


SFA BILL ANALYSIS

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Senate Bill 386 (as enrolled)
 Sponsor: Senator Doug Carl
 Senate Committee: Finance
 House Committee: Taxation

Date Completed: 8-24-90

RATIONALE

Under the Internal Revenue Code a savings institution that has incurred a net operating loss can, under certain conditions, apply the current-year loss to its tax liability in previous years. Claiming a "loss carryback", then, allows a savings institution to use an allowable loss that is greater than its tax liability in the current year, and carry the loss back to a tax year when it had sufficient tax liability to use the loss; the institution thus is able to claim a refund in the current year for previously paid Federal taxes. It has been pointed out that some savings institutions that claimed loss carrybacks for Federal tax purposes may, under the Single Business Tax (SBT) Act, be liable for additional single business tax amounts for the year to which a loss was carried back.

The additional SBT liability has to do with the effect of a loss carryback on the reserve that savings institutions are required to maintain in order to cover bad debts. An institution, in calculating Federal taxable income, is allowed under Section 593 of the Internal Revenue Code to deduct a portion of its yearly addition to its reserve for bad debts (known as the bad debt deduction). Due to a change in Federal tax law in 1978, if an institution carries a loss back to a year beginning after January 1, 1979, the bad debt deduction for that year must be recomputed because the deduction is based on a percentage of taxable income. Because a loss carryback reduces the taxable income of the year to which the loss is carried back, recomputing the bad debt deduction results in a lower deduction for that year. At the same time, however, lowering the bad debt deduction increases Federal taxable

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income for the year. (Example: A savings institution incurs an operating loss in 1989 that exceeds the institution's tax liability for that year. The institution therefore chooses to carry the excess loss back to 1985, when it had sufficient tax liability to use the loss. The institution must recalculate the bad debt deduction that it took in 1985. Because the institution's 1985 bad debt deduction is lower, its taxable income for that year is higher.)

For Federal tax purposes, an institution benefits by claiming a loss carryback because it makes the claim on the current-year tax filing and is not required to file an amended Federal return for the year to which the loss carryback is applied. The SBT Act, however, bases the SBT on Federal taxable income, but contains no provision for loss carrybacks to previous years. ("Tax base" is defined in the Act as business income plus or minus certain adjustments. "Business income" means Federal taxable income.) Thus, when a loss carryback is claimed against Federal taxes, and the required recomputation of the bad debt deduction is made and increases Federal taxable income, a savings institution's single business tax base for the year to which the loss carryback is applied will not reflect the recomputation.

Reportedly, the Department of Treasury has sent notices to financial institutions, that claimed loss carrybacks, that it intends to assess additional single business tax against those institutions. (In the preceding example, the savings institution would be assessed SBT on the increased amount of its 1985 Federal taxable

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income that resulted from lowering its 1985 bad debt deduction.) Some institutions have challenged the assessment, claiming that losses that result in lower Federal tax liability should not result in increased liability under the single business tax. It has been suggested that the Act be amended to settle the dispute between the Department and financial institutions.

CONTENT

The bill would amend the Single Business Tax Act to provide that for tax years after 1978, for a financial institution that carried back to a previous year a net operating or capital loss for Federal tax purposes, and as a result had to recompute the allowable addition to its reserve for bad debts (as required under the Internal Revenue Code) which in turn resulted in an increase in its SBT base, the following would apply: there would be no change in the financial institution's tax base for a year prior to the year of the loss due to the loss carryback or reduction in the bad debt reserve; the financial institution would have to add to its tax base in the year of the loss the amount of the loss up to the sum of 50% of the Federal income tax reduction to the bad debt reserve for tax years prior to 1975, and 100% for subsequent tax years. If a taxpayer filed an amended return (concerning only the above circumstances) before June 15, 1990, no penalties or interest could be assessed against the taxpayer for taxes due on that amended return as a result of the bill's provisions.

If a taxpayer complied with the bill, the Department of Treasury could not assess an outstanding liability under the Income Tax Act that resulted solely from the 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" (the section added to the Act by the bill).

Proposed MCL 208.21a

FISCAL IMPACT

Senate Bill 386 would lead to an indeterminate reduction in SBT taxes paid by savings and loan associations (S&Ls). Data are not available on

the number of S&Ls that would be affected by Senate Bill 386 or the expected change in tax liability.

ARGUMENTS

Supporting Argument

Federal tax law allows savings institutions to employ a form of income averaging over a 10-year tax period by using loss carrybacks--when a loss in one year exceeds an institution's tax liability it can apply the excess loss to a previous year's tax liability. A complex series of changes in Federal tax policy, and their effect on the way savings institutions calculate tax liability under the SBT Act, have left some institutions that claimed loss carrybacks with a potential single business tax liability for the year to which a loss carryback was applied. This has created a situation in which some institutions, by claiming a loss carryback for Federal tax purposes in the current year to improve their tax position, are faced with the possibility of having to pay additional single business taxes for previous years. Savings institutions contend that this is unfair because the SBT Act, passed in 1975, could not have foreseen later changes in Federal tax law that would have the impact that loss carrybacks now have on savings institutions. They say that a loss in a current year applied to Federal taxes in a prior year should not increase State taxes in the prior year. The Department has contended that any change that increases a financial institution's Federal taxable income in a given year should be reflected in the institution's SBT base for that year. The bill represents a compromise between the Department and the savings institutions by changing the timing of the requirement that savings institutions add to their tax bases losses carried back to previous years, and by providing that the Department could not assess penalties and interest against a savings institution for taxes due on an amended return filed before June 15, 1990.

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