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STATE OF MICHIGAN
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DEPARTMENT OF TREASURY
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REVENUE ADMINISTRATIVE BULLETIN 2001-2
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Single Business Tax Base for a Foreign Person

RAB 2001-2. This Revenue Administrative Bulletin (RAB) describes provisions of the Single Business Tax Act enacted by 1999 PA 115 that relate to the tax base of a foreign person for tax years beginning on or after January 1, 2000. For tax years beginning before January 1, 2000, see RAB 1999 – 10.

ISSUES

I. Who is a "foreign person" for Single Business Tax Purposes?

II. What activity subjects a foreign person to the Single Business Tax?

III. How does a foreign person calculate the tax base attributable to United States business activity, including the following?

1. Business Income: MCL 208.19(5)(a); MSA 7.558(19).
2. Additions and Subtractions: MCL 208.9; MSA 7.558(9).
3. Compensation: MCL 208.4(3); MSA 7.558(4), MCL 208.19(3); MSA 7.558(19).

IV. How does a foreign person calculate gross receipts for the following purposes?

1. Filing Threshold: MCL 208.73; MSA 7.558(73).
2. Gross Receipts Reduction: MCL 208.31(2); MSA 7.558(31).
3. Small Business Credit: MCL 208.36; MSA 7.558(36).

V. How does a foreign person calculate the "statutory exemption" under MCL 208.35(1)(a); MSA 7.558(35)?

VI. How does a foreign person apportion the United States tax base to Michigan?

VII. Do the foreign tax base provisions enacted by 1999 PA 115 affect U.S. persons?

VIII. Is a foreign person required to file estimated, quarterly payments for the first tax year starting on or after January 1, 2000?

IX. What nation's currency is used for Single Business Tax purposes?

CONCLUSIONS

I. **"Foreign Person."** A "foreign person" is a business organization formed or organized under the laws of a country other than the United States (U.S.) or a political subdivision of a country other than the U.S. For an individual such as a sole proprietor, a "foreign person" means an individual who is not a U.S. citizen or U.S. resident. A person who is required to file for U.S. federal income tax purposes as a U.S. person is not a foreign person under the Single Business Tax Act (SBTA) [MCL 208.19(6); MSA 7.558 (19)].

II. **Michigan Business Activity and Nexus.** A foreign person with business activity and nexus in Michigan during tax years that begin on or after January 1, 2000 is subject to the Single Business Tax (SBT).

Business Activity. Business activity is any type of endeavor for gain or advantage, whether direct or indirect, including the transfer, rental, lease, or license of property, the performance of services, and activities incidental to such activities, whether occurring in intrastate, interstate, or foreign commerce [MCL 208.3(2); MSA 7.558(3)]. Business activity is "within this state" if any part of the activity is engaged in or caused to be engaged in within Michigan. The RAB 1998-1 "SBT Nexus Standards" contains examples of business activities within Michigan.

Nexus. Michigan's SBT nexus standards (RAB 1998-1) are the same for foreign persons and U.S. persons.

III. **A foreign person calculates the tax base under MCL 208.19; MSA 7.558(19), and other applicable provisions of the SBTA.**

> **NOTE: "Gross Receipts Short Method Filers."** A foreign person may use SBT Form C-8000S to calculate the reduced, adjusted tax base for purposes of the "gross receipts reduction" in the same manner as a U.S. person and thereby avoid the tax base calculations described in Section III of this RAB. Under this method, the reduced, adjusted tax base is calculated by reference to 50% of adjusted, apportioned gross receipts, as calculated on the C-8000S [MCL 208.31(2); MSA 7.558(31)]. The amount calculated on Form C-8000S is entered on the appropriate line ("taxable base") on SBT Form C-8000. For an explanation of the calculation of gross receipts, see Section IV of this RAB. A person that files in this manner (a "short-method filer") may enter this amount (50% of adjusted, apportioned gross receipts) on the SBT Form C-8000, and need not perform any other tax base calculations described in Section III of this RAB. A person is not required to pay tax or file a return if the apportioned, adjusted gross receipts are less than $250,000.

1. **United States Business Income - General.** A foreign person that has federal taxable income under the U.S. Internal Revenue Code (IRC) generally reports "business income" for SBT purposes as federal taxable income reported on the U.S. federal income tax return (such as the U.S. Form 1120F for foreign corporations). A foreign person that is not subject to U.S. federal income taxes shall calculate business income using a *pro forma* U.S. federal income tax return. The *pro forma* U.S. income tax return must include the gross income and deductions allowed under the IRC, calculated in U.S. dollars as if the foreign person is a U.S. person. A foreign person may obtain information needed to complete the *pro forma* U.S. 1120 or the appropriate U.S. federal income tax form using the accounting information maintained by that taxpayer. The law requires the taxpayer to follow the IRC provisions on gross income and deductions when completing the *pro forma* U.S. income tax form. MCL 208.19(5)(a); MSA 7.558(19).

   U.S. Form 5471 "Information Return of U.S. Persons With Respect to Certain Foreign Corporations." A "controlled foreign corporation" as defined under the U.S. IRC may use gross income and adjustments as reported on U.S. Form 5471, Schedule C (Income Statement). The Form 5471 is filed by certain U.S. persons who are shareholders of a foreign corporation. The taxpayer may use the Form 5471 as filed for federal income tax purposes instead of a *pro forma* U.S. 1120. The taxpayer shall attach a copy of the Form 5471 to its SBT return.

   a. **Business Income – Taxpayers that Report U.S. Federal Taxable Income on Form U.S. 1120F (or other applicable U.S. form for foreign persons).** Generally, a foreign person that is required to report U.S. federal taxable income under the IRC shall include in business income for SBT purposes all federal taxable income reported on the U.S. federal income tax form (such as the 1120F for foreign corporations). This amount must be adjusted, if necessary, to include net income from all sales of property that originate within the U.S., regardless of where title transfers. Business income includes income from sales of property by a foreign person shipped or delivered from outside the U.S. to a purchaser within the U.S. if **either** of the following occur:

      i. Title transfers in the U.S. **or**
      ii. The income is actually reported on the U.S. federal income tax form filed by the foreign person (or required to be filed by the foreign person) regardless of where title transfers.

   b. **Business Income – Taxpayers not subject to U.S. Federal Income Taxes; Sales of Property to purchasers within the U.S.** This subparagraph (b.) applies to certain foreign persons that are not required to

report U.S. federal taxable income or pay U.S. federal income tax due to a provision of the IRC or an income tax treaty. For a foreign person who sells property that is shipped from a point outside the U.S. to a purchaser within the U.S., "business income" shall be derived from "worldwide net income" (described below). "Worldwide net income" shall be apportioned to the U.S. by a fraction, the numerator of which is gross receipts from sales for which title transfers within the U.S. and the denominator of which is worldwide gross receipts from all sales.

