Additions and Subtractions

Additions and subtractions are included to the extent reported or excluded in federal taxable income.

Depreciation and Amortization

Include 100% of the amount deducted on the federal return for depreciation and amortization on tangible assets including IRC Section 179 expense. (MCL 208.9(4)(c))

Taxes

Add single business tax and all taxes on or measured by net income to the extent deducted on the federal return. (MCL 208.9(3))

Dividends, Interest, and Royalties

Dividend, interest and royalty income or expense reflected in federal taxable income is eliminated in arriving at the tax base. The dividend subtraction for corporations should be reduced by US Form 1120, Line 29A dividend exclusion. (MCL 208.9(4))

Floor Plan Interest Adjustment

For purposes of including interest in the Michigan single business tax base, interest does not include payment or credits made to or on behalf of a taxpayer by a manufacturer, distributor or supplier of inventory to defray any part of the taxpayer's floor plan interest if these payments are used by the taxpayer to reduce interest expense in determining federal taxable income. (MCL 208.9(4)(f))

Internal Policy Directive 2003-5

In Internal Policy Directive 2003-5 "Interest" is defined as a charge allowed by law or fixed by the respective parties for the use or forbearance of money, a charge for the loan or forbearance of money, or a sum paid for the use or forbearance of money, or for the delay in payment of money.

The following factors must be present before a charge can qualify as "interest":

1. **A debtor-creditor relationship must exist between the two parties.**

2. **The charge must be based on a percentage of an account balance and not a flat fee.**

3. **It must be a rate fixed pursuant to contract or law.**

4. **It must reflect the time value of money.**

In addition, purchase discounts taken do not qualify as interest. Furthermore, subvention payments do not qualify as interest because they are not made for the use or forbearance of money. Moreover, generally accepted accounting principles are not controlling when determining if a charge qualifies as "interest".

Oil and gas royalties which are excluded in the depletion deduction calculation under the IRC will not be added back. Likewise, the same type of royalty will not be subtracted when it is included in income. Cable television franchise fees paid to units of government will not be added back.

A fee or charge that a franchisee or sub-franchiser is required to pay or agrees to pay for the right to enter into a business under a franchise agreement, are not added to the tax base.

In Little Caesar v Dept of Treasury, the Michigan Court of Appeals ruled that the one time initial payment made by the franchisee to the franchisor was not a royalty and consequently was not an add back for the franchisee. However, the court ruled the ongoing monthly payments that a franchisee made to the franchisor was a royalty and therefore included in the tax base of the franchisor.
Public Act 229 of 2001 reversed the Little Caesar decision by removing both the one time initial payment as well as the ongoing payments from the definition of royalty effective January 1, 2001.

Zenith Data Systems Corporation and Heath Company, Inc. v. Michigan Department of Treasury MTT. 922 (1994)

This case involves payments made to Zenith for the use of software acquired from third party licensors (software suppliers) as modified and in some cases supplemented by Zenith and packaged (pre-loaded) together with hardware. Zenith, in licensing agreements with the software suppliers (Condor, Microsoft, Ashton-Tate and others) had acquired the non-exclusive right to use, modify, distribute and grant sublicenses of the software products (operating systems) to distributors, dealers and end-users. The state agreed that payments made to the software licensors (Condor, et al) by Zenith constituted royalty payments and as such were added back to the SBT base. The dispute arises because Zenith maintained that the payments to them from their customers as sub-licensees (end-users) of the licensors (Condor, et al) also constitute royalties and as such were entitled to be deducted from the SBT tax base. The Department of Treasury maintains that the payments are royalty payments only when received by a proprietary owner of the rights generating the receipts or in other words only the original licensors (Condor, et al).

The word “royalties” is not statutorily defined in the Single Business Tax act, therefore guidance was sought from IRC Section 543 as well as previous court cases. In general, a royalty is more commonly thought of as a payment for use of another’s patent or

copyright (compensation for the use of property). However, the existence of the copyright or patent is not crucial. What is crucial is the nature of the transaction.

