



**House
Legislative
Analysis
Section**

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SBT: SAVINGS INSTITUTIONS' CARRYBACKS

Senate Bill 386 (Substitute H-4)
First Analysis (2-20-90)

Sponsor: Sen. Doug Carl
Senate Committee: Finance
House Committee: Taxation

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THE APPARENT PROBLEM:

The treasury department and representatives of Michigan savings institutions have reached an agreement resolving a dispute over the treatment of such institutions under the Single Business Tax Act when they take advantage of a provision in federal tax law that allows them to "carry back" losses from one tax year to previous tax years. According to tax specialists, a savings institution can under federal law take losses suffered in one tax year that exceed its tax liability in that year and carry them back for up to ten prior tax years in which they can be used to reduce tax liability. When an institution does this, however, it must also recompute the deduction allowed for contributions to its bad debt reserve (because that deduction is based on a percentage of taxable income). This means an institution's federal taxable income would be reduced by the amount of the losses carried back minus the reduction in the bad debt reserve deduction. When a savings institution reduces its federal tax liability in this way, however, it increases its tax liability for past years under Michigan's single business tax. This is because, tax specialists point out, loss carrybacks must be added back in to an institution's tax base in full when calculating the SBT; no reduction is allowed for alterations in the bad debt reserve deduction. Thus, a savings institution's SBT tax base increases for a past year by an amount equal to the reduction at the federal level in the bad debt reserve deduction. (This is a problem only for savings institutions, tax experts say, because of their special treatment under the federal tax law. Loss carryback add-ons do not affect the SBT tax base of other kinds of businesses.) Reportedly, the Department of Treasury has been seeking increased tax payments, with interest, from savings institutions for years for which losses have been carried back, and savings institutions have been protesting on the grounds that the Single Business Tax Act never anticipated the changes in federal law that have led to this problem and never intended that a savings institution's tax liability should be increased in this manner.

THE CONTENT OF THE BILL:

The bill would amend the Single Business Tax Act to alter the treatment for tax years beginning after 1978 of a financial institution that carries back a net operating loss or capital loss for federal income tax purposes and must as a result recompute the allowable addition to its reserves for bad debts (which in turn would, except for the provisions in this bill, increase its SBT tax base). In such cases, under the bill, there would be no change in the SBT tax base for a year prior to the year of the loss due to a federal loss carryback or a reduction in the bad debt reserve. A financial institution would add to its tax base in the year of the loss 50 percent of reductions to bad debt reserves for tax years prior to 1975 and 100 percent of reductions to bad debt reserves for tax years after 1975. (It should be noted that the single business tax took effect

in 1976. Prior to that savings institutions were subject to a corporate income tax.) If a taxpayer filed an amended return required by circumstances addressed by this bill before June 15, 1990, there would be no penalties or interest assessed. If a taxpayer complied with the bill, the Department of Treasury would not assess an outstanding liability under the Income Tax Act that resulted solely from adjustments in the taxpayer's bad debt reserve. The bill specifies that it "does not suspend the running of the statute of limitations for a tax year beginning before 1979 for any purpose other than for purposes of complying with this section" (meaning the section added by this bill).

MCL 208.21a

HOUSE COMMITTEE ACTION:

The House Taxation Committee adopted a substitute that changed the section of the Single Business Tax Act being amended (to avoid conflict with amendments made by another bill) and altered somewhat the method by which the tax liability of savings institutions would be reduced, including the liability of savings institutions under the corporate income tax that was in effect prior to the adoption of the SBT.

FISCAL IMPLICATIONS:

A spokesperson for the Department of Treasury has said the bill would result in a loss of SBT revenue from savings institutions in the short run (approximately \$2 million in this tax year) but that the change in timing of the add-back should mean that the state will begin receiving increased revenue sooner than it otherwise would have when savings institutions begin showing operating profits rather than losses.

ARGUMENTS:

For:

The bill represents a compromise between the treasury department and representatives of savings institutions (savings-and-loans and savings banks) over how to establish the single business tax liability of a savings institution that has used a current operating loss to reduce tax liability in one or more prior tax years. Federal tax law allows savings institutions to employ a form of income averaging over a ten-year period by carrying back excess losses from the year in which they were incurred to an earlier year. In doing so, however, savings institutions have found themselves increasing their state tax liabilities in those earlier years, and the treasury department has sought payment of those back taxes. This problem only affects savings institutions because of special federal tax provisions that require a recomputation of certain deductions for past years when losses are carried back to those years. Representatives of saving institutions say it is unfair to increase their SBT liability based on federal computations introduced since the SBT was adopted and

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never anticipated by state law. They say that a loss in the current year used to reduce federal taxes in a prior year should not increase state taxes in that prior year. To do so is to increase state taxes based on increases in operating losses, which is unfair. The bill addresses the problem, tax specialists say, not by eliminating the add-backs of loss carrybacks but by changing the timing of the add-backs. Instead of adjusting state tax liability in past years, savings institutions will be required to add on to a current year's tax base the amount of a loss suffered in that year in an amount limited by the size of the change in the bad debt deduction in the year or years to which the loss was carried back.

POSITIONS:

The Department of Treasury supports the bill. (2-14-90)

The Michigan League of Savings Institutions supports the bill. (2-14-90)