"Worldwide net income" shall be calculated using a *pro forma* U.S. income tax form for U.S. persons (such as the Form 1120 for corporations) calculated as if the foreign person is a U.S. person.

Worldwide Net Income Calculation not Required if Title Transfers Abroad – If a foreign seller of tangible personal property has nexus with Michigan, but for *all* of its sales the title transfers outside the U.S., the calculation of worldwide net income and deductions on a *pro forma* U.S. income tax form is not required.

i. **Title Transfer for Sales of Property.** Business income includes income from sales shipped or delivered to purchasers within the U.S. where title transfers within the U.S. IRC regulations and case law generally determine "title transfer." The Department may determine the place where title actually transfers on a case-by-case basis. The taxpayer (seller) must retain records of the time and place that legal title, possession, and risk of loss transferred to the buyer. Without proper documentation, it is presumed that title transfers to the buyer at the time and place that the buyer or the buyer's representative takes possession. The factors that are relevant to determine when and where all rights, title, and interest in the property transfer to the purchaser include but are not limited to:
    A. **Possession**. The time and place where the seller delivers possession of the property to the buyer, a representative of the buyer, or a common carrier is likely to be where title transfers.
    B. **Risk of Loss**. The time and place where the buyer assumes the risk of loss.
    C. **"Title transfer."** As used in MCL 208.19(5)(a); MSA 7.558(19), "title transfer" is generally consistent with IRC Regulation 1.861-7. The title transfers at the time and place where the rights, title and interest of the seller in the property are transferred to the purchaser.

D. **Tax Law of Seller's Jurisdiction**. Whether under the tax laws of another nation that has jurisdiction over the seller, the sale is considered to take place in that jurisdiction.

c. **Business Income - U.S. Services**. Business income from services means gross income from U.S. business activity, including the performance of services, minus the deductions allowed under the IRC that are related to that gross income [MCL 208.19(5)(a); MSA 7.558(19)]. A person who reports federal taxable income under the IRC as a foreign person (such as an 1120F filer) includes in business income all U.S. federal taxable income reported on the U.S. Form 1120F. In addition, 1120F filers and non-1120F filers must include any other income (whether or not reported on the U.S. 1120F) that is derived from services performed within the U.S. as indicated in this Section.

i. Business income includes net income from services performed by a foreign person completely within the U.S. From the gross income derived from services performed completely within the U.S. shall be deducted the expenses, losses, and other deductions allowed under the IRC that are properly allocated or apportioned thereto and a ratable part of any expenses, losses, and other deductions that cannot be definitely allocated to some item of gross income, in a manner generally consistent with methods provided in the IRC and regulations promulgated thereunder. (See IRC Sec. 861(b) and regulations to the extent consistent with the SBTA.)

ii. Business income does not include income from services performed by a foreign person completely outside the U.S.

iii. For services performed both within and outside the U.S., business income includes a *pro rata* proportion of the gross proceeds from the services based on "cost of performance" [MCL 208.19(5)(a); MSA 7.558(19)]. Cost of performance means direct costs determined in a manner consistent with U.S. generally accepted accounting principles. The *pro rata* proportion is determined using a reasonable method of apportionment that reflects the portion of business activity performed within the U.S. A proper apportionment method may consider the ratio of costs of performance within the U.S. to the costs of performance incurred everywhere

related to the services. The taxpayer may use a relative time method, or other method of allocating or apportioning the gross income from services to the U.S. that would be acceptable under IRC Reg. 1.861-4(b)(1)(I). From the gross income allocated or apportioned to the U.S. is deducted the expenses, losses, and other deductions allowed under the IRC that are properly allocated or apportioned thereto and a ratable part of any expenses, losses, or other deductions that cannot be definitely allocated to that gross income, in a manner generally consistent with methods provided in the IRC and regulations promulgated thereunder. (See IRC Sec. 863 and regulations.)

d. **Other Income**. **"**Business income**"** includes U.S.-source income such as income from rental of property located in the U.S., royalties, gain from the sale of property, stock, patents or copyrights, or "fixed or determinable annual or periodic gains, profits, and income" as defined under the IRC 871 and 881. The U.S.-source gross income is included in SBT business income with no deductions, as provided under the IRC. This income is included in business income if it is reported on the 1120F ("non-effectively connected income") or if it is subject to U.S. withholding tax under the IRC (without regard to any income tax treaty). The taxpayer's total U.S. business income is subject to the adjustments under MCL 208.9; MSA 7.558(9).

2. **Additions and Subtractions.** The tax base of a foreign person includes the "adjustments under section 9 that are related to U.S. Business activity" [MCL 208.19(1); MSA 7.558(19)]. The adjustments are referred to as "additions" or "subtractions." Additions are certain amounts (other than compensation) that the taxpayer deducted when calculating net income. These deductions are "added back" on the SBT return when calculating the SBT tax base. "Subtractions" generally are certain items of income that were included when calculating net income. These items of income are subtracted from net income ("business income") when calculating the SBT tax base.

a. **Additions**. The "additions" are included in the tax base to the extent that they relate to the U.S. business activity. Typically, these are expenses that add value to the taxpayer's goods or services and that were deducted in calculating net income or *pro forma* net income. Additions include taxes, interest expense, dividends paid, certain royalties paid, and depreciation expense. Generally, a foreign person who files an 1120F uses the amounts deducted in calculating federal taxable income on the 1120F. A foreign person who calculates worldwide net income using a *pro forma* U.S. 1120 whose income

is derived from the sale of tangible personal property shall apportion the worldwide "additions" to the U.S. using the same method as for business income (a fraction, the numerator of which is sales to U.S. purchasers where title transfers in the U.S. and the denominator of which is worldwide sales). Therefore, a foreign person whose income is derived from the sale of tangible personal property and where title for all sales passes to the purchaser outside the U.S. includes zero "additions" in the U.S. tax base. The taxpayer would report zero business income and zero additions on the SBT Form C-8000. If 50% of the taxpayer's sales are "U.S. title transfer sales" then 50% of the net income and additions from the *pro forma* U.S. income tax return are reported on the SBT Form C-8000. (See Example 5 in the Law and Analysis Section of this RAB). Foreign persons who perform services in the U.S. shall apportion the additions to the U.S. in the same proportion as business income as described in Section III (1) (c) of this RAB.

