JOHN ENGLER
GOVERNOR

STATE OF MICHIGAN
DEPARTMENT OF TREASURY
LANSING

DOUGLAS B. ROBERTS
STATE TREASURER

REVENUE ADMINISTRATIVE BULLETIN 2002-16

Approved: September 9, 2002

Single Business Tax – Financial Organizations Defined

RAB 2002-16. This Revenue Administrative Bulletin (RAB) indexes specific businesses that are financial organizations and explains the statutory tests to determine when any other person is a financial organization for Single Business Tax (SBT) purposes. It describes the SBT tax base for a financial organization as well as the assets and gross receipts income used to satisfy the statutory tests.

ISSUES

I. Who is a "financial organization" for SBT purposes?

II. What is the SBT tax base for financial organizations?

III. What business entities may be classified as financial organizations under the asset and income test?

IV. How is the 90% intangible asset test applied?

V. What types of receipts determine the 90% gross receipts income test?

CONCLUSIONS

I. The Single Business Tax Act (SBTA) at MCL 208.10(4) defines a "financial organization" as:

A. bank, including any banking institution organized under the laws of the United States and any bank or thrift institution incorporated or organized under the laws of any state or foreign country. The business of banking usually consists of receiving deposits, making loans, or exercising fiduciary powers. The term includes savings banks and production credit associations. A bank may be insured or noninsured under the Federal Deposit Insurance Act (12 U.S.C. 1813(h)). Also, a bank may be a private bank;

B. industrial bank;

C. trust company;

D. building and loan association;

E. savings and loan association;

F. bank holding company as defined in 12 U.S.C. 1841 [The term "company" includes any corporation, partnership, business trust, association or similar organization, or any other trust as prescribed in the United States Code regarding bank holding companies.];

G. credit union;

H. safety deposit company;

I. collateral deposit company;

J. regulated investment company (RIC) as defined in section 851 of the Internal Revenue Code (IRC); **and,**

K. any other association, joint stock company, or corporation at least 90% of whose assets consist of intangible personal property and at least 90% of whose gross receipts income consists of dividends, interest, and other charges resulting from the use of money or credit.

All the above are financial organizations for SBT purposes and must compute the SBT base under Section 21 of the SBTA. Furthermore, if a financial organization conducts business within and without Michigan it must apportion the tax base pursuant to Section 65 of the SBTA. See RAB 2002-14 *Single Business Tax – Apportionment Sourcing for Financial Organizations*.

II. The tax base for a financial organization is business income subject to the adjustments provided in Section 9 of the SBTA, with the exception of Section 9(4)(f) (interest addition) and (7)(b) (interest subtraction). In addition, a financial organization may deduct, to the extent included in federal taxable income, interest income derived from obligations of the United States and must add expenses deducted from federal taxable income, less expenses which are added to the SBT base, times the following fraction:

$$\frac{\text{Interest from U. S. obligations + Interest on Michigan obligations}}{\text{Total Interest Income}}$$

A financial organization that is defined or treated as a regulated investment company under the IRC is not subject to the adjustments provided in Section 9(2) (addition for interest and dividend income from states other than Michigan), (4)(d) (addition for dividends paid or accrued), and (7)(a) (subtraction for dividends received).

III. The specific types of businesses listed in Conclusion I A-J (i.e., bank, bank holding company, savings and loan, RIC, etc.) do not apply the 90%-90% test since they are statutorily per se "financial organizations" for SBT purposes. The 90%-90% test only applies to "any other association, joint stock company, or corporation" not specifically listed in Section 10(4) of the SBTA. Both the 90% asset and 90% gross receipts income tests must be met before a business entity constitutes a financial organization for SBT purposes. The phrase "association, joint stock company, or corporation" means a corporation or any legal entity treated as a corporation for federal tax purposes.

IV. The 90% intangible asset test is applied annually at the close of the taxable year. When computing the 90% intangible asset test, classify the assets as they are reported for federal income tax purposes. Assets are valued at historical cost.

V. The 90% gross receipts income test is also applied annually and is determined by dividing total dividends, interest, and other charges for the use of money or credit by the total gross receipts income for the tax year.

"Dividends" means the same as for federal income tax purposes as defined in the Internal Revenue Code §316. "Interest" means that term as defined by Michigan case law for SBT purposes.

