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This Week in State Tax (TWIST)



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Michigan: Deferred qualified opportunity fund gain taxable to resident; no credit for another state's tax paid in earlier year

The Michigan Department of Treasury recently issued a technical advice letter addressing the treatment of federally deferred Qualified Opportunity Zone capital gain for an individual who changed residency from California to Michigan. The taxpayer had sold stock while a California resident in 2021 and invested the proceeds in a Qualified Opportunity Fund. Although Internal Revenue Code (IRC) section 1400Z-2 deferred the gain for federal purposes until the earlier of disposition of the investment or December 31, 2026, California did not conform to the federal deferral and taxed the gain in 2021. The taxpayer sought the advice letter to determine whether the gain would be taxable by Michigan if recognized after becoming a Michigan resident and, if so, whether Michigan would provide relief for the California tax previously paid in 2021.

The Department concluded that the gain would be taxable by Michigan if the taxpayer was a Michigan resident when it was recognized for federal purposes irrespective of the California treament. Michigan individual income tax generally begins with federal adjusted gross income, and gain from the sale of intangible personal property, including stock, is allocated to Michigan when the taxpayer is a resident. The Department further concluded that Michigan law provided no mechanism to allocate the gain to California based on the taxpayer's residence when California taxed the gain. Michigan's resident credit also provided no relief because the credit for taxes paid applies to income tax imposed by another state for the same tax year in which Michigan taxes the income. Accordingly, California tax imposed in 2021 could not be used to calculate a credit against Michigan tax imposed when the deferred gain is recognized in 2026.

Please contact Dan De Jong with questions about Michigan Tax Treatment of Qualified Opportunity Fund Gain Previously Taxed by California.

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