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CORPORATE INCOME TAX – FINANCIAL INSTITUTION FRANCHISE TAX

Pursuant to MCL 205.6a, a taxpayer may rely on a Revenue Administrative Bulletin issued by the Department of Treasury after September 30, 2006 and shall not be penalized for that reliance until the bulletin is revoked in writing. However, reliance by the taxpayer is limited to issues addressed in the bulletin for tax periods up to the effective date of an amendment to the law upon which the bulletin is based or for tax periods up to the date of a final order of a court of competent jurisdiction for which all rights of appeal have been exhausted or have expired that overrules or modifies the law upon which the bulletin is based.

RAB 2019-22. This Revenue Administrative Bulletin (RAB) describes the procedures for computing the tax base of a financial institution and a unitary business group of financial institutions. The RAB also discusses apportionment of the tax base using a gross business factor and the eliminations required. This guidance is based on Chapter 13 of Michigan's Income Tax Act, as amended by 2018 PA 460 (PA 460) effective December 27, 2018.

THE TAXABLE ENTITY

Under Part 2 of the Michigan Income Tax Act, also known as the Corporate Income Tax Act (CIT), a taxpayer is defined as a corporation, an insurance company, a financial institution or a unitary business group.[1] A financial institution is defined as:

> (i) A bank holding company, a national bank, a state chartered bank, a state chartered savings bank, a federally chartered savings association, or a federally chartered farm credit system institution.
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> (ii) Any entity, other than an insurance company subject to the tax imposed under chapter 12, who is directly or indirectly owned by an entity described in subparagraph (i) and is a member of the unitary business group.
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> (iii) A unitary business group of entities described in subparagraph (i) or (ii), or both.[2]

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[1] MCL 206.611(5).
[2] MCL 206.651(g).

A unitary business group is defined the same for all taxpayer types under the CIT, including financial institutions:

> "Unitary business group" means a group of United States persons that are corporations, insurance companies, or financial institutions, other than a foreign operating entity, 1 of which owns or controls, directly or indirectly, more than 50% of the ownership interest with voting rights or ownership interests that confer comparable rights to voting rights of the other members, and that has business activities or operations which result in a flow of value between or among members included in the unitary business group or has business activities or operations that are integrated with, are dependent upon, or contribute to each other. Unitary business group includes an affiliated group that makes the election to be treated, and to file, as a unitary business group under section 691(2).[3]

The contours of the taxable entity are outlined by the interplay of these definitional provisions. A single financial institution is a taxable entity. A unitary business group of financial institutions is also a taxable entity; because this type of unitary business group is circumscribed by the definition of a financial institution in MCL 206.651(g)(iii), the composition of this taxable entity excludes insurance companies subject to Michigan's gross premiums tax under chapter 12 of the CIT.[4] Therefore, such insurance companies cannot be included on the combined return filed by the unitary business group and must file a separate return.[5] A C corporation[6] that is owned directly or indirectly by a financial institution and unitary with it is, however, defined as a financial institution under the CIT. For purposes of the franchise tax, a C corporation that meets those criteria is no longer treated as a C corporation but is in fact a financial institution and must be included on the combined return filed by the financial institution group members.

FINANCIAL INSTITUTIONS SUBJECT TO A FRANCHISE TAX

Financial institutions are not subject to the 6.0% corporate income tax on business income but are instead subject to a franchise tax at a rate of .29%, which is imposed upon the tax base of the financial institution as determined under section 655 after allocation or apportionment.[7]

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[3] MCL 206.611(6).
[4] See MCL 206.651(g)(ii).
[5] Filing and reporting procedures are discussed *infra*.
[6] This bulletin refers to corporate taxpayers that are not insurance companies and not financial institutions as standard taxpayers.
[7] MCL 206.653.

