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**STATE AND LOCAL TAX NEWSLETTER**

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**When Does the Single Business Tax Act Authorize the Department of Treasury to Reference or Use Specific Terms, Definitions or Rules contained in the Internal Revenue Code?**

**GRAND RAPIDS, MI – Monday, June 2, 2008 – A substantial part of my practice at EHTC involves audits and appeals. Currently I have six cases, three of which are in the Michigan Tax Tribunal, challenging the Department of Treasury (Treasury) statutory right to import specific terms, definitions or rules from the Internal Revenue Code (IRC). The Single Business Tax Act (SBTA) provides specific conditions with limitations as to when a taxpayer or Treasury can invoke or use a specific term, definition or rule from the IRC. Treasury has disqualified taxpayers from the SBT small business credit by importing the IRC classification of "corporation" and definition of "officer." They have used the IRC attribution rules to redefine "shareholder" and "active shareholder" even though those terms are specifically defined in the SBTA. The following discussion speaks to the specific conditions which allow an IRC reference.**

I believe the SBTA permits the use of terms, definitions or rules contained in the IRC in two circumstances:

1. When a specific IRC section number is referenced in the SBTA, or
2. When SBTA Section 2(2) [MCL 208.2(2)] is applicable.

[Ed Kisscorni, CPA/  
MBA](#)

[edk@ehtc.com](mailto:edk@ehtc.com)

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## **PROPERTY (AD** **VOLOREM) TAX**

**(2) A term used in this act and not defined differently shall have the same meaning as when used in comparable context in the laws of the United States relating to federal income taxes in effect for the tax year unless a different meaning is clearly required. A reference in this act to the internal revenue code includes other provisions of the laws of the United States relating to federal income taxes. [MCLA 208.2 (2)]**

The SBT small business credit is provided in Section 36 of the SBTA. [MCL 208.36] Section 36 controls the qualification, disqualification and computation of the small business credit.

There are two references to the IRC in Section 36. Paragraph 7 references IRC Section 1563 for purposes of identifying a group of corporations under common control. Paragraph 1(d) references IRC Section 318(a)(1) for purposes of identifying family members.

Paragraph 1(d) defines shareholder as follows:

**"Shareholder" means a person who owns outstanding stock in the business. An individual is considered as the owner of the stock owned, directly or indirectly, by or for family members as defined by section 318(a)(1) of the internal revenue code. [MCL 208.36(1)(d)]**

In these two situations, use of IRC definitions is authorized and limited as stated in the SBTA. The specific statutory language, the plain reading of the law, authorizes in the case of the IRC Section 318(a)(1) reference, use of that subparagraph and only that subparagraph.

Section 36 of the SBTA [MCL 208.36] provides specific definitions of "active shareholder," "officer," and "shareholder" for use in determining the qualification, disqualification and computation of the small business credit. There is no need and Section 2(2) of the SBTA does not authorize use of IRC definitions when such terms

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are clearly defined in the SBTA.

**(a) "Active shareholder" means a shareholder who receives at least \$10,000.00 in compensation, director's fees, or dividends from the business, and who owns at least 5% of the outstanding stock. [MCL 208.36(1)(a)]**

**(b) "Officer" means an officer of a corporation other than a subchapter S corporation including the chairperson of the board, president, vice-president, secretary, and treasurer, or persons performing similar duties. [MCL 208.36(1)(b)]**

**(d) "Shareholder" means a person who owns outstanding stock in the business. An individual is considered as the owner of the stock owned, directly or indirectly, by or for family members as defined by section 318(a)(1) of the internal revenue code. [MCL 208.36(1)(d)]**

There are terms, definitions or rules, relevant to the SBT, not specifically defined in the SBTA. In such cases, SBTA Section 2(2) opens the door to import from the IRC. However, such terms, definitions or rules can be imported only if not "defined differently" and used in "comparable context."

### **Defined Differently**

Section 2(2) of the SBTA states "A term used in this act and not defined differently ..."

I believe Treasury conveniently ignores that Section 2(2) (MCL 208.2(2)) of the SBTA (IRC reference) only applies to a term used in the SBTA if it is not "defined differently." The terms discussed above are relevant to the qualification, disqualification and computation of the SBT small business credit. Terms, definitions or rules contained in the IRC relate to the taxation of income. They are defined differently in that they are used in a different context.

Section 2(2) of the Michigan Income Tax Act (MITA) contains language similar to Section 2(2) of the SBTA.

MITA Section 2 (MCL 206.2(2)) provides as follows:

**Any term used in this act shall have the same meaning as when used in comparable context in the laws of the United States relating to federal income taxes unless a different meaning is clearly required. Any reference in this act to the internal revenue code shall include other provisions of the laws of the United States relating to federal income taxes.**

Although these sections of the MITA and the SBTA are similar, there is an important distinction between these two sections. Under the MITA, United States law always applies unless a different meaning is clearly required; whereas, under the SBTA, United States law only applies if the term is not "defined differently." The Legislature clearly meant something when it intentionally added "defined differently" to the SBTA Section 2(2).

