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Single Business Tax – Apportionment Sourcing for Financial Organizations

RAB 2002-14. This Revenue Administrative Bulletin (RAB) provides guidance to financial organizations regarding apportionment and sourcing and related issues for Single Business Tax (SBT) purposes.

ISSUES

- I. When does a financial organization apportion its tax base?
- II. What is the apportionment formula for financial organizations?
- III. What items of gross business are sourced to Michigan when a financial organization must apportion its tax base?

CONCLUSIONS

- I. A financial organization is a bank, industrial bank, trust company, building and loan or savings and loan association, bank holding company as defined in 12 U.S.C. 1841, credit union, safety and collateral deposit company, regulated investment company as defined in the Internal Revenue Code (IRC), and any other association, joint stock company, or corporation at least 90% of whose assets are intangible personal property and 90% of whose gross receipts income is dividends or interest or other charges resulting from the use of money or credit [MCL 208.10(4)]. A financial organization apportions its tax base when it conducts business activities partially within and partially without Michigan [MCL 208.65]. A financial organization that conducts “business activity” only within Michigan allocates its entire tax base to Michigan. “Gross business” is enumerated in MCL 208.65 and “business activity” is defined in MCL 208.3(2). The provisions in section III of this RAB determine when “gross business” is sourced to Michigan or another jurisdiction.
- II. The apportionment formula for a financial organization consists of a single-factor (“gross business factor”) that is based on the taxpayer’s “gross business.” The gross business factor is a fraction, the numerator of which is the taxpayer’s total gross business in Michigan and the denominator of which is the total gross business everywhere.

Under section 65(b) of the Single Business Tax Act (SBTA), as amended, “gross business” includes the sum of:

- (i) Fees, commissions, or other compensation for financial services.
- (ii) Gross profits from trading in stocks, bonds, or other services.
- (iii) Interest charged to customers for carrying debit balances of margin accounts, without deduction of any costs incurred in carrying the accounts.
- (iv) Interest and dividends received.
- (v) Any other gross income resulting from the operation as a financial organization.

III. In order to determine what items of “gross business” are sourced to Michigan, each item must be separately identified and the corresponding sourcing rule applied. The term “gross business” contains five components. There are five tables below, one for each of the five components of “gross business.” Identified in the first column of each of the five tables are specific items that are classified under one of the five components of gross business. The second column in the table contains the particular sourcing rule for each of the specifically identified items.

FEES, COMMISSIONS OR OTHER COMPENSATION FOR FINANCIAL SERVICES	SOURCED TO MICHIGAN IF:
1. Receipts from Credit Card Receivables (including without limitation, interest and fees or penalties in the nature of interest from credit card receivables and receipts from fees charged to card holders such as annual fees)	the billing address of the card holder is in Michigan
2. Credit Card Issuer’s Reimbursement Fees	the billing address of the card holder is in Michigan
3. Receipts from Merchant Discount (computed net of card holder’s chargebacks, but shall not be reduced by any interchange transaction fees or by an issuer’s reimbursement fees paid to another for charges made by its card holders)	the commercial domicile of the merchant is in Michigan
4. Loan Servicing Fees for Loans Secured by Real Property	<ul style="list-style-type: none"> a. real property is located in Michigan, or b. the real property is located both within and without Michigan and one or more other states if more than 50% of the fair market value of the real property is located within Michigan, or c. more than 50% of the fair market value of the real property is not located within any one state, then if the borrower is located in Michigan

5. Loan Servicing Fees for Loans Not Secured by Real Property	the borrower is located in Michigan
6. Fees for Servicing Secured or Unsecured Loans of Another	the borrower is located in Michigan
7. Receipts from Services (not otherwise apportioned under these guidelines)	<ul style="list-style-type: none"> a. the service is performed in Michigan b. the service is performed both within and without Michigan and the greater proportion of business activity is performed in Michigan based on cost of performance

