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**STATE AND LOCAL TAX NEWSLETTER**

*Business Strategists & Certified Public Accountants*

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**Federal IRC Section 318 Attribution: The Michigan Standard?**

GRAND RAPIDS, MI – Monday, March 31, 2008 – Last week this newsletter discussed the uncertainty about the statutory use of the term "indirectly" for application of the "control test" for a "unitary business group." However, it is clear that the Department of Treasury (Treasury) will use the constructive ownership rules of Internal Revenue Code (IRC) Section 318. This article is a review of IRC section 318 and its link to the Michigan Business Tax Act (MBTA).

"Unitary business group" is defined in Section 117(6) of the MBTA. The terms "owns or controls, directly or indirectly, more than 50%" implies ownership or control through attribution.

**"Unitary business group" means 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, ..."**

The Treasury, in FAQ U-6 stated, "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)]

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. [Treasury FAQ U6]

**Section 318 Attribution**

**(1) Attribution between family members.**

An individual shall be considered as owning the stock owned, directly or indirectly, by or for (i) his spouse (other than a spouse who is legally separated from the individual under a decree of divorce or separate maintenance), and (ii) his children, grandchildren, and parents. [IRC 318(1)(A)]

For purposes of family attribution, a legally adopted child of an individual shall be treated as a child of such individual by blood. [IRC 318(1)(B)]

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### **(2) Attribution from partnerships, estates, trusts, and corporations.**

Stock owned, directly or indirectly, by or for a partnership or estate shall be considered as owned proportionately by its partners or beneficiaries. [IRC 318(2)(A)]

Stock owned, directly or indirectly, by or for a trust shall be considered as owned by its beneficiaries in proportion to the actuarial interest of such beneficiaries in such trust. [IRC 318(2)(B)(i)]

Stock owned, directly or indirectly, by or for any portion of a trust of which a person is considered the owner shall be considered as owned by such person. [IRC 318(2)(B)(ii)]

If 50 percent or more in value of the stock in a corporation is owned, directly or indirectly, by or for any person, such person shall be considered as owning the stock owned, directly or indirectly, by or for such corporation, in that proportion which the value of the stock which such person so owns bears to the value of all the stock in such corporation. [IRC 318(2)(C)]

### **(3) Attribution to partnerships, estates, trusts, and corporations.**

Stock owned, directly or indirectly, by or for a partner or a beneficiary of an estate shall be considered as owned by the partnership or estate. [IRC 318(3)(A)]

Stock owned directly or indirectly, by or for a beneficiary of a trust shall be considered as owned by the trust, unless such beneficiary's interest in the trust is a remote contingent interest. [IRC 318(3)(B)(i)]

Stock owned, directly or indirectly, by or for a person who is considered the owner of any portion of a trust shall be considered as owned by the trust. [IRC 318(3)(B)(ii)]

If 50 percent or more in value of the stock in a corporation is owned, directly or indirectly, by or for any person, such corporation shall be considered as owning the stock owned, directly or indirectly, by or for such person. [IRC 318(3)(C)]

### **(4) Options.**

If any person has an option to acquire stock, such stock shall be considered as owned by such person. An option to acquire such an option, and each one of a series of such options, shall be considered as an option to acquire such stock. [IRC 318(4)]

### **(5) Re-attribution.**

The general rule under Section 318(a)(5)(A) is that stock constructively owned by a shareholder under any of the attribution rules discussed above is deemed to be actually owned for purposes of re-attribution to others. Thus, for example, stock which is attributed from a husband to wife under the family member rules of Section 318(a)(1)(A)(i) is further attributed to a corporation in which the wife owns 50% of the value of the stock under the shareholder-to-corporation rules of Section 318(a)(3)(C).

Section 318(a)(5)(B)-(D) limits re-attribution by prescribing the point at which relationship no longer justifies constructive ownership. Thus, the limitations set

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forth in Section 318(a)(5)(B)-(D) detail the situations in which relationship between the parties is too tenuous and remote to justify attribution of stock ownership.

The limitations on re-attribution prohibit double inclusion, family re-attribution and sidewise attribution.

**(6) Direct or indirect ownership.**

Section 318(a)(1) – family member, Section 318(a)(2) – entity to member, and Section 318(a)(3) – member to entity attribute stock owned "directly or indirectly" by or on behalf of a related person. It is apparent that the provisions intend to encompass stock to which the related person holds title as well as stock beneficially owned by the related person but held in the name of another. [Income Tax Regulations Section 1.544-2] For example, stock held by a person's nominee would be indirectly owned by that person. There is, however, no guidance concerning the meaning of "directly or indirectly" for purposes of the Section 318 attribution rules.

Please stay tuned for more news and follow the [MichiganStateAndLocalTax Blog](#) for information as it becomes available.

If you have questions please feel free to contact me. I would be happy to be of assistance.

Sincerely,

Ed Kisscorni, CPA/MBA



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