

Treasury Issues Two New FAQs which Clarify Treatment of a Brother-Sister Group of Entities for Purposes of the Control Test for a Unitary Business Group

On Thursday, April 16, 2009, in plenty of time before the due date for the 2008 MBT returns, the Department of Treasury issued two new FAQs which clear up the confusion on how to apply the attribution rules of IRC Section 318 to a brother-sister group of entities for purposes of the control test for a unitary business group. There has been no aspect of the MBT more confusing than this issue. For small and medium size businesses, the brother-sister form of organizational structure is most common.

FAQ U51

In FAQ U51, Treasury explains the use of the IRS Section 318 attribution rules to deem ownership to a corporation of stock owned by the corporation's shareholders. "In the case of a brother-sister set of corporations, for example, each owned by 2 unrelated individuals, the corporations will satisfy the control test under MCL 208.1117. Under IRC 318(a)(3)(C), one corporation is the indirect owner of 100% of the ownership interests in the other."

U51. Would a group of companies who have a flow of value between them but are owned by two unrelated persons, each owning 50%, be considered a unitary business group?

Yes. To meet the definition of a unitary business group in the Michigan Business Tax Act (MBTA) the U.S. persons, other than foreign operating entities, which cannot be included in the group, must pass a control test and 1 of 2 relationship tests. MCL 208.1117(6). The control test requires that one of the U.S. persons own or control, directly or indirectly, more than 50% of the ownership interests with voting rights or similar rights of the other U.S. persons. MCL 208.1117(6).

For purposes of MBTA section 117(6), the Department will use as guidance attribution rules expressed in IRC § 318 or analogous authority to determine indirect or constructive ownership and control. While IRC § 318 specifically pertains to corporate stock ownership, the Department will apply its principles to all forms of entities subject to the MBT.

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FAQ U52

In FAQ U52, Treasury expands the explanation to include a non-corporate group of entities and points out the difference in the attribution between corporations and non-corporate groups of entities. They failed to point out that an S Corporation is treated as a partnership for purposes of the Section 318 attribution rules.

For a corporation, other than an S Corporation, attribution from a shareholder to the corporation does not happen unless the shareholder possesses 50% or more of the value of stock in the corporation.

For a partnership, the partnership is deemed to own all the stock owned by its partners.

U52. If five or fewer persons who are unrelated individuals, estates or trusts own a controlling interest in a brother-sister group of entities, will that satisfy the control test for purposes of qualifying as a unitary business group?

It depends on the type of entities in the brother-sister group of entities.

Under the SBT, controlled groups and entities under common control were generally defined to include situations where the same five or fewer unrelated individuals, estates or trusts owned a controlling interest in two or more entities taking into account the ownership of each such person only to the extent such ownership is identical with respect to such entity. See, e.g., RAB 1989-48. However, under the MBT, a unitary business group is:

a group of United States persons, other than a foreign operating entity, 1 of which owns or controls, directly or indirectly, more than 50% of the ownership interest with voting rights or ownership interests that confer comparable rights to voting rights of the other United States persons, and that has business activities or operations which result in a flow of value between or among persons included in the unitary business group or has business activities or operations that are integrated with, are dependent upon, or contribute to each other. For purposes of this subsection, flow of value is determined by reviewing the totality of facts and circumstances of business activities and operations. [MCL 208.1117(6).]

The Department will follow IRC 318 or analogous authority to determine indirect, or constructive, ownership and control, except that the Department will apply IRC 318 to all ownership interests. The attribution rules of IRC 318 vary depending on whether ownership and control is attributed to or from a corporation, partnership, trust, or estate.

For corporations, so long as none of the five or fewer unrelated individuals, estates or trusts own more than 50% of the brother-sister group of corporations, or no two individuals, estates or trusts own 50% each, then the unitary business group control test under the MBT will not be satisfied. Under IRC 318(a)(3)(C), a corporation will only be deemed to own the stock of any shareholder if the shareholder owns 50% or more of the stock in that corporation.

Example: Alice, Bernice, Carol, Donna, Eunice each own 20% of Corporations A and B. Neither Corporation A nor Corporation B will have indirect control or ownership of the other through IRC 318 since none of the shareholders owns 50% or more of either corporation. The MBT unitary business group control test fails.

In contrast, for partnerships, so long as any group of individuals, estates or trusts own more than 50% combined of the brother-sister group of partnerships, then the unitary business group control test under the MBT will be satisfied. Under IRC 318(a)(3)(A) as applied to the MBT, a partnership is deemed to own the ownership interests owned by any of its partners.

Example: Al, Brett, Carl, Dave, and Ed each own 20% partnership interests in Partnerships Y and Z. Under IRC 318, Partnership Y indirectly owns and controls 100% of Partnership Z (and *vice versa*) since Partnership Y is deemed to own all the partnership interests owned by Al, Brett, Carl, Dave, and Ed (which totals 100% of Partnership Z). The MBT unitary business group control test is met.

It must always be pointed out that a group of entities will not be required to file a combined unitary return unless they pass both the control and one of the two relationship tests. Also, Treasury is using an expansive use of Section 318 to apply to all forms of entities and all forms of ownership in those entities.

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www.ehtc.com/ehc/salt.htm

www.MichiganStateAndLocalTax.com (Blog)

[The Michigan Business Tax 2009 Desktop Reference Manual](#)

[The Control Test For A Michigan Business Tax Unitary Business Group](#)

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