

TAX BASE OF FINANCIAL INSTITUTIONS

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Senate Bills 361 and 362 (S-1) as passed by the Senate

Sponsor: Sen. Darwin Booher

House Committee: Tax Policy

Senate Committee: Finance

Complete to 9-25-18

Analysis available at
<http://www.legislature.mi.gov>

SUMMARY:

Taken together, Senate Bills 361 and 362 would put into statute new provisions regarding the corporate income tax base of financial institutions (i.e., banks). Both bills would apply to tax years beginning after December 31, 2017.

Both bills would amend Chapter 13 of Income Tax Act, which deals specifically with financial institutions other than insurance companies (which are covered in Chapter 12). Senate Bill 361 would amend Sections 651 and 655 of the Act, while Senate Bill 362 would amend Sections 653 and 657. Under Chapter 13, the tax base of a financial institution, after allocation or apportionment, is subject to a rate of 0.29%. This would remain unchanged.

The bills would:

- 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 a financial institution's tax base is 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 following deductions before allocation or apportionment (as described below):
 - The average daily book value of U.S. obligations and Michigan obligations owned by members of the unitary business group;
 - The equity capital of a person subject to the tax under Chapter 12 (insurance companies), not to exceed 125% of the minimum regulatory capitalization requirements of the member.

[Currently, the Act describes a financial institution's tax base as "net capital," minus up to 125% of capitalization requirements.]

Total equity capital would refer to that amount as reported by a financial institution or top-tiered parent entity on various forms designated by the Federal Financial Institutions Examination Council (FFIEC) and filed with the Office of the Comptroller of the Currency, the Federal Deposit Insurance Corporation (FDIC), or the Federal Reserve System.

A ***top-tiered parent entity*** would be defined as the highest level entity within a unitary business group that is required to file with a regulatory agency using FFIEC standards.

- Specify that, if a U.S. person included in a unitary business group of financial institutions or a financial institution combined return is subject to tax under Chapter 11 (the standard Corporate Income Tax) or Chapter 12 (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 (the financial institutions income tax).
- Revise the apportionment formula for a financial institution with respect to gross business attributable to the foreign business of a controlled foreign corporation. The tax base of a financial institution whose business activities are subject to tax both within and outside the state is apportioned to Michigan by multiplying the tax base by the gross business factor. The gross business factor is a fraction where the numerator is total gross business in Michigan and the denominator is the total gross business everywhere. Under the bill, the denominator must include any gross business attributable to the foreign business of a person that is a foreign operating entity or a foreign person or attributable to operations outside of the United States.
- Specify, also, for a unitary business group of financial institutions that acquired or disposed of members during the tax year that the gross business factor would include the gross business of the part-year member for only a portion of the tax year.

The bills also contain an enacting section that stipulates that the amendments proposed to be made to Section 651 of the Act are curative and intended to clarify existing law and accurately reflect the application of that section in accordance with a 2016 notice to taxpayers regarding five-year averaging calculation of net equity capital for financial institutions.

Each bill is tie-barred to the other, which means that neither could take effect unless both were enacted.

MCL 206.651 et al.

FISCAL IMPACT:

Between tax years 2012 and 2016, annual revenue from financial institutions averaged \$53.4 million, but ranged from a low of \$42.9 million to a high of \$61.9 million. Changing the tax base to reflect a single tax year as opposed to a five-year average would have no impact on revenue over the long run, but would likely exacerbate revenue volatility by eliminating the smoothing effect that a five-year average attempts to provide.

Adjusting the apportionment formula to include gross business attributable to a foreign operating entity in the denominator will reduce the fraction of overall business activity subject to the tax and thereby reduce general fund revenue by an estimated \$10 million to \$15 million on a full fiscal year basis.

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■ This analysis was prepared by nonpartisan House Fiscal Agency staff for use by House members in their deliberations, and does not constitute an official statement of legislative intent.