### **Comparable Context**

Section 2(2) of the SBTA also states "A term ... shall have the same meaning as when used in comparable context ..." Comparable context is not applicable because the SBT is a value added tax whereas the Federal income tax is a tax on income. Under this Section, a term used in the SBTA will only have the same meaning under United States law "when used in comparable context in the laws of the United States relating to federal income taxes." This makes sense relative to the MITA because both the MITA and the laws of the United States relating to federal income taxes govern income taxes; however, there is no comparable context to the Michigan Single Business Tax in the laws of the United States relating to federal income taxes. The SBT is a value-added tax imposed upon the privilege of doing business, or economic activity itself-not income received from that economic activity. [*Wismer & Becker Contracting Engineers v. Dep't of Treasury*, 146 Mich. App. 690, 696 (1986)] By definition, the income tax and the single business tax are completely different. There is no equivalent in the federal income tax law for the small business credit allowed by the SBTA. Treasury has no business defining a term, definition or rule in the SBTA outside of its clear meaning in Section 36(1).

This reasoning is supported in *Wismer & Becker* cited above. The Michigan Court of Appeals interpreted "comparable context" under MCL 208.2. The Court of Appeals declined to turn to the Internal Revenue Code.

**Petitioner's second and final argument in favor of its interpretation of §§ 45, 46, 49 and 51 is that since § 702 of the Internal Revenue Code (IRC), 26 U.S.C. § 702, requires a partner to aggregate its separate income or loss and its distributive share of partnership income or loss, and since § 2(2) of the SBTA, M.C.L. § 208.2(2); M.S.A. § 7.558(2)(2), provides that a term not defined differently shall have the same meaning as when used in a comparable context of the IRC, § 2(2) requires petitioner to aggregate its share of joint venture property, wages and sales and its separate property, wages and sales for purposes of three-factor apportionment under Chapter 3.**

**We disagree. Section 702 of the IRC is not a comparable provision because it has nothing to do with apportioning business activity or income of a multistate business among the states in which the taxpayer does business. Moreover, unlike the SBTA, the IRC does not tax partnerships or joint ventures separately and, consequently, requires a member of a joint venture to aggregate its separate income or loss with its share of joint venture income or loss in order to tax joint venture income. *Id.*, at 703-4.**

Similarly, there is absolutely no comparable provision in the Internal Revenue Code for disallowing a SBT small business credit.

In interpreting similar language found in the MITA, the Michigan Court of Appeals has stated that simply lifting a definition from the IRC is not enough without having a comparable context. In *Inter Cooperative Council v. Dep't of Treasury*, 257 Mich. App. 219 (2003), the Court was asked to determine the definition of

"cooperative housing corporation" (which at the time was undefined anywhere in Michigan law) for a homestead tax exemption.

**The ITA does not define the term "cooperative housing corporation." However, the act provides that "[a]ny term used in this act shall have the same meaning as when used in comparable context in the laws of the United States relating to federal income taxes unless a different meaning is clearly required.... (MCL 206.2(2))**

**In this case, the tribunal looked to § 216 of the IRC, 26 USC 216, which uses the same terms "cooperative housing corporation" and "tenant-stockholder." Section 216(a) allows a "tenant-stockholder" to deduct amounts paid or accrued to a "cooperative housing corporation" within a taxable year. Because the context of § 216 is comparable to the provisions in the two Michigan acts at issue, we conclude that the tribunal properly looked to this section in the IRC.**

In an unpublished opinion, the Michigan Court of Claims in *Alliance Obstetrics & Gynecology, PLC v Michigan Department of Treasury* (Alliance), barred the Department of Treasury from using the IRC definition of "corporation" for purposes of the SBTA Section 36 small business credit. In *Alliance*, Treasury sought out a definition of "corporation" which is not defined in Section 36 or anywhere else in the SBTA. The judge barred use of SBTA Section 2(2) to enter the IRC because it was "defined differently" and not used in a "comparable context." Treasury appealed the *Alliance* decision.

### **Final Thought**

**Use of a term, definition or rule from the IRC should be rare, given the limitations imposed by Section 2(2) of the SBTA.**

Stay tuned for more news and follow the [MichiganStateAndLocalTaxBlog](#) for information as it becomes available. If you have any questions, please go ahead and contact me. I would be happy to be of assistance.

Sincerely,

Ed Kisscorni, CPA/MBA



BUSINESS STRATEGISTS  
CERTIFIED PUBLIC ACCOUNTANTS

EHELBARGER, HIMEBAUGH, TAMM & CO., P.C.

**Echelbarger, Himebaugh, Tamm & Co., P.C.**  
**5136 Cascade Rd. SE #2A**  
**Grand Rapids, MI 49546**

**(616)575-3482 / [ehc@ehc.com](mailto:ehc@ehc.com) / [www.ehc.com/](http://www.ehc.com/)**

**[www.MichiganStateandLocalTax.com](http://www.MichiganStateandLocalTax.com)**

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