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BILL ANALYSIS

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Senate Bill 234 (as introduced 3-24-15)
Sponsor: Senator Darwin L. Booher
Committee: Finance

Date Completed: 9-17-15

CONTENT

The bill would amend Chapter 13 of the Income Tax Act, which imposes a franchise tax on financial institutions, to do the following with respect to a financial institution's tax base (which is net capital subject to adjustments):

- **Provide that, for a unitary business group of financial institutions, net capital would be the net capital of the taxpayer or the top-tiered parent entity of the unitary business group of which the financial institution was a member.**
- **Require net capital to be determined as of the close of the tax year, rather than based on a five-year average.**
- **Provide a deduction for the equity capital of an applicable controlled foreign corporation.**
- **Eliminate gross business attributable to the foreign business of an applicable controlled foreign corporation, from its gross business factor in the apportionment formula.**
- **Include the gross business of all members of a unitary business group of financial institutions in its gross business factor in the apportionment formula.**

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 Chapter 12.

Under the bill, instead, a financial institution's tax base would be its net capital adjusted as follows before allocation or apportionment:

- Deduct the average daily book value of U.S. obligations owned by members of the unitary business group.
- Deduct the average daily book value of Michigan obligations owned by members of the unitary business group.

-- Deduct the equity capital of a member of the unitary business group that is subject to the tax imposed under Chapter 12, not to exceed 125% of the member's minimum regulatory capitalization requirements.
-- Deduct the equity capital of an applicable controlled foreign corporation, not to exceed 125% of the corporation's minimum regulatory capitalization rate.

For a unitary business group of financial institutions, net capital calculated under these provisions would be the net capital of the taxpayer or the top-tiered parent entity of the unitary business group of which the financial institution was a member.

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 financial institution unitary business group or a financial institution combined return were subject to the Corporate Income Tax or the tax imposed on insurance companies, any business income or equity capital attributable to that person would have to be eliminated from the 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 Part 2.

The bill would define "equity capital", for a financial institution that is not a member of a unitary business group, as the total equity capital of the financial institution, and for a unitary business group, the total equity capital of the top-tiered parent entity of the group, as of the last day of the tax year as reported on any of the forms specified in the bill, that are filed with the Office of the Comptroller of the Currency, the Federal Deposit Insurance Corporation, or the Federal Reserve System by the financial institution or the top-tiered parent entity of the unitary business group.

The bill would define "applicable controlled foreign corporation" as a controlled foreign corporation (as defined in the Internal Revenue Code) that satisfies all of the following:

-- The financial institution owns more than 50% of the outstanding interest in the controlled foreign corporation.
-- Consolidated financial reporting is required under generally accepted accounting principles.

<u>Apportionment</u>

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 an applicable controlled foreign corporation.

For a unitary business group of financial institutions, the gross business factor would have 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 that was received during the portion of the tax year in which the group owned that member.

If Section 655(3)(b) applied, the gross business factor of the unitary business group would have to include the gross receipts of the nonsurviving member included in the surviving financial institution's gross business during the tax year. (Section 655(3)(b) concerns situations in which two or more financial institutions are combined into one.)

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.

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