FINANCIAL INSTITUTION TAX BASE

Total Equity Capital

A financial institution's tax base is different than that of a C corporation or insurance company. The tax base of a financial institution for tax years beginning in 2019 and later is its total equity capital subject to certain deductions before allocation or apportionment. For a unitary business group of financial institutions, its tax base for tax years beginning in 2019 and later is the total equity capital of the top-tiered parent entity within the unitary business group, subject to certain statutory deductions.

The CIT defines total equity capital as the amount reported by the financial institution, or in the case of a unitary business group of financial institutions, the top-tiered parent entity, on certain regulatory forms designated by the Federal Financial Institutions Examination Council (FFIEC) and filed with the office of the comptroller of currency, the Federal Deposit Insurance Corporation (FDIC), or the Federal Reserve System. The appropriate regulatory form on which total equity capital is reported depends on the size and nature of the reporting entity. The forms currently designated by the FFIEC and required by the CIT are:

(1) The consolidated financial statement for holding companies, FR Y-9C.
(2) The parent company only financial statements for small holding companies, FR Y-9SP.
(3) To the extent that FR Y-9C or FR Y-9SP are not filed for the tax year, the consolidated reports of condition and income, call reports, FFIEC 031, 041, or 051.

If any of these reports is no longer designated by the FFIEC for filing, a financial institution will report that amount of total equity capital reported on a successor form or a report similar in content and designated by the FFIEC.[8]

A financial institution uses the FFIEC regulatory report for the period ending with the financial institution's fiscal year end. Likewise, for a unitary business group of financial institutions, the taxpayer uses the FFIEC regulatory report for the period ending with the top-tiered-parent entity's fiscal year end. If the financial institution or top-tiered parent entity does not submit a report for the period ending that coincides with its fiscal year end, the taxpayer should use the last FFIEC regulatory report issued during its fiscal year.

> **Example.** Holding Company X has a fiscal year ending September 30, 2019 and is required to file the parent company only financial statements for small holding companies, the FRY-9SP. Those reports are required semi-annually as of the last calendar day of June and December. Because Holding Company X does not issue an FFIEC regulatory report as of September 30, 2019, it reports for Michigan taxes its total equity capital from its June 30, 2019 FR Y-9SP.

[8] MCL 206.651(t)(iv).

Total equity capital is reduced by the following deductions before allocation or apportionment:[9]

(1) The average daily book value of the United States obligations owned during the tax year by members of the unitary business group.[10]
(2) The average daily book value of Michigan obligations owned during the tax year by members of the unitary business group.[11]
(3) The equity capital of an insurance company owned by any member of the unitary business group of financial institutions but only to the extent of the ownership interest and not to exceed 125% of the minimum regulatory capitalization requirements of the insurance company.[12]

Deductions from total equity capital are limited to those entities that are members of the unitary business group and may only be taken to the extent that the members' equity is included in the total equity capital reported on the designated regulatory report. When computing the amount to deduct, each member should look to its tax year that ends with or within the tax year of the top-tiered parent entity and was the tax year used to calculate the total equity capital of the top-tiered parent entity.

Example. Bank A owns 51% of Bank B, 60% of Bank C and 100% of Bank D. Bank B fails to meet the relationship test and is not unitary with the other banks. Banks A, C, and D form a unitary business group. Bank B has U.S. obligations of $50,000,000. The tax base starting point, Bank A's total equity capital as reported on its FFIEC regulatory report, includes its investment in Bank B. However, because Bank B is not a member of the unitary business group, the group may not deduct Bank B's U.S. obligations.

Additionally, the deduction for the equity capital of an entity taxed as an insurance company is limited to an amount up to, but not exceeding, 125% of the minimum regulatory capitalization requirements of the insurance company.[13] The amount of the deduction cannot exceed the amount

