SFA BILL ANALYSIS

Senate Fiscal Agency • Lansing, Michigan 48909 • (517) 373-5383

House Bill 5362 (as reported without amendment)
Sponsor: Representative Michael J. Bennane
House Committee: Taxation
Senate Committee: Finance

Date Completed: 3-27-90

RATIONALE

Under the Single Business Tax (SBT) Act, the tax base of a taxpayer is Federal taxable income modified by various additions and subtractions as provided in the Act. It has been pointed out that a disparity may exist between the Act and the Department of Treasury's treatment of the tax base of a regulated investment company (commonly called a mutual fund).

Generally, a mutual fund that meets the requirements of the Internal Revenue Code regarding its investment portfolio, and distributes all earnings to shareholders, will not have a Federal tax liability because it can deduct dividends paid to shareholders. Under the SBT Act, a mutual fund must include in its tax base Federal taxable income (typically, zero); plus compensation to employees; plus, to the extent deducted in arriving at Federal taxable income, dividends paid; minus, to the extent included in Federal taxable income, dividends received. Since a mutual fund usually has no employee compensation (because the fund advisor or broker provides services separately from the fund itself), the tax base of a mutual fund is usually only the excess of the dividends it paid over the dividends it received. According to the Department of Treasury, however, it considers dividends paid by a mutual fund as income passed through to shareholders and does not require such income to be included in a fund's tax base.

In addition, a mutual fund's interest and dividend income that was derived from obligations and securities of other states, and that the mutual fund excluded from its Federal taxable income, must be added to the fund's tax base. This means, then, that if a mutual fund had a portfolio that included some obligations or securities of other states that were Federally tax-exempt, such investments would have to be included in the fund's SBT base even though the earnings were passed on to shareholders. Because the Department of Treasury has said that it does not require such pass-through income to be included in a fund's tax base, mutual funds have typically not included such income in their tax bases. In fact, the Department reports that it is unaware of any mutual funds that have any SBT liability. It has been suggested that the Act be amended to conform to the Department's treatment of mutual funds.

CONTENT

The bill would amend the Single Business Tax Act to allow a financial organization, defined or treated as a regulated investment company under the Internal Revenue Code (a mutual fund), to exempt from its tax base gross interest income and dividends derived from obligations or securities of other states; and any dividends paid or received (except dividends that represent a reduction of premiums to policyholders of insurance companies).

MCL 208.21

FISCAL IMPACT

The bill would lead to a minor, indeterminate reduction in Single Business Tax revenues. According to the Department of Treasury, no SBT revenues are currently being collected from mutual funds.

ARGUMENTS

Supporting Argument

The bill would clarify the tax status of mutual funds under the Single Business Tax Act. Essentially, mutual funds would not have to pay the tax unless they had employees. Mutual funds typically are managed by separate investment advisors who are not employees of the funds, which are special kinds of trusts that pass earnings through to shareholders. The bill simply would codify the Treasury Department's current treatment mutual funds.

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