b. **Subtractions** [MCL 208.9(7)(a), (b), and (c); and subsections (8) and (9); MSA 7.558(9)]. Certain amounts included in income for income tax purposes are deducted from business income when calculating the tax base for SBT purposes. These items include dividend income, interest income (except for financial institutions), some royalties, a capital loss not deducted in arriving at federal taxable income and business income, and gains and losses of corporate partners. These amounts are subtracted from business income to the extent included in business income. For taxpayers who calculate business income using a *pro forma* federal income tax return and whose business income is derived from the sales of tangible personal property, the subtractions are apportioned to the U.S. using the same method as for business income (a fraction, the numerator of which is sales to purchasers in the U.S. where title transfers in the U.S. and the denominator of which is worldwide sales). Foreign persons who perform services in the U.S. shall apportion the subtractions to the U.S. in the same proportion as business income as described in Section III (1) (c) of this RAB.

3. **Compensation**. "Compensation" is remuneration of any kind that an employer pays to an employee, officer, or director for services [MCL 208.4(3); MSA 7.558(4)]. The compensation included in a foreign person's tax base is limited to certain compensation paid to employees, officers, or directors who perform services within the U.S. [MCL 208.19(3); MSA 7.558(19)].

A foreign person's tax base includes the daily compensation paid to each employee, officer, and director who perform services within the U.S., multiplied by the number of days that the employee, officer, or director performs services within the U.S. in the tax year. An employee of a foreign person who performs services within the U.S. for part of a day is considered to perform services within

the U.S. for one whole day [MCL 208.19(3); MSA 7.558(19)]. A day during which the person performs no services in the U.S. is not counted. A day during which an employee spends any time traveling within the U.S. is counted if the employee is compensated for that day.

Special Circumstances. If it is not possible to determine the actual daily compensation for services performed on contact days, an average daily compensation amount can be used.

IV. **Gross Receipts for Foreign Persons.** The term "gross receipts" is defined the same for foreign and U.S. persons. "Gross receipts" means the sum of sales worldwide, rental or lease receipts, and royalties from all sources. Gross receipts includes but is not limited to receipts from sale of property and all amounts received for services. In addition, gross receipts includes amounts such as interest, dividends, rents, royalties, and annuities. 2000 PA 477. (The changes to the definition of "gross receipts" made by 2000 PA 477 apply to tax years beginning after December 31, 2000.) The gross receipts calculation under the SBTA is relevant for various purposes, including the following:

1. **Filing Threshold**. A foreign person whose adjusted, apportioned gross receipts are less than $250,000 is not required to file an SBT return. A foreign person's gross receipts under MCL 208.73(1); MSA 7.558(73) are the adjusted worldwide gross receipts, apportioned to Michigan based on the ratio of Michigan property, payroll, and sales to worldwide property, payroll and sales. The payroll and property factors are each weighted 5% and the sales factor is weighted 90%. The sales factor numerator includes Michigan destination sales.

2. **Gross Receipts Reduction** [MCL 208.31(2); MSA 7.558(31)]. For purposes of the gross receipts reduction, gross receipts includes the adjusted worldwide gross receipts that are apportioned to Michigan using the same method as for the filing threshold.

3. **Small Business Credit.** A qualifying foreign person is entitled to the "small business credit" under MCL 208.36; MSA 7.558(36).

   a. **$10 million Gross Receipts Limitation**. Foreign persons use worldwide, unapportioned gross receipts to determine the $10 million disqualifying threshold.

   b. **"Adjusted Business Income."** A foreign person with no U.S. federal taxable income includes only compensation and directors fees of officers and active shareholders in the "adjusted business income" calculation.

V. **Statutory Exemption** [MCL 208.35(1)(a); MSA 7.558(35)]. A foreign person may exempt the first $45,000 of the tax base allocated or apportioned to Michigan, subject to certain limitations. A foreign person that has no U.S. federal taxable income under the IRC includes only compensation and directors fees when determining the increases and the phase out for the exemption. A foreign person that has U.S. federal taxable income includes that amount (for example: as reported on the 1120F) and compensation, and other amounts specified in MCL 208.35(1)(a); MSA 7.558 (35) to the extent deducted federally.

VI. **A Foreign Person Apportions the U.S. Tax Base to Michigan by Formula.** The tax base of a foreign person consists of value-added business activity attributable to the U.S. as set forth in Section III of this RAB. The U.S. tax base is apportioned to Michigan by a formula that uses Michigan factors and U.S. factors [MCL 208.40; MSA 7.558(40) to 208.69; MSA 7.558(69)]. The tax base and apportionment provisions for foreign transportation companies are explained in another RAB.

Property Factor. For a foreign person, the property factor is a fraction, the numerator of which is the average value of the taxpayer's real and tangible personal property owned or rented by the taxpayer in Michigan during the tax year and the denominator of which is the taxpayer's real and tangible personal property owned or rented in the U.S. during the tax year [MCL 208.46(2); MSA 7.558(46)]. The property factor is weighted 5%.

Payroll Factor. For a foreign person, the payroll factor is a fraction, the numerator of which is the total wages paid by the taxpayer for services performed in Michigan during the tax year and the denominator of which is the total wages paid for services performed in the U.S. during the tax year. MCL 208.49(2); MSA 7.558(49). This factor is weighted 5%.

The Sales Factor. For a foreign person, the sales factor is a fraction, the numerator of which is the total sales of the taxpayer in Michigan during the tax year, and the denominator of which is the total sales of the taxpayer in the U.S. during the tax year [MCL 208.51(1); MSA 7.558 (51)]. This factor is weighted 90%. If a foreign person has no property or payroll in Michigan, these factors are eliminated, and the sole factor used is the sales factor, weighted 90%.

Michigan Destination Sales. A sale of tangible personal property is "within this state" (a "Michigan destination sale") if it is shipped or delivered to any purchaser within this state regardless of the free on board point or other conditions of the sale (such as the place where title transfers). A foreign person's sales factor numerator includes all sales that are shipped or delivered to a purchaser within Michigan, regardless of where the sale originates or the location from which the goods are shipped.