"Other charges resulting from the use of money or credit" include items that are not necessarily "interest" for SBT tax base purposes but that are treated as interest for federal tax purposes. This includes excess servicing fees treated as stripped interest for federal tax purposes and discount points. Fees such as appraisal fees, origination fees, or application fees are not included in the numerator of the fraction. "Interest or other charges resulting from the use of money or credit" are included in the numerator of the fraction used for 90% gross receipts income test.

Total gross receipts income as used in MCL 208.10(4) includes gross proceeds from sales, fees for services, commissions, gross dividends, gross interest including that from tax exempt obligations, gross rents, gross royalties, gross proceeds from the sale of capital assets and business property, any other taxable income reported on the federal tax return and any tax exempt income.

LAW AND ANALYSIS

The definition of "financial organization" for SBT purposes specifically includes banks, industrial banks, trust companies, building and loan associations, savings and loan associations, bank holding companies, credit unions, safe deposit companies, collateral deposit companies, and regulated investment companies. In addition, the definition includes any other association, joint stock company, or corporation if 90% of its assets are intangible personal property and 90% of its gross receipts income is from interest, dividends, and other income from the use of money or credit. Therefore, a business entity of a type not specifically listed as a financial organization (i.e., "bank," bank holding company, or RIC) may still be a financial organization for SBT purposes if it meets the 90%-90% test. [MCL 208.10(4)]

If not a per se financial organization, the 90%-90% test is made at the entity level. For example, if a limited liability company (LLC) elects to be treated as a corporation, the 90%-90% test would be applied to the LLC. The 90%-90% test would not apply to a single member limited liability company (SMLLC) that is a disregarded entity because it has not elected to be treated as a corporation and, as a single member entity, it cannot be "any other association, joint stock company, or corporation". If a SMLLC or Q Sub is one of the enumerated financial organizations (i.e., "bank," bank holding company, or RIC), the entity is per se a financial organization and, like all of the per se financial organizations, the 90%-90% test does not apply. On the other hand, a Q Sub is a corporation by its very nature and the 90%-90% test would be applied to determine if the Q Sub is a financial organization if it is not a per se financial organization.

Michigan courts have defined the term "interest" narrowly. The Michigan Supreme Court in *Town & Country Dodge Inc v Dep't of Treasury*; 420 Mich 226; 362 NW2d 618 (1984) stated:

> Interest is compensation allowed by law or fixed by the respective parties for the use or forbearance of money, "a charge for the loan or forbearance of money," or a sum paid for the use of money, or for the delay in payment of money. Balch v Detroit Trust Co, 312 Mich 146, 152; 20 NW2d 138 (1945); Coon v Schlimme Dairy Co, 294 Mich 51, 56; 292 NW 560 (1940); Marion v Detroit, 284 Mich 476, 484; 280 NW 26 (1938); Drennan v Herzog, 56 Mich 467, 469; 23 NW 170 (1885). See also 47 CJS, Interest & Usury, § 3, pp 18-22.

In *Perry Drug Stores Inc v Dep't of Treasury*, 229 Mich App 453; 582 NW2d 533 (1998), the Michigan Court of Appeals restated that: "The definition of "interest" requires that the parties have "fixed" a rate for the use or forbearance of money, usually pursuant to a contract or by law. Town & Country, supra at 241, 362 NW2d 618, quoting Old Colony R Co v Comm'r of Internal Revenue, 284 US 552, 560, 52 S Ct 211, 76 LEd 484 (1932)."

The term "gross receipts income" is unique and is not defined in the SBTA. Had the Legislature intended "gross receipts income" to mean "gross receipts" as defined at MCL 208.7(3) it would have stated so. The purpose of the term "gross receipts income" is to establish a method to evaluate the nature of the business of "any other association, joint stock company, or corporation" in regard to financial transactions.

DEFINITIONS

When used in this bulletin:

"IRC" means the United States Internal Revenue Code of 1986 in effect on January 1, 1999, or, at the option of the taxpayer, in effect for the tax year.

"MCL" means Michigan Compiled Laws.

"SBTA" means the Michigan Single Business Tax Act, 1975 PA 228, MCL 208.1, et seq. as amended.

"Treas Reg" means the Income Tax Regulations under the Internal Revenue Code, Title 26 of the United States Code.