

## ARIZONA CORPORATE TAX RULING

### CTR 95-1

This substantive policy statement is advisory only. A substantive policy statement does not include internal procedural documents that only affect the internal procedures of the agency and does not impose additional requirements or penalties on regulated parties or include confidential information or rules made in accordance with the Arizona administrative procedure act. If you believe that this substantive policy statement does impose additional requirements or penalties on regulated parties you may petition the agency under Arizona Revised Statutes § 41-1033 for a review of the statement.

#### **ISSUE:**

Is an Arizona corporate taxpayer required to add the Michigan single business tax to Arizona gross income in computing Arizona taxable income?

#### **APPLICABLE LAW:**

Arizona Revised Statutes (A.R.S.) § 43-1121.3 requires that taxes which are based on income paid to other states be added to the Arizona gross income of a corporation if they were deducted in computing federal taxable income.

The following court cases address the question of whether or not the Michigan single business tax (SBT) is a tax based on income:

*Trinova Corporation v. Michigan Department of Treasury*, 111 S.Ct. 818 (1991) held that the Michigan SBT is not an income tax and that the elements used by Michigan to calculate value added are interrelated parts of a single tax.

*Appeal of Dayton Hudson Corporation*, California State Board of Equalization, No. 94-SBE-003, February 3, 1994, held that the Michigan SBT is a value added tax that is not measured by gross income and is, therefore, deductible. Additionally, the Michigan SBT could not be separated into deductible and nondeductible portions.

#### **DISCUSSION:**

Taxes deducted in computing federal taxable income need not be added to Arizona gross income in computing Arizona taxable income unless the taxes are based on income. Taxes which are based on income must be added to Arizona gross income in order to compute Arizona taxable income.

In order to determine if the Michigan SBT must be added to Arizona gross income in computing Arizona taxable income, one must first determine whether or not it is a tax based on income.

An income tax is based on the concept of the business being able to pay. This is evident in the fact that taxable income is the profit remaining after the gross income of a business has been offset by its allowable deductions and expenses. A value added tax (VAT), however, is based on the fact that a business adds value to its product, whether it be a tangible product or a service. The value added is generally the sum of wages, interest, rent, profit, and any other cost of production not previously subject to tax. In effect, it is the end product or service that is to be taxed, not the operations of the entire business as with an income tax.

The U.S. Supreme Court in *Trinova Corporation v. Michigan Department of Treasury*, supra, states:

A VAT differs in important respects from a corporate income tax. A corporate income tax is based on the philosophy of the ability to pay, as it consists of some portion of the profit remaining after a company has provided for its workers, suppliers, and other creditors. A VAT, on the other hand, is a much broader measure of a firm's total business activity. Even if a business entity is unprofitable, under normal circumstances it adds value to the products and, as a consequence, will owe some VAT.

The Michigan SBT is a value added tax levied against entities having business activity in the state of Michigan. The SBT is a tax on the privilege of doing business and is not an income or gross receipts tax. The SBT is administered like an income tax in that information on the federal income tax returns will be used, and the Internal Revenue Code definitions and dates are enforced. It was designed to affect all businesses in the same manner, regardless of the size, form, or nature of the business. It is basically a tax on profits, payroll, interest expenses, and depreciation, less any expenditures for capital investments.

The California State Board of Equalization made the statement in its decision in *Appeal of Dayton Hudson Corporation* that, "(T)he fact that the Michigan tax base includes an element of return of capital requires us to conclude that the tax is measured by something other than gross income. Therefore, we agree with the appellant that the MSBT is not a tax on gross income and therefore is deductible."

These cases have also addressed the question of whether the Michigan SBT can be separated into a deductible and nondeductible portion. The California State Board of Equalization in *Dayton Hudson*, quoting the U.S. Supreme Court in *Trinova*, determined that the " 'Michigan SBT, however, is not three separate and independent taxes' (*Trinova Corporation v. Department of Treasury*, supra), but is an indivisible tax upon a different, bona

vide measure of business activity, the value added."

**RULING:**

The Michigan single business tax is not a tax based on income. Therefore, corporate taxpayers are not required to add the Michigan single business tax to Arizona gross income in computing Arizona taxable income.

Harold Scott, Director

Signed: February 10, 1995

Explanatory Notice

The purpose of a tax ruling is to provide interpretive guidance to the general public and to department personnel. A tax ruling is intended to encompass issues of law which are not adequately covered in statute, case law or administrative rules. A tax ruling is a position statement which provides interpretation, details or supplementary information concerning the application of the law. **Relevant statute, case law, or administrative rules, as well as a subsequent ruling, may modify or negate any or all of the provisions of any tax ruling.** See GTP 92-1 for more detailed information regarding documents issued by the Department of Revenue.