A foreign person's sales factor denominator ("U.S. sales") includes all sales that are shipped or delivered to any purchaser within the U.S. regardless of the free on board point or other conditions of the sale, notwithstanding that the IRC or a tax treaty may allocate or apportion the income from such sale to another jurisdiction. Sales shipped or delivered to purchasers outside the U.S. are not included in the apportionment formula for the tax base.

Services and Sales of Intangibles. A "Michigan sale" of intangible property (and the performance of services) is determined under MCL 208.53; MSA 7.558(53). Gross receipts from services are "in this state" (included in the numerator of the sales factor) if the greater part of the business activity is performed in this state, based on the cost of performance related to those services [MCL 208.53; MSA 7.558(53)]. Cost of performance includes the direct costs associated with the services based on generally accepted accounting principles used in the U.S.

VII. **United States Persons**. The changes for foreign persons that were enacted by 1999 PA 115 (MCL 208.19; MSA 7.558(19), and other foreign tax base provisions) do not change the tax base calculation for United States persons. A U.S. person reports business income as federal taxable income as reported for U.S. federal income tax purposes for all tax years. The compensation is worldwide compensation paid to all employees, officers, and directors. This includes amounts reported on the U.S. federal Form 940 and amounts paid to the taxpayer's employees wherever located.

VIII. **Estimated Quarterly Payments**. A foreign person that had no tax liability for tax years starting before January 1, 2000 (RAB 1999-10) is not required to file an estimated return or make estimated payments under MCL 208.71 for the first tax year starting on or after January 1, 2000.

IX. **Converting Foreign Currency to U.S. Dollars**. A foreign person shall convert foreign currency to U.S. currency for SBT purposes. The applicable exchange rate is the average rate for the taxpayer's tax year. The taxpayer shall prepare the entire SBT return and any *pro forma* U.S. income tax return in U.S. dollars.

LAW AND ANALYSIS

"Foreign Person" Defined. A "foreign person" is a business entity or business organization formed or organized under the laws of a country other than the U.S. or a political subdivision of a country other than the U.S. For an individual such as a sole proprietor, a "foreign person" means an individual who is not a U.S. citizen or U.S. resident. "Foreign person" includes a person that is either subject to or not subject to taxation under the U.S. IRC of 1986 as amended. "Foreign person" does not include a "U.S. person" as defined in the SBTA. A person who is required to file for U.S. federal income tax purposes as a U.S. person is not a foreign person under the SBTA. A corporation or business entity organized under the laws of a state of the U.S.

is not a foreign person. The SBT applies to every "person" with business activity in Michigan, including an individual, partnership, or business entity of any kind, regardless of the form of organization [MCL 208.6(1); MSA 7.558(6)].

A foreign person, such as a foreign limited liability company organized under the laws of a foreign country, that is owned by one U.S. person, is a foreign person and must calculate its tax base under the provisions of the SBTA applicable to foreign persons. This is true notwithstanding that the U.S. owner elects to disregard the foreign LLC as a separate entity for U.S. federal income tax purposes. The foreign LLC must calculate its tax base separately as a foreign person and then combine its tax base with the U.S. person's tax base. The U.S. person calculates its tax base as a U.S. person. The U.S. person (the single member of the LLC) shall file an SBT return that includes the tax base of the foreign LLC. In this case, the foreign LLC would have no separate filing requirement. Furthermore, if the foreign LLC would not have nexus with Michigan if it were treated as a separate entity, but the U.S. owner has nexus, the foreign LLC has nexus as a result of the U.S. person's election to disregard the foreign LLC as a separate entity. For nexus purposes, the foreign LLC is treated as a branch or division of the U.S. owner, and therefore each may establish nexus on behalf of the other.

Michigan Business Activity and Nexus. A foreign person with business activity [MCL 208.3(2); MSA 7.558(3)] and nexus in Michigan during tax years that begin on or after January 1, 2000 is subject to the SBT. Revenue Administrative Bulletin 1998-1, "Single Business Tax Nexus Standards," applies equally to foreign and U.S. taxpayers. The standards for whether a foreign person is subject to the SBT are determined by Michigan state law, without regard to whether the person is subject to tax under the U.S. IRC, international income tax treaties, other treaties, or bilateral agreements. Michigan has authority to tax international commerce unless specifically prohibited by U.S. federal law, the U.S. Constitution, or a ratified treaty. The "permanent establishment" standard found in income tax treaties does not apply to the SBT. The U.S. Supreme Court has upheld a state's power to tax persons engaged in international commerce. *Container Corporation of America* v *Franchise Tax Board* 463 US 159; 103 S Ct 2933; 77 L Ed 2d 545 (1983); *Barclays Bank* PLC v *Franchise Tax Board,* 512 US 114; 114 S Ct 2068; 129 L.Ed.2d 93 (1994); *Wardair* v *Florida Dep't of Revenue,* 477 US 1; 106 S Ct 139; 91 L Ed 2d 1 (1986).

U.S. Business Income – General. "Business income" constitutes the "net profit" component of value added. For a U.S. person, "business income" means "federal taxable income" as reported on the U.S. federal income tax return, even if zero or negative. MCL 208.19; MSA 7.558(19) defines "business income" for purposes of the tax base of a foreign person.

> " 'Business income' means, for a foreign person, gross income attributable to the taxpayer's United States business activity and gross income from sources within the United States minus the deductions allowed under the internal revenue code that are related to that gross income" [MCL 208.19(5)(a); MSA 7.558(19)].

The methods for calculating business income described in this RAB shall be implemented in a manner that reasonably reflects net income (and deductions) related to the taxpayer's U.S. business activity, and the department may require adjustments on a case-by-case basis. Furthermore, federal statutes and regulations used to determine U.S. source income, or for other purposes under this RAB, shall be applied and interpreted in a manner consistent with the purposes of the SBTA.

"Worldwide net income" apportioned to the United States.

> **Example 1:** Foreign Co. manufactures personal property outside the U.S. for sale to customers worldwide, including the U.S. Foreign Co. does not have a permanent establishment in the U.S. Foreign Co.'s gross sales to the U.S. equal $5,000,000 (title to the property transfers to the U.S. purchasers in the U.S.); and gross sales worldwide equal $50,000,000 [$5,000,000 / $50,000,000 = .1]. Based on this fraction, ten percent (10%) of worldwide net income is attributable to U.S. business activity. The worldwide net income is calculated on a *pro forma* U.S. 1120 as if the foreign person is a U.S. person. The worldwide net income, equals $6,000,000 (from the *pro forma* U.S. 1120). The U.S. business income is $600,000 (10% of $6,000,000). The U.S. business income, ($600,000) is included in the U.S. tax base calculation and entered on the SBT form C 8000, along with U.S. additions (apportioned), minus subtractions (apportioned) and plus U.S. compensation. (The U.S. tax base is subsequently apportioned to Michigan using the three-factor formula in SBTA Chapter 3.)