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[9] MCL 206.655(1).
[10] "United States obligations" means all obligations of the United States exempt from taxation under 31 USC 3124(a) or exempt under the United States constitution or any federal statute, including the obligations of any instrumentality or agency of the United States that are exempt from state or local taxation under the United States constitution or any statute of the United States.
[11] "Michigan obligations" means a bond, note, or other obligation issued by a governmental unit described in section 3 of the shared credit rating act, 1985 PA 227, MCL 141.1053.
[12] The gross premiums tax in chapter 12 of the CIT does not apply to captive insurance companies under chapters 46 and 47 of the Insurance Code.
[13] The statutory deduction refers to the minimum regulatory capitalization requirements of "the member." Because the definition of financial institution under MCL 206.651(g)(ii) and (iii) excludes insurance companies from a unitary business group *of financial institutions*, this RAB interprets the provision as referring to the minimum regulatory capitalization requirements of the insurance company.

of the financial institution taxpayer's investment in the insurance company.[14]

> **Example.** Insurance Company A has minimum regulatory capitalization requirements in Michigan of $7,500,000. Parent Financial Institution has an investment of $8,000,000 in Insurance Company A. Even though 125% of the minimum regulatory capitalization requirements is $9,375,000, Parent Financial Institution's deduction may not exceed its $8,000,000 investment in Insurance Company A.[15]

The minimum regulatory capitalization requirements for an insurance company are the fixed statutory minimums set forth in the Insurance Code of 1956.[16] More specifically, the phrase minimum regulatory capitalization requirements means the minimum amount of paid-in capital or surplus of assets that an insurance company, as defined in MCL 206.607(5), is required by Michigan to possess and maintain in order to transact insurance business in Michigan for the tax year. In the absence of an amount prescribed by statute, rule, or regulation, the amount shall be that which the Michigan Department of Insurance and Financial Services or its successor required the insurance company to possess and maintain to transact insurance in the state for the tax year.

Determining Total Equity Capital for a Unitary Business Group of Financial Institutions

When the taxpayer is a unitary business group of financial institutions, total equity capital is the amount the top-tiered parent entity reports on the designated regulatory report, discussed *supra*, for the tax year. The CIT defines the top-tiered parent entity as the highest level entity within the unitary business group that is required to file with a regulatory agency under FFIEC standards. Each separate unitary business group's total equity capital will be that amount reported by the highest level entity within that group that is required to file the designated FFIEC report.

Eliminations of equity capital under section 655(3)(c)

Generally, the purpose of an elimination adjustment is to avoid taking an item into account more than once when determining a unitary business group’s tax liability. In calculating the total equity capital of the unitary business group, the Legislature in 2018 PA 460 added section 655(3)(c) requiring the elimination of any business income or equity capital attributable to members—either included in the group or included on the combined return—that are subject to tax under chapter 11

[14] For purposes of this deduction, equity capital is calculated in accordance with Generally Accepted Accounting Principles.
[15] Even though an insurance company is not a member of a unitary business group of financial institutions, the parent-entity financial institution may still deduct its investment in the insurance company as outlined, because that investment is an asset included in the taxpayer's equity capital tax base.
[16] MCL 500.100 *et seq*. The statutory minimum capital and surplus requirement amount is published by the National Association of Insurance Commissioners (NAIC) for the Uniform Certificate of Authority Applications and is updated by the Department of Insurance and Financial Services.

(the tax on C corporations) or chapter 12 (the tax on insurance companies).[17] The provision implies that the Legislature intended to avoid duplicate taxation of any business income or equity capital under separate chapters of the CIT.

But there is no duplicate taxation under the separate chapters of the CIT. For several reasons, the statutory elimination added by PA 460, as written, does not result in any eliminations. First, the definition of a financial institution[18] includes any entity that is owned by and unitary with a financial institution. C corporations in that category are subject to the franchise tax on financial institutions and are, therefore, not subject to tax under chapter 11 of the CIT.[19] Thus, no elimination of equity capital or business income attributable to C corporations in the unitary business group of financial institutions can be taken. Further, financial institutions cannot eliminate equity capital or business income attributable to C corporations that are not members of the unitary business group of financial institutions or on the combined return. Business income attributable to a C corporation is not a component of the franchise tax base and, therefore, cannot be eliminated.