GROSS PROFITS FROM TRADING STOCKS, BONDS OR OTHER SECURITIES	SOURCED TO MICHIGAN IF:
Receipts from Investment Assets and Activities and Trading Assets and Activities (including without limitation; investment securities; trading account assets; federal funds; securities purchased and sold under agreements to resell or repurchase; options; futures contracts; forward contracts; notional principal contracts such as swaps and equities; and foreign currency transactions)	
1. The Amount of Net Gains (not less than zero) and other Income from Investment Assets and Activities	the assets are assigned to a regular place of business of the taxpayer within Michigan
2. The Amount of Net Gains and other Income from Trading Assets and Activities (including but not limited to assets and activities in the matched book and in the arbitrage book and foreign currency transactions. Amounts described in section 1 of this table shall not be included in the amount described under this section of this table).	the assets are assigned to a regular place of business of the taxpayer within Michigan

INTEREST CHARGED TO CUSTOMERS FOR CARRYING DEBIT BALANCES ON MARGIN ACCOUNTS (without deduction of any costs incurred in carrying the accounts)	SOURCED TO MICHIGAN IF:
	the customer is located in Michigan

INTEREST AND DIVIDENDS RECEIVED	SOURCED TO MICHIGAN IF:
<p>Interest from Loans Secured by Real Property (the amount includes interest and fees or penalties in the nature of interest) *the determination of whether real property is located within Michigan shall be made as of the time the original agreement was made and any and all subsequent substitutions of collateral shall be disregarded</p>	<p>a. property is located within Michigan b. the property is located both within Michigan and one or more other states if more than 50% of the fair market value of the real property is located within Michigan c. if more than 50% of the fair market value of the real property is not located within any one state, then if the borrower is located in Michigan</p>
<p>Interest from Loans Not Secured by Real Property (the amount includes interest, fees or penalties in the nature of interest)</p>	<p>the borrower is located in Michigan</p>
<p>Interest and Dividends from Investment Assets and Activities (including without limitation, investment securities; trading account assets; federal funds; securities purchased and sold under agreements to resell or repurchase; options; futures contracts; forward contracts; notional principal contracts such as swaps and equities; and foreign currency transactions)</p>	<p>the average value of the assets are assigned to a regular place of business of the taxpayer within Michigan</p>
<p>Interest From Federal Funds Sold and Purchased and From Securities Purchased Under Resale Agreements and Securities Sold Under Repurchase Agreements</p>	<p>the agreements are assigned to a regular place of business of the taxpayer within Michigan</p>
<p>Interest and Dividends From Trading Assets and Activities (including but not limited to assets and activities in the matched book and in the arbitrage book and foreign currency transactions)</p>	<p>the value of the traded assets is assigned to a regular place of business of the taxpayer within Michigan</p>

OTHER GROSS INCOME RESULTING FROM THE OPERATION AS A FINANCIAL ORGANIZATION	SOURCED TO MICHIGAN IF:
<p>Gross Income From Sale of Loans</p>	
<p>1. Loans Secured by Real Property (net income from the sale of loans includes income recorded under the coupon stripping rules of section 1286 of the IRC)</p>	<p>a. the property is in Michigan, or b. the property is located both within Michigan and one or more other states if more than 50% of the fair market value of the real property is located within Michigan c. if more than 50% of the fair market value of the real property is not located in any one state, then if the borrower is located in Michigan</p>

<p>2. Loans not Secured by Real Property (gross income from the sale of loans includes income recorded under the coupon stripping rules of section 1286 of the IRC)</p>	<p>the borrower is in Michigan</p>
<p>Receipts From the Lease of:</p>	
<p>1. Real Property (rent, lease or sublease receipts)</p>	<p>the property is located in Michigan</p>
<p>2. Tangible Personal Property (lease or rent receipts)</p>	<p>the property is located within Michigan when it is first placed in service by the lessee</p>
<p>3. Transportation Tangible Personal Property (lease or rent receipts)</p>	<p>a. the property is used in Michigan b. the extent of use of such property within Michigan cannot be determined then if the property has its principal base of operations within Michigan</p> <p>*A motor vehicle will be deemed to be used wholly in the state in which it is registered. *The extent an aircraft will be deemed to be used in Michigan is determined by multiplying all of the receipts from the lease or rental of the aircraft by a fraction, the numerator of which is the number of landings of the aircraft in Michigan and the denominator of which is the total number of landings of the aircraft.</p>

LAW AND ANALYSIS

For purposes of the SBT, financial organizations are statutorily defined and have their own unique statutory section regarding apportionment, which the act refers to as “attribution” of the tax base [MCL 208.65]. Under the SBTA, a financial organization is a bank, industrial bank, trust company, building and loan or savings and loan association, bank holding company as defined in 12 U.S.C. 1841, credit union, safety and collateral deposit company, regulated investment company as defined in the IRC, and any other association, joint stock company, or corporation at least 90% of whose assets are intangible personal property and 90% of whose gross receipts income is dividends or interest or other charges resulting from the use of money or credit [MCL 208.10(4)].