The apportionment method described in example 1 determines the "business income attributable to U.S. business activity" as required by MCL 208.19; MSA 7.558(19). This is different than the apportionment formula for foreign persons provided in MCL 208.40; MSA 7.558(40), *et. seq*., that is used to apportion the U.S. tax base to Michigan. Business income from sales of tangible personal property includes gross income from sales for which title transfers in the U.S. Therefore an appropriate formula for determining "U.S. business income" is the ratio of U.S. title transfer sales to worldwide sales. The U.S. business income determined in this manner (and the other components of the U.S. tax base) are generally apportioned to Michigan using the three-factor formula for foreign persons.

Title Transfer for Sales of Property. Business income includes income from sales shipped or delivered to purchasers within the U.S. where title transfers within the U.S. [MCL 208.19(5)(a); MSA 7.558(19)]. This rule applies to foreign persons who manufacture or purchase property from a location outside the U.S. and sell the property to a person within the U.S., where the business activity related to the sale occurs substantially outside the U.S. The income from such sales is not attributable to U.S. business activity and is not from sources within the U.S. for SBT purposes [MCL 208.19(5)(a); MSA 7.558(19)]. This title transfer rule does not apply to foreign persons that manufacture or purchase property in the U.S. for sale to persons either within or without the U.S. The income from such business activity is attributable to U.S. business activity and is from sources within the U.S. within the meaning of MCL 208.19; MSA 7.558(19). In

addition, business income includes all income that is included in federal taxable income under the IRC.

"Title transfer." [MCL 208.19(5)(a); MSA 7.558(19)] "Title transfer" is generally consistent with IRC Regulation 1.861-7. The title transfers at the time and place where the rights, title, and interest of the seller in the property are transferred to the purchaser. The law generally honors the allocation of rights and duties effected by the parties to an agreement. *Connors & Mack Hamburgers, Inc*, v *Department of Treasury*, 129 Mich App 627; 341 NW2d 846 (1983). However, mere recitations in a contract, bill of sale, or documents of title do not control where title transfers if the material facts and circumstances suggest otherwise. It is the substance of a transaction rather than the terms applied to it by the parties which determines its character for tax purposes. *Central Discount Co* v *Dep't of Revenue*, 355 Mich 463; 94 NW2d 805 (1959). In extraordinary circumstances, the department may determine the place where title actually transfers based on all relevant facts and circumstances. The following examples illustrate circumstances under which the department would generally honor the contractual terms regarding title transfer, and when circumstances may require further examination to determine whether there is any legal or economic consequence to the terms agreed upon by the parties.

> **Example 1.1:** A Canadian Corporation manufactures and sells property to U.S. customers. The contractual terms of the sale provide that the title to the property transfers to the purchaser at the seller's dock in Canada. The purchaser takes delivery and makes payment at the seller's dock in Canada and transports the property to the U.S. in its own trucks. The title to the property transfers outside the U.S. for SBT purposes.
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> **Example 1.2:** Same as Example 1.1, except that the purchaser picks up the property at the seller's dock in Canada and transports the property to the U.S. using a third-party transportation company. The title to the property transfers outside the U.S. for SBT purposes.
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> **Example 1.3**: Same as Example 1.2 above, except that the seller agrees to bear the cost of insuring the safe delivery of the property until it reaches the purchaser's dock in the U.S. The title to the property transfers outside the U.S. for SBT purposes, notwithstanding that the seller bears the cost of insuring the goods in transit.
>
> **Example 1.4:** FOCO, Inc**.,** a foreign corporation located outside the U.S., sells property to purchasers within Michigan. The contractual terms of the sale provide that legal title to the goods transfers to the purchaser outside the U.S. The seller bears the risk of loss until the point of delivery at the purchaser's dock in Michigan. The seller delivers the goods in its own trucks and unloads and assembles the goods at the purchaser's plant in Michigan. The purchaser has the right to reject non-conforming goods after inspection at the time of delivery. In this case, the Department has the right to weigh all the facts and circumstances to determine where title actually transfers for SBT purposes.

Foreign Corporation Manufactures Goods within the United States

Example 2: FP, Inc., a foreign corporation, manufactures goods at a factory within the U.S. and sells the goods to purchasers within and without the U.S. FP, Inc. files for U.S. federal income taxes on U.S. federal Form 1120F. The income from the sales to purchasers in the U.S. is attributable to the U.S. and included in business income. All income from sales to purchasers outside the U.S. is included in business income, regardless of where title transfers, and regardless of whether a foreign office or representative participates in the sale. This income is included regardless of whether it is reported on the U.S. federal Form 1120F.

Example 3: Assume the same facts as Example 2, except FP, Inc. closes its U.S. plant, but maintains a stock of inventory in the U.S. from which representatives in the U.S. fill orders for sales of goods. FP, Inc. does not file a U.S. Form 1120F. The income from such sales is included in business income, notwithstanding that the stock of goods does not constitute a permanent establishment under the applicable income tax treaty. (FP would calculate its tax base using a *pro forma* U.S. Federal Form 1120.)

Example 4: **Foreign Person with U.S. permanent establishment that also has sales to U.S. not connected with the U.S. permanent establishment.** FC, Inc., a foreign corporation, has a U.S. permanent establishment that makes sales of widgets to customers in the U.S. FC, Inc., reports the net income from sales of widgets made through its U.S. office as effectively connected income on U.S. Form 1120F. FC's foreign office also sells another product (gidgets) to U.S. customers. The sales of gidgets are handled completely by the foreign office located outside the U.S. Title to the gidgets transfers to the customer in the U.S. The net income from the sales of gidgets must be included in business income reported on the SBT return. The net income from the "U.S. title transfer sales" is determined by the method described in Section III 1) (b) of this RAB. The taxpayer determines "worldwide net income" using a *pro forma* U.S. 1120. However the taxpayer must subtract from its worldwide net income the net income reported on the U.S. 1120F to avoid reporting the income twice. In addition, the taxpayer shall not include the sales made by the U.S. permanent establishment in its title transfer apportionment formula when apportioning worldwide net income to the U.S. The net income from the U.S. 1120F is combined with the apportioned worldwide net income (*pro forma* U.S. 1120 income) and reported on the SBT form. (For treatment of "additions" and "subtractions" see example 5.)