The Department of Treasury argued that the payments made to Zenith pursuant to their licensing agreements should not have been considered to be royalties because Zenith did not have a proprietary interest in the software in that the software is copyrighted by others. Although Zenith did not have a proprietary interest in the entire computer software package, it did have a proprietary interest in the software it produced and did receive payment for such. Therefore, the nature of the transaction is one of a licensing agreement producing royalties.

The Michigan Tax Tribunal ruled that payments Zenith received from consumers for computer software that Zenith modified and then distributed pursuant to licensing agreements were royalties that could be deducted from the Single Business Tax base.

Michigan Circuit Court of Appeals, Docket #175522 (1996). The Circuit Court affirmed the tax tribunal decision. In the process, it set out a clear distinction as to what payments would qualify as royalties.

Realtron Corporation v. Michigan Department of Treasury
Michigan Tax Tribunal Docket #173926

The Michigan Tax Tribunal ruled that on-line access charges from a computerized multiple listing service could be labeled as royalties

The issue of what are royalties for the Single Business Tax has been controversial, involving some recent court decisions. For purposes of this tax, royalties are excluded from the tax base. In the Realtron case, the taxpayer dealt with compiling and publishing catalogs providing data on current real estate listings.

The taxpayer also provided similar information on-line by means of a computerized system. It was the taxpayer's contention that the on-line access charges for using the computerized system were royalties. However, the Treasury Department asserted that these charges were "service fees." In finding for the taxpayer, the Tax Tribunal held that the charges were for the use, by means of on-line access, of copyrighted software programs. Thus, it ruled that the fees were royalties. It cited its recent decision in Zenith Data Systems v. Michigan Department of Treasury. On appeal to the Michigan Circuit Court of Appeals, a July 12, 1996, ruling in Realtron Corporation and Subsidiaries v. Michigan Department of Treasury; the Court ruled "We hold that the revenue attributable to the use of plaintiff's software is royalty income exempt from taxation, but that revenue received by plaintiff attributable to its overhead costs and services such as the installation of computer hardware and telephone lines, is taxable under the SBT."

The original Realtron Corp. case was remanded back to the Michigan Tax Tribunal by the Circuit Court. In a November 9, 2001 decision, the Michigan Tax Tribunal ruled that 80% of the customer paid access fee represented the right to access the software and therefore a "royalty" under the SBT.

For tax years beginning after December 31, 1993, royalties paid by a licensee of application computer software, operating system software or system software under a licensing agreement would not have to be included in the firm's single business tax base. Further, for tax years beginning after December 31, 1997, royalties received by a licensor, distributor, developer, marketer, or copyright holder of system software under a license agreement could be deducted from the tax base, but not royalties from application computer software or operating system software. (MCL 208.9(4)(g))

The term "application computer software" would refer to a set of statements or instructions that when incorporated into a machine-usable medium is capable of causing a machine or device having information-processing capabilities to indicate, perform or achieve a particular business function, task or result for the non-technical end user. The term also includes any other computer software that does not qualify as operating systems software or system software.
(MCL 208.9(4)(g)(viii)(A))

The term "operating system software" would refer to a set of statements or instructions that when incorporated into a machine or device having information-processing capabilities is an interface between the computer hardware and the application computer software or systems software.
(MCL 208.9(4)(g)(viii)(B))

The term "system software" would refer to a set of statements or instructions that interacts with operating system software that is developed, licensed and intended for the exclusive use of data processing professionals to build, test, manage or maintain application computer software for which a license agreement is signed by the licensor and licensee at the time of the transfer of the software and that is not transferred to the licensee as part of or in conjunction with a sale or lease of computer hardware. (MCL 208.9(4)(g)(viii)(C))

Losses

Any carry forward or carry back of a net operating loss or capital loss is added to the extent deducted in arriving at federal taxable income. In effect, you consider only income/(loss) that pertains to the current year's operations. (MCL 208.9(4)(a and b))

Partnership Distributions

Add the loss or subtract the gain from the tax base that is attributable to another taxable entity. This means that a distribution (gain/loss) from a partnership to a partner who is either a corporation or another partnership is to be either added or subtracted. (MCL 208.9(9))

Excluded Capital Gains

This section requires the addition of any capital gain relating to the business activity of individuals (excluded capital gains from federal form 4797 or Schedule D).
(MCL 208.9(6))