Insurance companies, unlike C corporations, are statutorily excluded from a unitary business group of financial institutions.[20] Since the statutory precondition for eliminating business income or equity capital requires that it be attributable to an entity in the unitary business group or filing on the combined return, there can be no elimination of business income or equity capital attributable to an insurance company because they are not in the group and must file separately.

Equity Capital Averaging

For the two tax years beginning after December 31, 2018, and before December 31, 2020, the CIT requires five-year averaging of the taxpayer's net equity capital.[21] Net equity capital is derived by subtracting the statutory deductions described *supra* from total equity capital as reported on the applicable federal regulatory report at the close of each tax year. For a single financial institution, the tax base is determined by adding its net equity capital at the close of the current tax year with its net equity capital for the preceding four years and dividing the result by five. For example, the 2019 tax year equity capital is computed as follows:

$$\frac{(2019_{EC} + 2018_{EC} + 2017_{EC} + 2016_{EC} + 2015_{EC})}{5}$$

For purposes of averaging, equity capital for years prior to 2019 is nonetheless determined under the definition of that term in 2018 PA 460. A shorter lookback period may apply if the financial

[17] MCL 206.655(3)(c).
[18] MCL 206.651(g).
[19] MCL 206.611(5).
[20] See MCL 206.651(g)(ii) and (iii).
[21] Net equity capital is not defined in the statute and is a term used in this bulletin for ease of reference.

institution has not been in existence for five years. In that case, the summed total is divided by the number of years the financial institution was in existence. A partial year is treated as a full tax year.[22]

The tax base for a unitary business group of financial institutions is calculated in similar fashion, beginning with the total equity capital of the top-tier parent entity and adjusting to net equity capital, for each of the years used in averaging.[23] The tax base of a unitary business group that has been in existence for at least five years is computed by summing the unitary business group's net equity at the close of the current tax year and the preceding four and dividing the result by five.

For tax years beginning after December 31, 2020, the tax base is determined as of the close of the tax year without averaging.

Mergers and acquisitions: Calculation of equity capital for combining financial institutions where five-year averaging is required.

When two or more financial institutions combine into one, the combined institution is treated as if it had been a single financial institution for the entire tax year in which the combination occurs and for each tax year after the combination.[24] For purposes of calculating net capital during the five-year averaging period, the Department previously interpreted the statute to require net capital for both the surviving and acquired entities for tax years prior to the year of combination to be included.

In a Notice issued November 21, 2016, the Department revised its interpretation to require that when two or more financial institutions combine, only the surviving financial institution's net capital for the years prior to the year of combination is used to calculate the surviving entity's tax base. Thus, for years prior to the year of combination, only the books and records of the surviving financial institution are used to compute the five-year averaging calculation. The Department gave full retroactive effect to the change in policy, allowing it to apply to all open tax years.[25] The Legislature codified this Notice in Enacting Section 1(2) of PA 460.[26]

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[22] MCL 206.655(2).
[23] As is the case with a single financial institution, a unitary business group of financial institutions must also determine its net equity capital before averaging.
[24] MCL 206.655(3)(b).
[25] See Department's November 21, 2016 Notice to Taxpayers Regarding Five-Year Averaging Calculation of Net Equity Capital for Financial Institutions Combining with Other Financial Institutions. See also MCL 205.27a.
[26] Enacting section 1(2) provides that "the provisions of section 655 of the income tax act of 1967, . . . are curative and intended to clarify existing law and accurately reflect the interpretation and application of those provisions in accordance with the notice to taxpayers dated November 21, 2016, regarding 5-year averaging calculation of net equity capital for financial institutions."