Additions and Subtractions. The tax base of a foreign person includes the "sum of business income and adjustments under section 9 that are related to U.S. Business activity" [MCL 208.19(1); MSA 7.558(19)]. The additions identified in the SBTA are as follows:

MCL 208.9(2); MSA 7.558(9). Gross interest income and dividends from certain obligations or securities of states other than Michigan are related to U.S. business activity and are added to business income and apportioned to the U.S. as provided in section III of this RAB.

MCL 208.9(3); MSA 7.558(9). All taxes on or measured by net income and the Single Business Tax to the extent the taxes were deducted in arriving at U.S. federal taxable income (on U.S. Form 1120F or the appropriate U.S. form for foreign persons). For persons who calculate business income using a *pro forma* U.S. 1120, add income taxes and SBT to the extent deducted in arriving at net income, and apportioned to the U.S. as provided in section III of this RAB.

MCL 208.9(4)(a); MSA 7.558(9). A carryback or carryover of a net operating loss that is related to U.S. business activity. For a foreign person that is a U.S. federal income tax payer, the NOL carryback or carryover is added back to the extent deducted for federal income tax purposes (i.e., on the 1120F). For a person that is not a U.S. federal income tax payer, a carryback or carryover of a net operating loss calculated on a pro forma U.S. income tax return is apportioned to the U.S. as provided in section III of this RAB.

MCL 208.9(4)(b); MSA 7.558(9). A carryback or carryover of a capital loss to the extent deducted in arriving at U.S. federal taxable income for a U.S. income tax payer. For a foreign person who is not a U.S. federal income tax payer, a carryback or carryover of a capital loss calculated is added back as provided in section III of this RAB.

MCL 208.9(4)(c); MSA 7.558(9). A deduction for depreciation, amortization, or immediate or accelerated write-off related to the cost of tangible assets. For a U.S. income tax payer, add all depreciation deducted on the U.S. Form 1120F. For a non-U.S. income tax payer, add depreciation that would be claimed for U.S. income tax purposes, calculated on a *pro forma* U.S. 1120. This amount is apportioned to U.S. business activity as provided in section III of this RAB.

MCL 208.9(4)(d); MSA 7.558(9). A dividend paid or accrued. For a U.S. income tax payer, add all dividends deducted on the U.S. Form 1120F. A non-U.S. income tax payer adds dividends that would be deducted for U.S. income tax purposes, calculated on a *pro forma* U.S. 1120. This amount is apportioned to U.S. business activity as provided in section III of this RAB.

MCL 208.9(4)(f); MSA 7.558(9). Interest expense is included in business income deducted on U.S. Form 1120F. For a non-U.S. income tax payer, add interest that would be deducted for U.S. income tax purposes, calculated on a *pro forma* U.S. Form 1120. This amount is apportioned to U.S. business activity as provided in section III of this RAB.

MCL 208.9(4)(g); MSA 7.558(9). All royalties paid, except those exempted from the tax base under MCL 208.9(4)(g); MSA 7.558(9), to the extent deducted on U.S. Form 1120F. A non-U.S. income tax payer adds royalty expense that would be deducted for U.S. income tax purposes, calculated on a *pro forma* U.S. 1120. This amount is apportioned to U.S. business activity as provided in section III of this RAB.

Subtractions.

MCL 208.9(7)(a); MSA 7.558(9). For a taxpayer that files a U.S. 1120F, subtract a dividend received or considered received to the extent included in federal taxable income as reported on the U.S. 1120F. A non-U.S. income tax payer subtracts a dividend received as provided in this RAB.

MCL 208.9(7)(b); MSA 7.558(9). For a taxpayer that files an U.S. 1120F, subtract interest income (except as indicated under MCL 208.9(7)(b); MSA 7.558(9)) to the extent included in federal taxable income on the Form 1120F. A non-U.S. income tax payer subtracts interest income as provided in this RAB.

MCL 208.9(7)(c); MSA 7.558(9). For a taxpayer that files a U.S. 1120F, subtract royalties, except amounts included in the tax base under MCL 208.9(7)(c); MSA 7.558(9), to the extent included in federal taxable income as reported on the U.S. 1120F. A non-U.S. income tax payer subtracts royalty income, except amounts included in the tax base under MCL 208.9(7)(c); MSA 7.558(9), as provided in this RAB.

MCL 208.9(8); MSA 7.558(9). Deduct a capital loss not deducted in arriving at federal taxable income, or business income, in the year the loss occurred. A non-U.S. income tax payer calculates this subtraction as provided in this RAB.

MCL 208.9(9); MSA 7.558(9). To the extent included in federal taxable income, or business income, add the loss or subtract the gain from the tax base that is attributable to another entity whose business activities are taxable or would be taxable if the business activities were in this state. A non-U.S. income tax payer calculates this subtraction as provided in this RAB.

Tax Base Calculation for Seller of Tangible Personal Property

Example 5: Canco, Inc., a Canadian corporation located in Canada sells tangible personal property to customers in Michigan, throughout the U.S., and worldwide. Canco’s employees travel to Michigan to solicit sales. The title to these sales transfers to the purchaser in Canada. Canco’s worldwide gross sales of tangible personal property equal $100,000,000, and sales to purchasers in the U.S. equal $75,000,000. Of the U.S. sales, $50,000,000 are shipped to customers in Michigan and $25,000,000 are to purchasers in other states. Canco’s sales employees spend a total of 60 days in the U.S. during the tax year and the total

compensation paid to the sales employees for all U.S. contact days equals $300,000. None of the compensation is considered to be "paid in this state" for payroll factor purposes (MCL 208.50; MSA 7.558(50)). Canco does not own or lease property located in the U.S. The U.S. tax base is calculated as follows:

Worldwide Gross (total) Income = $55,300,000 [in U.S. dollars calculated on the pro forma U.S. Form 1120]. Assume that dividends and interest income total $300,000 and cost of goods sold equals $45,000,000.