Once a business entity is determined to be a “financial organization” under the SBTA, the specific statutory section regarding attribution applies [MCL 208.65].

The tax base of a financial organization attributable to Michigan includes its entire tax base if its business activities are solely confined to this state [MCL 208.65(a)]. However, if a financial organization’s business activities are conducted partially within and partially without Michigan then the formula for apportioning its tax base is a single factor called the “gross business factor.” The “gross business factor” is a fraction whose numerator is the sum of its gross business in Michigan and whose denominator is the sum of its gross business everywhere [MCL 208.65(b)].

Under MCL 208.65, the term “gross business” means the sum of: (i) fees, commissions, or other compensation for financial services; (ii) gross profits from trading in stocks, bonds or other services; (iii) interest charged to customers for carrying debit balance of margin accounts; (iv) interest and dividends received; and, (v) any other gross income resulting from the operation as a financial organization.

If a financial organization determines that it conducts business activity both within and without Michigan, then it is necessary to determine what portion of its “gross business” is sourced to Michigan (included in the gross business factor). This RAB provides guidelines for sourcing specific items of “gross business.”

When a financial organization determines that it must apportion its tax base because it conducts business activities partially within and partially without Michigan, then it must identify the specific items of “gross business” that need to be sourced. Once the items of “gross business” have been identified, the financial organization shall use the apportionment tables in this RAB to determine whether the item will be sourced to Michigan. If, pursuant to the apportionment tables in this RAB, an item of “gross business” is sourced to Michigan then the item shall be added to the numerator and denominator of the fraction. However, if an item of “gross business” is not sourced to Michigan pursuant to the apportionment tables in this RAB, then the item shall only be added to the denominator of the fraction.

The value of real property and tangible personal property owned by the taxpayer is the original cost or other basis of such property for federal income tax purposes without regard to depletion, depreciation or amortization. Loans are valued at their outstanding principal balance, without regard to any reserve for bad debts. If a loan is charged-off in whole or in part for federal income tax purposes, the portion of the loan charged off is not outstanding. A specifically allocated reserve established pursuant to regulatory or financial accounting guidelines which is treated as charged-off for federal income tax purposes shall be treated as charged-off for purposes of application of this RAB. Credit card receivables are valued at their outstanding principal balance, without regard to any reserve for bad debts. If a credit card receivable is charged-off in whole or in part for federal income tax purposes, the portion of the receivable charged-off is not outstanding. The average value of property owned by the taxpayer is computed on an annual basis by adding the value of the property on the first day of the taxable year and the value on the last day of the taxable year and dividing the sum by two. If averaging on this basis does not properly reflect average value, the Commissioner of Revenue may require averaging on a more frequent basis. The taxpayer may elect to average on a more frequent basis. When averaging on a more frequent basis is required by the Commissioner of Revenue or is elected by the taxpayer, the same method of valuation must be used consistently by the taxpayer with respect to property within and without this state and on all subsequent returns unless the taxpayer receives prior permission from the Commissioner of Revenue or the Commissioner of Revenue requires a different method of determining average value.

The sourcing guidelines contained in this RAB provide certainty in determining what items are to be included in the apportionment formula for financial organizations.

DEFINITIONS

The following definitions apply to this RAB:

- (1) “Billing address” means the location indicated in the books and records of the taxpayer on the first day of the taxable year (or on such later date in the taxable year when the customer relationship began) as the address where any notice, statement and/or bill relating to a customer’s account is mailed.
- (2) “Borrower or credit card holder located in this state” means:
 - (a) a borrower, other than a credit card holder, that is engaged in a trade or business which maintains its commercial domicile in this state; or,
 - (b) a borrower that is not engaged in a trade or business or a credit card holder whose billing address is in this state.
- (3) “Commercial domicile” means:
 - (a) the headquarters of the trade or business, that is, the place from which the trade or business is principally managed and directed; or,
 - (b) if a taxpayer is organized under the laws of a foreign country, or of the Commonwealth of Puerto Rico, or any territory or possession of the United States, such taxpayer’s commercial domicile shall be deemed for the purposes of the SBTA to be the state of the United States or the District of Columbia from which such taxpayer’s trade or business in the United States is principally managed and directed. It shall be presumed, subject to rebuttal, that the location from which the taxpayer’s trade or business is principally managed and directed is the state of the United States or the District of Columbia to which the greatest number of employees are regularly connected or out of which they are working, irrespective of where the services of such employees are performed, as of the last day of the taxable year.
- (4) “Credit card” means credit, travel or entertainment card.
- (5) “Credit card issuer’s reimbursement fee” means the fee a taxpayer receives from a merchant’s bank because one of the persons to whom the taxpayer has issued a credit card has charged merchandise or services to the credit card.
- (6) “Loan” means any extension of credit resulting from direct negotiations between the taxpayer and its customer, and/or the purchase, in whole or in part, of such extension of credit from another. Loans include participations, syndications, and leases treated as loans for federal income tax purposes. Loans shall not include: properties treated as loans under Section 595 of the federal IRC; futures or forward contracts; options; notional principal contracts such as swaps; credit card receivables, including purchased credit card relationships; non-interest bearing balances due from depository institutions; cash items in the process of collection; federal funds sold; securities purchased under agreements to resell; assets held in a trading account; securities; interests in a REMIC, or other mortgage-backed or asset-backed security; and other similar items.
- (7) “Loan secured by real property” means that fifty percent or more of the aggregate value of the collateral used to secure a loan or other obligation, when valued at fair market value as of the time the original loan or obligation was incurred, was real property.
- (8) “Merchant discount” means the fee (or negotiated discount) charged to a merchant by the taxpayer for the privilege of participating in a program whereby a credit card is accepted in payment for merchandise or services sold to the card holder.

- (9) "Participation" means an extension of credit in which an undivided ownership interest is held on a pro rata basis in a single loan or pool of loans and related collateral. In a loan participation, the credit originator initially makes the loan and then subsequently resells all or a portion of it to other lenders. The participation may or may not be known to the borrower.
- (10) "Principal base of operation" with respect to transportation property means the place of more or less permanent nature from which said property is regularly directed or controlled. With respect to an employee, the "principal base of operations" means the place of more or less permanent nature from which the employee regularly, (1) starts his or her work and to which he or she customarily returns in order to receive instructions from his or her employer, or (2) communicates with his or her customers or other persons, or (3) performs any other functions necessary to the exercise of his or her trade or profession at some other point or points.
- (11) "Real property owned" and "tangible personal property owned" mean real and tangible personal property respectively, (a) on which the taxpayer may claim depreciation for federal income tax purposes, or (b) property to which the taxpayer holds legal title and on which no other person may claim depreciation for federal income tax purposes (or could claim depreciation if subject to federal income tax). Real and tangible personal properties do not include coin, currency, or property acquired in lieu of or pursuant to a foreclosure.
- (12) "Regular place of business" means an office at which the taxpayer carries on its business in a regular and systematic manner and which is continuously maintained, occupied and used by employees of the taxpayer. The taxpayer shall have the burden of proving that an investment asset or activity or trading asset or activity was properly assigned to a regular place of business outside of this state by demonstrating that the day-to-day decisions regarding the asset or activity occurred at a regular place of business outside this state. Where the day-to-day decisions regarding an investment asset or activity or trading asset or activity occur at more than one regular place of business and one such regular place of business is in this state and one such regular place of business is outside this state, such asset or activity shall be considered to be located at the regular place of business of the taxpayer where the investment or trading policies or guidelines with respect to the asset or activity are established. Unless the taxpayer demonstrates to the contrary, such policies and guidelines shall be presumed to be established at the commercial domicile of the taxpayer.
- (13) "Rolling stock" means railroad freight or passenger cars, locomotives, or other rail cars.
- (14) "Sourcing" means determining the tax situs of a transaction.
- (15) "Syndication" means an extension of credit in which two or more persons fund and each person is at risk only up to a specified percentage of the total extension of the credit or up to a specified dollar amount.
- (16) "Transportation property" means vehicles and vessels capable of moving under their own power, such as aircraft, trains, water vessels and motor vehicles, as well as any equipment or containers attached to such property, such as rolling stock, barges, trailers or the like.