APPORTIONMENT

Gross Business Factor

The tax base of a financial institution whose business activities are subject to tax both within and outside of Michigan is apportioned using the "gross business factor."[27] A financial institution is subject to tax in another state if it is either subject to "a business privilege tax, a net income tax, a franchise tax measured by net income, a franchise tax for the privilege of doing business, or a corporate stock tax or a [franchise tax measured on equity capital]" or the state has jurisdiction to tax the financial institution whether it does or not.[28]

The "gross business factor" is a fraction; the numerator is the total gross business of the financial institution in Michigan during the tax year, and the denominator is the total gross business of the financial institution everywhere during the tax year.[29] For a unitary business group of financial institutions, gross business includes the gross business of every financial institution included in the unitary business group without regard to whether the financial institution has nexus in Michigan.[30] Each member must include gross business occurring within its tax year that ends with or within the tax year of the top-tiered parent entity and was the tax year used to calculate the total equity capital of the top-tiered parent entity.

Gross Business Eliminations

To calculate the gross business factor for a unitary business group of financial institutions, any items of gross business transacted between financial institution members included in the group are eliminated from each respective member's gross business calculation.[31] The resulting net gross business for each member is then summed to determine the gross business for the unitary business group. This requires members of a unitary business group of financial institutions to track all transactions between members that affect gross business. Each member is required to make the offsetting accounting adjustments to reflect gross business net of gross business between members. When making eliminations, each member should look to its own tax year. In instances where members have different tax year-ends, there may be timing differences associated with transactions between members. Schedules supporting eliminations should be maintained by the taxpayer and available for review.

Once all eliminations are made, the resulting net gross business for each member is then summed to determine the gross business for the unitary business group.

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[27] MCL 206.657(1).
[28] MCL 206.657(2)(a) and (b).
[29] MCL 206.657(3).
[30] MCL 206.657(4).
[31] *Id*.

In enacting section 655(3)(c) requiring eliminations from the tax base, the Legislature also added language requiring the elimination of any sales or gross business attributable to members—either included in the unitary business group or on the combined return—that are subject to tax under chapter 11 (the tax on C corporations) or subject to tax under chapter 12 (the tax on insurance companies). For the same reasons stated *supra*, this statutory elimination, as written, does not result in any eliminations.

Items Included in and the Sourcing of Gross Business

Items comprising gross business include the following and are sourced to Michigan under section 659 as follows:

> (a) 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 credit card holders such as annual fees, are in this state if the billing address of the credit card holder is located in this state.
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> (b) Credit card issuer's reimbursement fees are in this state if the billing address of the credit card holder is located in this state.
>
> (c) Receipts from merchant discounts are in this state if the commercial domicile of the merchant is in this state.
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> (d) Loan servicing fees are in this state under any of the following circumstances:
>
>> (i) For a loan secured by real property, if the real property by which the loan is secured is in this state.
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>> (ii) For a loan secured by real property, if the real property by which the loan is secured is located both within and without this state and one or more other states and more than 50% of the fair market value of the real property is located in this state.
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>> (iii) For a loan secured by real property, if more than 50% of the fair market value of the real property by which the loan is secured is not located within any one state but the borrower is located in this state.
>>
>> (iv) For a loan not secured by real property, if the borrower is located in this state.
>
> (e) Receipts from services are in this state if the recipient of the services receives all of the benefit of the services in this state. If the recipient of the services receives some of the benefit of the services in this state, the receipts are included in the numerator of the

apportionment factor in proportion to the extent that the recipient receives benefit of the services in this state.[32]

(f) Receipts from investment assets and activities and trading assets and activities, including interest and dividends, are in this state if the financial institution's customer is in this state. If the location of the financial institution's customer cannot be determined, both of the following apply:

> (i) Interest, dividends, and other income from investment assets and activities and from trading assets and activities, including, but not limited to, 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; equities; and foreign currency transactions are in this state if the average value of the assets is assigned to a regular place of business of the taxpayer within this state. Interest from federal funds sold and purchased and from securities purchased under resale agreements and securities sold under repurchase agreements are in this state if the average value of the assets is assigned to a regular place of business of the taxpayer within this state. The amount of receipts and other income from investment assets and activities is in this state if assets are assigned to a regular place of business of the taxpayer within this state.
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> (ii) The amount of receipts from trading assets and activities, including, but not limited to, assets and activities in the matched book, in the arbitrage book, and foreign currency transactions, but excluding amounts otherwise sourced in this section, is in this state if the assets are assigned to a regular place of business of the taxpayer within this state.