Gross Sales	*$100,000,000*
Cost of goods sold	*($45,000,000)*
Dividends	*$200,000*
Interest	*$100,000*
Worldwide Total Income	*$55,300,000*

Deductions taken on pro forma U.S. 1120

Depreciation expense	*($8,000,000)*
Income Taxes /SBT paid	*($2,000,000)*
Interest expense	*($1,500,000)*
Royalties paid	*(0)*
Compensation	*($20,000,000)*
Other	*($13,500,000)*
Total Deductions	*$45,000,000*

Worldwide Total Income	*$55,300,000*
less Worldwide Deductions	*$45,000,000*
Worldwide Net Income	*$10,300,000*

Worldwide Net Income = $10,300,000 [calculated using a pro forma U.S. 1120]

Worldwide net income is apportioned to the U.S. using the following formula:
$0 [US title transfer sales] / $100,000,000 [worldwide sales] = 0 [apportionment fraction]

U.S. business income = 0 [$10,300,000 X 0 = 0]

SBT Business Income = 0

Enter 0 on the line designated for "business income" on SBT form C-8000

[There would be no need to go through the above calculations for business income because U.S. title transfer sales factor equals zero, and therefore, U.S. business income is zero. The work is provided for illustration purposes.]

SBT "Additions" ("addbacks") *[certain amounts deducted when calculating net income].*

Depreciation expense $8,000,000
Income Taxes and SBT paid $2,000,000
Interest expense $1,500,000
Royalties paid 0
Total Worldwide addbacks = $11,500,000

Worldwide Addbacks apportioned to the U.S. = 0

Worldwide Addbacks [$11,500,000] X title transfer apportionment fraction [0] = 0

Enter 0 on the SBT form C-8000 line designated for "total additions."

SBT "Subtractions"

Dividends Received $200,000
Interest Income $100,000
Royalty Income $0______
Total subtractions = $300,000

Worldwide "subtractions" apportioned to the U.S. = 0

Enter zero on the SBT form C-8000 line designated for "subtractions."

U.S. Compensation = $300,000

Total U.S. tax base = $300,000 [$0 business income + $0 additions – $0 subtractions + $300,000 compensation]

Michigan Apportionment % [Michigan factors / U.S. factors] = .599 (sales factor weighted 90%)

Michigan payroll = 0
Michigan property = 0
Michigan sales = $50,000,000
U.S. sales = $75,000,000
Divide Michigan sales by U.S. sales
Sales Factor = .666666 [unweighted]
Sales Factor X 90% = .599999

Total U.S. Tax Base = $300,000
Apportioned Michigan Tax Base = $180,000 [$300,000 X .599999 = $179,999.97] (rounded)

Example 5 (Part B) – Assume the same facts as Part A, except that title to U.S. destination sales transfers in the U.S.

The worldwide net income is apportioned to the U.S. using the title transfer apportionment formula (U.S. title transfer sales / worldwide sales).

Worldwide Net Income = $10,300,000
Title Transfer Apportionment Fraction = $75,000,000 / $100,000,000 = .75
U.S. Net Income = $7,725,000 (Enter on "business income" line of SBT form C8000)

Worldwide Additions = $11,500,000
Title Transfer Apportionment Fraction = .75
U.S. Additions = $8,625,000 (Enter on "total additions" line of SBT form C8000)

U.S. Compensation = $300,000 (same as Example 5, Part A) (Enter on "total compensation" line of SBT form C8000)

Worldwide Subtractions = $300,000
Title Transfer Apportionment Fraction = .75
U.S. Subtractions = $225,000 (Enter on "total subtractions" line of SBT form C8000)

U.S. Tax Base = U.S. Net Income + U.S. Additions – U.S. Subtractions + U.S. Compensation

U.S. Tax Base = $16,425,000

The U.S. Tax Base is apportioned to Michigan using a three-factor formula as follows:

Michigan Sales / U.S. Sales X 90%
+
Michigan Property / U.S. Property X 5%
+
Michigan Payroll / U.S. Payroll X 5%

There is no Michigan property or payroll. Therefore, the fraction is calculated follows:

Michigan Sales $50,000,000 / U.S. Sales $75,000,000 X .9 = .599999

Michigan Tax Base
$16,425,000 [U.S. Tax Base] X .599999 = **$9,854,984**

Compensation.

Compensation includes wages, benefits, and all other amounts defined in MCL 208.4(3); MSA 7.558(4). For a foreign person, the tax base includes the daily compensation paid to an employee, officer, or director for all days that the employee performs services in the U.S. for any part of a day [MCL 208.19(3) and (5)(b); MSA 7.558(19)].

“Compensation” is remuneration of any kind that an employer pays to or on behalf of an employee, officer, or director for services. However, the compensation included in a foreign person’s tax base is limited to compensation paid to employees, officers, or directors that perform services within the U.S. [MCL 208.19(3); MSA 7.558(19)]. Amounts paid to employees, officers, or directors that have no physical contact with the U.S. are not included in SBT “compensation.”

A foreign person’s tax base includes the daily compensation paid to each employee, officer, and director multiplied by the number of days that the employee, officer, or director performs services within the U.S. in the tax year. An employee of a foreign person who performs services within the U.S. for part of a day is considered to perform services within the U.S. for one whole day. MCL 208.19(3); MSA 7.558(19). In determining the number of days that an employee, officer, or director has physical contact with the U.S., for purposes of MCL 208.19(3) and MCL 208.19(5)(b) include all days that the person has physical contact with the U.S. and performs services for the employer within the U.S. This method of counting days is consistent with IRC Reg. 1.861-4, which is used for purposes of determining gross income from labor and personal services performed within the U.S. by foreign persons. However, the *de minimis* exceptions in the IRC do not apply to the SBTA.

In general, compensation equals the wages and other remuneration actually deducted on the U.S. federal income tax form for foreign persons, such as the 1120F (compensation of officers, salaries and wages, pension, profit sharing plans, and employee benefit programs connected to the U.S. trade or business). If applicable, the wages reported on U.S. Federal Form 940 (Employer’s Annual Federal Unemployment Tax Return) are generally consistent with the daily compensation described in MCL 208.19(3); MSA 7.558(19). The “wages” portion of compensation must be reported on a cash basis. The “non-wage” portion of compensation (“fringe benefits”) must be reported on either a cash or accrual basis consistent with the taxpayer’s method of accounting for income tax purposes.

