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BILL ANALYSIS

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Senate Bill 234 (Substitute S-1 as passed by the Senate)
Sponsor: Senator Darwin L. Booher
Committee: Finance

Date Completed: 4-11-16

CONTENT

The bill would amend Chapter 13 of the Income Tax Act, which imposes a franchise tax on financial institutions, to do the following:

-- **Provide that a financial institution's tax base would be the total equity capital of the financial institution or top-tiered parent entity, in the case of a unitary business group of financial institutions, subject to several deductions.**
-- **Define "total equity capital" and "top-tiered parent entity".**
-- **Require the tax base to be determined as of the close of the tax year, rather than based on a five-year average.**
-- **Specify that, if a United States person included in a unitary business group of financial institutions or a financial institution combined return were subject to the Corporate Income Tax or the tax on insurance companies, any business income or equity capital attributable to that person would have to be eliminated from the total equity capital of the unitary business group, and any sales or gross business attributable to that person would have to be eliminated from the apportionment formula under Chapter 13.**
-- **Revise the apportionment formula for a financial institution with respect to gross business attributable to the foreign business of a controlled foreign corporation, and for a unitary business group of financial institutions that acquired or disposed of members during the tax year.**

The bill would be effective for tax years beginning after December 31, 2015.

Tax Base

Part 2 of the Act provides for the Corporate Income Tax (Chapter 11), a tax on insurance companies (Chapter 12), and a tax on financial institutions (Chapter 13). Under Chapter 13, every financial institution with substantial nexus in this State is subject to a franchise tax. The tax is imposed upon the tax base of the financial institution after allocation or apportionment, at the rate of 0.29%.

A financial institution's tax base is its net capital, which means equity capital as computed in accordance with generally accepted accounting principles less the average daily book value of U.S. obligations and Michigan obligations. Net capital does not include up to 125% of the minimum regulatory capitalization requirements of a person subject to the tax imposed under Chapter 12.

Under the bill, instead, a financial institution's tax base would be the total equity capital of the financial institution or top-tiered parent entity, in the case of a unitary business group of financial institutions, subject to the deduction of the following items before allocation or apportionment, to the extent that they were included in total equity capital:

-- The average daily book value of United States obligations owned by members of the unitary business group.
-- The average daily book value of Michigan obligations owned by members of the unitary business group.
-- The equity capital of a person that was subject to the tax imposed under Chapter 12, not to exceed 125% of the minimum regulatory capitalization requirements of the member.

For purposes of the last item, "equity capital" would mean equity capital as calculated in accordance with generally accepted accounting principles.

The bill would define "total equity capital" as the same amount reported by the financial institution or top-tiered parent entity, in the case of a unitary business group of financial institutions, and as reported for the tax year on any of the Federal forms listed in the bill and designated by the Federal Financial Institutions Examination Council (FFIEC), that are filed with the Comptroller of the Currency, the Federal Deposit Insurance Corporation, or the Federal Reserve System. "Top-tiered parent entity" would mean the highest-level entity within the unitary business group that is required to file with a regulatory agency under the standards prescribed by the FFIEC.

The Act requires net capital to be determined by adding a financial institution's net capital as of the close of the current tax year and preceding four tax years and dividing the resulting sum by five (except as provided for a financial institution that has not been in existence for five years). The bill, instead, would require net capital to be determined as of the close of the tax year.

Under the bill, if a United States person included in a unitary business group of financial institutions or a financial institution combined return were subject to the Corporate Income Tax or the tax imposed under Chapter 12, any business income or equity capital attributable to that person would have to be eliminated from the total equity capital of the unitary business group, and any sales or gross business attributable to that person would have to be eliminated from the apportionment formula under Chapter 13.

Apportionment

If a financial institution's business activities are subject to tax both within and outside of Michigan, the financial institution's tax base must be apportioned to this State; this is done by multiplying the tax base by a fraction called the gross business factor.

As a rule, the numerator of this fraction is the total gross business of the financial institution in this State during the tax year, and the denominator is its total gross business everywhere during the tax year. The bill states that the denominator could not include any gross business attributable to the foreign business of a controlled foreign corporation.

For a unitary business group of financial institutions, the bill would require the gross business factor to include the gross business of all members of the unitary group during the tax year. For members that were acquired or disposed of by the group during the tax year, the gross business factor would have to include the gross business of the part-year member for that portion of the tax year during which the member met the control and relationship parameters under Section 611(6) of the Act, or for the portion of the tax year for which the member filed as a part of an affiliated group under Section 691(2).

(Section 611(6) defines "unitary business group" as a group of United States persons that are corporations, insurance companies, or financial institutions, other than a foreign operating entity, one of which owns or controls, directly or indirectly, more than 50% of the ownership interest with voting rights or ownership interests that confer comparable rights, and that has business activities or operations that result in a flow of value between or among members included in the unitary business group or has business activities or operations that are integrated with, are dependent upon, or contribute to each other. The term includes an affiliated group that makes the election to be treated, and to file, as a unitary business group under Section 691(2).

Section 691(2) permits a person that is part of an affiliated group (as defined in the Act) to elect to have all of the persons that are included in the affiliated group to be treated as a unitary business group.

MCL 206.651 et al. Legislative Analyst: Suzanne Lowe

FISCAL IMPACT

The bill would have an unknown impact on General Fund revenue that would depend on the specific characteristics of affected taxpayers and the specific fiscal years being considered. For example, the bill would change the tax base from reflecting a five-year average to reflecting only a single year. Without regard to any of the bill's other provisions, compared to current law, General Fund revenue would be higher in years when the single-year tax base was greater than the average tax base over the last five years; and would be lower in any year in which the single-year tax base was less than the five-year average. The bill also would affect the calculation of both the tax base and how that tax base is apportioned to Michigan. It is expected that the bill's changes to how the tax base is computed in a year generally would reduce revenue relative to current law. However, the apportionment calculation is computed as a percentage and the proposed changes would affect both the numerator and the denominator of that calculation. As a result, while it is expected that both effects would combine to reduce revenue, in certain years the changes also could result in the taxpayer's apportioning a larger share of a smaller tax base to Michigan and facing a greater liability than under current law.

Fiscal Analyst: David Zin