(g) Interest charged to customers for carrying debit balances on margin accounts without deduction of any costs incurred in carrying the accounts is in this state if the customer is located in this state.

(h) Interest from loans secured by real property is in this state if the property is located in this state, if the property is located both within this state and one or more other states and more than 50% of the fair market value of the real property is located in this state, or if more than 50% of the fair market value of the real property is not located within any one state but the borrower is located in this state.

(i) Interest from loans not secured by real property is in this state if the borrower is located in this state.

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[32] The Department previously issued RAB 2015-20, Corporate Income Tax, Where Benefit of Services is Received.

(j) Net gains from the sale of loans secured by real property or mortgage service rights relating to real property are in this state if the property is in this state, if the property is located both within this state and one or more other states and more than 50% of the fair market value of the real property is located within this state, or if more than 50% of the fair market value of the real property is not located in any one state but the borrower is located in this state.

(k) Net gains from the sale of loans not secured by real property or any other intangible assets are in this state if the depositor or borrower is located in this state.

(l) Receipts from the lease of real property are in this state if the property is located in this state.

(m) Receipts from the lease of tangible personal property are in this state if the property is located in this state when it is first placed in service by the lessee.

(n) Receipts from the lease of transportation tangible personal property are in this state if the property is used in this state or if the extent of use of the property within this state cannot be determined but the property has its principal base of operations within this state.[33]

FILING AND REPORTING

Unitary business groups of financial institutions must file a combined return that includes each United States person that is included in the unitary business group. A financial institution that is part of an affiliated group, as defined in MCL 206.603(1), may elect to have all of the persons included in that affiliated group treated as a unitary business group.[34] For administrative purposes, the Department requires a unitary business group to designate one member of the group to file the combined return. As with other taxpayers under the CIT, this reporting entity is referred to in Department guidance as the "designated member" or “DM.”

The DM of a unitary business group must register with the Department for the CIT. A DM is a member of a unitary business group that has nexus with Michigan under MCL 206.653(2), that has been authorized by the group to act on its behalf, and that will file the combined return required under MCL 206.691 for the unitary business group.

If the member that owns or controls the other members of the unitary business group has nexus with Michigan, then that controlling member must be the DM. Otherwise, the DM can be any member of the unitary business group with nexus. The DM may be an entity other than the top-tiered parent entity if the top-tiered parent entity does not have nexus with Michigan. In that case, the top-tier parent entity's total equity capital and tax year is still used to calculate the tax base. The DM must remain the same every year unless it ceases to be a member of the unitary business

[33] MCL 206.659.
[34] MCL 206.691(2).

group or the controlling member engages in activity in Michigan that subjects that member to nexus.

The unitary group must use the tax year of the top-tiered parent entity; so, for any entities that have a different tax year, the combined return of the unitary business group must include the tax year of each member whose tax year ends with or within the tax year of the top-tiered parent entity. The tax year of each member should reflect the results reported in each member's financial statements that were used to calculate and report the total equity capital of the top-tiered parent entity. These member tax years will also be used to determine the deductions taken from total equity capital to arrive at net equity capital and to make eliminations from gross business.

While an insurance company may be a member of a unitary business group, it cannot be a financial institution or be included on the combined return filed by the financial group. However, the group may subtract the equity capital of the insurance company member, subject to the limitations discussed *supra*.

When filing the annual return for financial institutions, both single filers and unitary business group filers must include with the return a copy of the federal regulatory report from which the total equity capital amount used on the return was taken. For unitary business group filers, the following must be identified on a schedule or other form required by the Department:

i) Any entities included in the federal regulatory report that are not members of the unitary business group,
ii) All members of the unitary business group, including members not included on the return of the financial institution(s),
iii) The identity of insurance companies owned by the financial institution whose equity was deducted in determining the net equity capital of the financial institution(s).