Example 6: A foreign corporation has a manufacturing plant in the U.S. and employs 500 persons who perform services only at the U.S. plant. All compensation, including wages and benefits [MCL 208.4(3); MSA 7.558(4)] paid to these 500 employees are included in the tax base [MCL 208.9(5); MSA 7.558(9)]. Some of the 500 employees are nonresident alien individuals that are not subject to federal withholding tax or whose wages are not reported on U.S. federal Form 940. The compensation paid to these nonresident alien individuals for services performed at the U.S. plant is included in the tax base for SBT purposes. In addition,

the foreign corporation's U.S. plant employs an individual who performs services completely outside the U.S.; the compensation paid to this employee is not included in compensation for SBT purposes. Finally, the corporation employs a person who performs services for 30 days each year in the U.S. The compensation paid for these 30 service days in the U.S. is included in the tax base.

Special Circumstances. The intent of MCL 208.19(5)(b); MSA 7.558(19) is to determine the actual daily compensation paid to an employee for a day that the employee performs services in the U.S. for any part of a day (a "contact day"). If it is not possible to determine the actual daily compensation paid to an employee for services performed on contact days, an average daily compensation amount can be used.

Example 7: An employee performs sales activity in the U.S. for 20 days during the tax year. The employee is paid commissions on sales. If it is not possible to determine a daily compensation rate for each day spent in the U.S., the daily compensation can be determined by computing the total compensation paid to the employee during the tax year, divided by the number of days worked. Compensation equals the average daily compensation multiplied by the number of U.S. contact days.

Gross Receipts – 2000 PA 477 amended the definitions of "gross receipts" and "sales" effective for tax years beginning after December 31, 2000. Details on this legislation will be provided in another RAB.

Filing Threshold. A foreign person whose adjusted, apportioned gross receipts are less than $250,000 is not required to file an SBT return. For purposes of MCL 208.73(1); MSA 7.558(73) gross receipts are apportioned, adjusted gross receipts. To properly apportion gross receipts to Michigan, the principles in MCL 208.19; MSA 7.558(19) are used to identify the gross receipts attributable to U.S. business activity and the U.S. gross receipts are apportioned to Michigan using the standard three-factor formula for foreign persons. However, the same result is achieved by apportioning worldwide gross receipts to Michigan by the following three-factor formula. The sales factor numerator consists of Michigan destination sales and the denominator consists of worldwide sales. The payroll and property factor numerators include Michigan payroll and property, and the denominators include payroll and property worldwide. The payroll and property factors are each weighted 5% and the sales factor is weighted 90%.

Gross Receipts Reduction [MCL 208.31(2); MSA 7.558(31)]. For a foreign person, apportioned gross receipts includes the adjusted receipts arising from sales and services worldwide that are apportioned to Michigan. The apportionment method is the same as for the gross receipts filing threshold (above). As described in Section III of this RAB, a foreign person may claim a gross receipt reduction in the same manner as an U.S. person. A foreign person may reduce its adjusted tax base by the amount by which 50% of gross receipts exceeds the adjusted tax base. If the adjusted tax base is less than 50% of gross receipts, the reduction does not apply. If a foreign person would benefit from the reduction, it may calculate its tax base by determining

its adjusted, apportioned gross receipts using SBT Form C-8000S, Part 2. That form determines the reduced adjusted tax base by multiplying adjusted, apportioned gross receipts by 50%. The Form C-8000 instructs the taxpayer to enter this amount on the appropriate line ("taxable base") of the SBT return (C-8000). A foreign person that files in this manner ("short-method filer") may enter this amount on the SBT Form C-8000, and need not perform any other tax base calculations described in Section III of this RAB.

Small Business Credit. A qualifying foreign person is entitled to the "small business credit" under MCL 208.36; MSA 7.558(36). Foreign persons use worldwide, unapportioned gross receipts to determine the $10 million disqualifying threshold. The purpose of the $10 million threshold is to measure the economic size of the business on a worldwide basis. MCL 208.36; MSA 7.558(36) provides that gross receipts are not apportioned for this purpose.

> **Example 8**: A foreign corporation has gross sales worldwide of $100 million. Gross sales made to U.S. customers that are reported on the U.S. 1120F equal $9 million. For small business credit purposes, gross receipts are $100 million.

Small Business Credit - "Adjusted Business Income." The small business credit uses the "adjusted business income" of certain business owners, officers, or shareholders, as a disqualifying threshold. The term "adjusted business income" is defined in MCL 208.36; MSA 7.558(36), and includes "business income" as defined in Section MCL 208.3; MSA 7.558(3), compensation of certain persons, and adjustments. A foreign person who is not a U.S. federal income tax filer has no business income under MCL 208.3; MSA 7.558(3) (U.S. "federal taxable income"). This also applies to the $475,000 adjusted business income limitation; and for individuals and partnerships, to the $115,000 adjusted business income limitation for any individual or partner. The $115,000 limitation for corporate shareholders and officers (other than S corporations) refers to "compensation" paid to an officer or shareholder, whether or not they are physically present in the U.S. The provisions in MCL 208.36(2)(b); MSA 7.558(36) apply to all foreign corporations, whether or not they are "flow through" entities (not taxed at the entity level) under foreign or U.S. income tax law.

The result is that foreign persons with no U.S. federal taxable income only include compensation and the other specified items in the "adjusted business income" calculation.

Statutory Exemption [MCL 208.35(1)(a); MSA 7.558(35)]. A foreign person may exempt the first $45,000 of the tax base allocated or apportioned to Michigan, with certain limitations. For most taxpayers, the exemption starts to phase out as "adjusted business income," exceeds $45,000, and is eliminated when adjusted business income equals $67,500. The phase out occurs at the rate of $2.00 for every $1.00 by which adjusted business income exceeds $45,000. A foreign person that is not required to file or pay U.S. federal income tax includes only compensation when determining the increases and the phase-out for the exemption. A foreign person that has U.S. federal taxable income includes that amount (as reported on 1120F) and compensation, and other amounts specified in MCL 208.35(a); MSA 7.558(35).

Currency. The Department's systems require that the SBT form and any *pro forma* U.S. form must be completed using U.S. dollars, not the taxpayer's functional foreign currency.

Foreign Financial Organization. A foreign person that is a financial organization as defined under the SBTA calculates its tax base under MCL 208.21; MSA 7.558(21), subject to the provisions of MCL 208.19. A foreign financial organization that is a U.S. federal income tax payer reports interest income as reported on the U.S. federal income tax form for foreign persons. A foreign financial organization that is not a U.S. federal income tax payer includes interest income in U.S. business income if the income would be considered U.S. source income under the IRC and regulations.