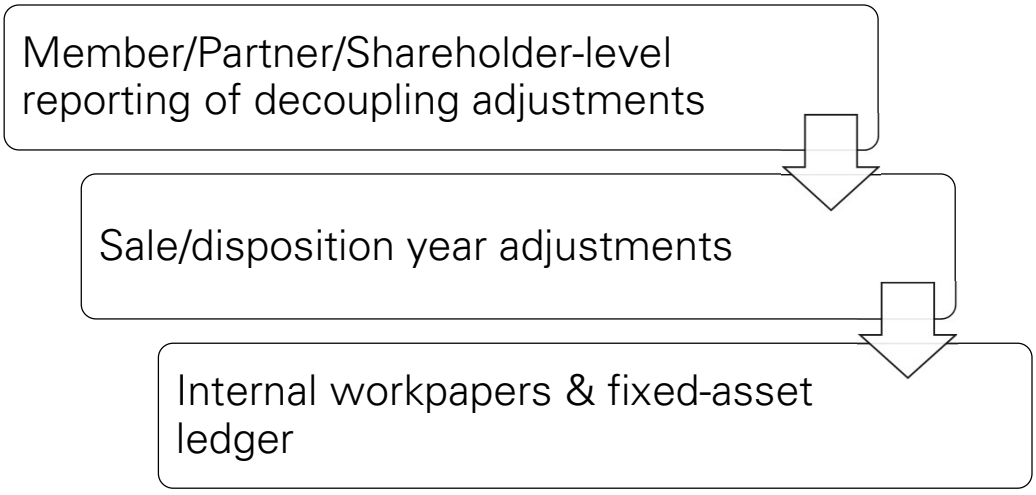
Michigan flow-through entity tax implications

Asset-by-asset depreciation tracking

Michigan-only basis schedules

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Pass-Through Entity Recordkeeping



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IRC §280E Decoupling – Cannabis Industry

- MI subtraction: ordinary & necessary expenses
- Amount disallowed by 280E
- Limited to licenses under:
  - Michigan Regulation & Taxation of Marihuana Act (MRTMA)
  - Medical Marihuana Licensing Act (MMFLA)
- Adult-use marihuana retailers,
- adult-use microbusinesses,
- Growers,
- Processors,
- Safety Compliance Facilities,
- Secure Transporters, and
- Other future business types licensed under the MRTMA

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Final Summary



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Topic	Federal Rule (2026)	Michigan Rule (2026)	Conformity Status	Practitioner Impact
Tax on Tips	Tips are taxable wages under IRC §61; no federal exclusion.	Excluded from Michigan taxable income (2026–2029). Michigan does not adopt federal inclusion.	Decoupled	Requires Michigan subtraction; withholding adjustments; 2025 gap creates planning issues.
Tax on Overtime	Overtime wages fully taxable federally.	Excluded from Michigan taxable income (2026–2029).	Decoupled	Employer payroll systems must track qualifying overtime; Michigan subtraction required.
Social Security Benefits	Up to 85% taxable depending on provisional income.	Fully exempt from Michigan income tax (expanded 2026).	Decoupled	Michigan subtraction required; affects AGI-based Michigan credits and phaseouts.
Retirement Income (Pensions, 401(k), IRA)	Fully taxable except for limited exclusions (e.g., military).	Michigan expands age-based and category-based subtractions beginning 2026.	Partially Conforming	Multi-layered subtraction rules require age, birth year, and income source analysis.
Standard Deduction & Personal Exemptions	Federal standard deduction sunsets after 2025 (reduced in 2026).	Michigan uses its own exemption and does not conform to federal standard deduction.	Decoupled	Federal sunset does not affect Michigan taxable income.
Earned Income Tax Credit	Federal EITC remains expanded.	Michigan EITC remains at 30% of federal	Partially Conforming	Michigan EITC increases refundability
Digital Assets / Cryptocurrency	Federal guidance evolving; taxable as property.	Michigan conforms to federal definition of income unless specifically decoupled.	Generally Conforming	Michigan follows federal gain/loss rules unless future decoupling occurs.

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Topic	Federal Rule (2026)	Michigan Rule (2026)	Conformity Status	Practitioner Impact
Bonus Depreciation (IRC §168(k))	Bonus depreciation phases down from 60% (2026).	Michigan disallows bonus depreciation; requires add-back and Michigan-specific depreciation.	Decoupled	Multi-year tracking required; common source of Michigan audit adjustments.
IRC §179 Expensing	Federal limit approx. $1.22M (indexed).	Michigan does not conform to federal limits; uses lower state-specific caps.	Decoupled	Michigan addition required when federal §179 exceeds Michigan limits.
NOL Rules	Federal NOLs limited to 80% of taxable income; unlimited carryforward.	Michigan corporate income tax has its own NOL rules; individual income tax does not allow NOLs.	Decoupled	Federal NOLs do not flow through to Michigan individual returns.
Pass-Through Entity (PTE) Adjustments	Federal depreciation, §179, and wage rules flow through to owners.	Michigan requires additions/subtractions for federal items Michigan does not adopt.	Partially Conforming	K-1 reconciliation required; affects Michigan FTE tax elections.
Cannabis Industry – IRC §280E	§280E disallows deductions for businesses trafficking Schedule I/II substances.	Michigan decouples from §280E; cannabis businesses may deduct ordinary & necessary expenses.	Decoupled	Michigan taxable income significantly lower than federal; entity choice and audit risk shift.

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Questions???

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