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External Multistate Tax Alert
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Enacted Michigan legislation - amends financial institution tax base calculation

Overview

On December 26, 2018, Governor Snyder signed Public Act No. 460 (PA 460) of 2018[1], which amends sections 651 and 655 of 1967 PA 281 (MCL 206.651 and 206.655). PA 460 amends the franchise tax base calculation for financial institutions for tax years beginning after December 31, 2018, except as otherwise noted. The amendments enacted by PA 460 include the following:

- Provides that a financial institution's tax base would be the total "equity capital" of the financial institution or "top-tiered parent entity" in the case of a unitary business group of financial institutions, subject to several deductions.
- Clarifies that eliminations from income and apportionment must be accounted for in the case of unitary business groups, including where unitary members file different Michigan tax returns (i.e., insurance companies and standard corporate income taxpayers).
- Defines "Federal Financial Institutions Examination Council" (FFIEC), "top tiered parent entity" and "total equity capital" for purposes of MCL 206.651.
- For tax years beginning after December 31, 2020, requires the equity capital tax base to be determined as of the close of the tax year, rather than based on a five-year average.

This tax alert summarizes these changes and provides some taxpayer considerations.

Background – Franchise tax computations for tax years beginning before January 1, 2019

For tax years beginning *before* January 1, 2019, the tax base for financial institutions is the financial institution's net capital.[2] Net capital means equity capital as computed in accordance with generally accepted accounting principles ("GAAP") less the average daily book value of United States obligations and Michigan obligations.[3] A financial institution's net capital is determined by adding the financial institution's net capital as of the close of the current tax year and preceding 4 tax years and dividing the resulting sum by 5.[4] The equity capital of a person that is subject to the tax imposed is not to exceed 125% of the minimum regulatory capitalization requirements of the member.[5] For a unitary business group of financial institutions, the net capital calculation does not include the investment of 1 member of the unitary business group in another member of that unitary business group.[6]

If a financial institution's business activities are subject to tax both within and outside of Michigan, the financial institution's tax base must be apportioned to Michigan by a gross business factor; this is done by multiplying the tax base by a fraction referred to as the gross business factor. Generally, the numerator of this fraction is the total gross business of the financial institution in Michigan during the tax year, and the denominator is its total gross business everywhere during the tax year.[7]

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[1] PA 460 of 2018, available here.
[2] MCL §206.655 (1).
[3] *Id*.
[4] MCL §206.655 (2).
[5] MCL §206.655 (1).
[6] MCL §206.655 (3).
[7] MCL § 206.657(3).

Tax Base and Apportionment for Financial Institutions as Amended by PA 460

PA 460 amended certain aspects of the tax base calculation and is intended to address uncertainties that have existed under the prior law and otherwise clarify the computation of a financial institution's franchise tax liability.

For tax years beginning after December 31, 2018 and ending before December 31, 2020, PA 460 amends the financial institution provisions such that the tax base for financial institutions is the total "equity capital" (instead of net capital) of the financial institution or the top-tiered parent entity in the case of a unitary business group of financial institutions,[8] subject to the following deductions before allocation or apportionment:

(a) The average daily book value of United States obligations owned during the tax year by members of the unitary business group.
(b) The average daily book value of Michigan obligations owned during the tax year by members of the unitary business group.[9]

The equity capital of a person that is subject to the tax imposed is not to exceed 125% of the minimum regulatory capitalization requirements of the member.[10] The tax base shall be determined by adding the financial institution's equity capital as of the close of the current tax year and preceding 4 tax years and dividing the resulting sum by 5.[11]

If a United States person included in a unitary business group of financial institutions or a financial institution combined return is subject to tax under chapter 11 or 12 (statute governing standard corporate income taxpayers and insurance companies, respectively), any business income or equity capital attributable to that person shall be eliminated from the total equity capital of the unitary business group and any sales or gross business attributable to that person shall be eliminated from the apportionment formula under this chapter.[12]

PA 460 also adds the following definitions to MCL 206.651:

<u>FFIEC:</u> "FFIEC" means the federal financial institutions examination council established pursuant to section 1004 of the financial institutions regulatory and interest rate control act of 1978, Public Law 95-630, 12 USC 3303.[13]

<u>Top Tiered Parent Entity:</u> "Top-tiered parent entity" means the highest level entity within the unitary business group that is required to file with a regulatory agency under the standards prescribed by the FFIEC.[14]

<u>Total Equity Capital:</u> "Total equity capital" means that same amount reported by the financial institution or top-tiered parent entity, in the case of a unitary business group of financial institutions, and as reported for the tax year on any of the following forms or successor forms listed in this subdivision and designated by the FFIEC, that are filed with the office of the comptroller of the currency, the Federal Deposit Insurance Corporation, or the Federal Reserve System:

(i) The consolidated financial statement for holding companies, FR Y-9C.
(ii) The parent company only financial statements for small holding companies, FR Y-9SP.
(iii) 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.
(iv) A report similar in content and designated by the FFIEC[15]

Tax Base and Apportionment for Financial Institutions for tax years after December 31, 2020

[8] PA 460 of 2018, amending MCL § 206.655(1)
[9] PA 460 of 2018, adding MCL § 206.655 (1)(a)&(b).
[10] PA 460 of 2018, adding MCL §206.655 (1)(c).
[11] MCL §206.655 (2).
[12] PA 460 of 2018, adding MCL §206.655 (3).
[13] PA 460 of 2018, amending MCL § 206.651.
[14] *Id.*
[15] *Id.*

For tax years beginning after December 31, 2020, PA 460 provides that the tax base shall be determined as of close of the tax year.[16]

Considerations

Overall, the amendments enacted by PA 460 seek to provide clarity to the existing tax base calculation for financial institutions, most notably by replacing "net equity" with "equity capital." Affected taxpayers should consult with tax advisors regarding the revised methodology for calculating the Michigan financial institution franchise tax base for tax years beginning after December 31, 2018.

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[16] PA 460 of 2018, amending MCL §206.655(2).