



Echelbarger, Himebaugh, Tamm & Co., P.C.
STATE AND LOCAL TAX NEWSLETTER

Business Strategists & Certified Public Accountants

2008-25

The power to make a difference.

The people to make it count.™

5136 Cascade Rd. SE #2A • Grand Rapids, MI 49546 • Phone: 616-575-3482 • Fax: 616-575-3481



Michigan Business Tax: Confusion over Whether a Brother-Sister Group of Entities Passes the Control Test for a Unitary Business Group

GRAND RAPIDS, MI – Monday, June 30, 2008 – The recently completed series of Michigan Business Tax (MBT) Advanced seminars sponsored by the Michigan Association of CPAs (MACPA) exposed significant confusion over whether a brother-sister group of entities passes the control test for a unitary business group. The answer, based on the Michigan Department of Treasury (Treasury) Frequently Asked Question (FAQ) U6 is no. However, many of the participants believe, based on application of the attribution rules, the answer should be "yes." The answer is of significant importance because the brother-sister type of multiple entity structure is very common among small and medium size business groups. This newsletter discusses the controversy and suggests Treasury may be wrong.

In both FAQ U9 and FAQ U25, Treasury has stated that brother-sister corporations wholly owned by a single individual or person can be members of a unitary business group assuming they pass the relationship test.

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)] [Treasury FAQ U6]

The Department will follow Internal Revenue Code (IRC) Section 318 or analogous authority to determine indirect, or constructive, ownership and control, except that the

[Ed Kisscorni, CPA/
MBA](#)

edk@ehtc.com

[Ed's Blog
www.MichiganState
andLocalTax.com](#)

[EHTC STATE AND
LOCAL TAX
SERVICES](#)

[INCOME &
FRANCHISE TAX](#)

[Tax Minimization
Studies](#)

[Business Structure
Reviews](#)

Department will apply IRC Section 318 to all ownership interests regardless of entity type. [Treasury FAQ U6]

[Allocation and
Apportionment Planning](#)

In the case of a brother-sister set of corporations wholly owned by an individual, the corporations will satisfy the control test under MCL 208.1117. Under IRC § 318(a)(3) (C), the first corporation is the indirect owner of more than 50% of the ownership interests in the second corporation. However, the brother-sister corporations will not comprise a unitary business group unless the corporations also satisfy one of the two relationship tests. [Treasury FAQ U6]

[Combined,
Consolidated, & Unitary
Planning](#)

If the brother-sister corporations have business activities or operations that result in a flow of value between them or have business activities or operations that are integrated with, are dependent upon, or contribute to each other, the corporations will comprise a unitary business group. [Treasury FAQ U25]

[Nexus Studies](#)

[Amended State Tax
Returns from IRS Audits](#)

It should be noted that Treasury is employing the doctrine of constructive ownership to define the statutory term "indirectly," as used in reference to "owns or controls." Furthermore, the FAQs state that IRC Section 318 or analogous authority will be used to determine indirect, or constructive, ownership and control. Also, Section 318 will be used in the whole and not limited to just Section 318(a)(1) as specified in the Section 115(2) [MCL 208.1115(2)] definition of "shareholder."

[Single Business Tax
Training](#)

[SALES & USE TAX](#)

[Reverse Audits](#)

In FAQ U24, Treasury said "NO" to the question: 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? No, so long as none of the five or fewer unrelated individuals, estates or trusts own more than 50% of the brother-sister group of entities. [Treasury FAQ U24]

[Compliance System
Review](#)

Treasury attempted, in FAQ U24 to distinguish the difference between the MBT using IRC Section 318 to determine constructive ownership and the Single Business Tax (SBT) rules used to determine a controlled 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. [RAB 1989-48] However, so long as none of the five or fewer unrelated individuals, estates or trusts own more than 50% of the brother-sister group of entities, these control tests under the SBT do not apply to the MBT for purposes of determining a unitary business groups. [Treasury FAQ U24]

[Direct Pay &
Compliance Agreements](#)

In FAQ U24, Treasury failed to caution that a group of five or fewer owning a controlling interest in two or more entities could satisfy the MBT control test when applying the attribution rules of Section 318.

[Exemption Certificate
Documentation](#)

[Industrial Processing /
Manufacturing](#)

[Exemption
Utility Studies](#)

[Nexus Studies](#)

In FAQ U6, Treasury again said "NO" to the question: Would a group of companies who have a flow of value between them but are owned by two nonrelated persons, each owning 50%, be considered a unitary business group?

[Sales & Use Tax
Training](#)

[Transportation Company](#)

[Procurement Company](#)

[PROPERTY \(AD VOLOREM\) TAX](#)

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

[Real Property Tax
Reviews](#)

[Personal Property Tax
Reviews](#)

TAX AUDIT & APPEALS

[Sales & Use Tax Audit
Defense & Appeals](#)

[Single Business Tax
Audit Defense & Appeals](#)

[Property Tax Audit
Defense & Appeals](#)

[State and Local Tax
Litigation Support](#)

[Merger & Acquisition Due
Diligence Reviews](#)

[Voluntary Disclosure](#)

BUSINESS INCENTIVE SERVICES

[Business Relocation &
Expansion Services](#)

[Tax Credits, Exemptions,
& Abatements](#)

[Grants, Financing, &
Infrastructure Assistance](#)

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. As the subject persons are described as nonrelated and each owning 50% of the group, the control test in section 117(6) is not met. Thus, these entities do not comprise a unitary business group. [Treasury FAQ U6]

Many tax practitioners believe FAQ U6 fails to take into consideration the application of IRC Section 318(a)(3)(C). If a shareholder owns directly or indirectly 50% or more of the value of the stock of a corporation, that corporation is deemed to own all, not just a proportionate amount, of the stock held by the shareholder. [Section 318(a)(3)(C)] Treasury properly cited URC Section 318(a)(3)(C) in FAQ U9 referenced above.

In the example raised in FAQ U6, many tax practitioners believe the companies will satisfy the control test under MBTA Section 117 [MCL 208.1117] because under IRC Section 318(a)(3)(C) the first company is the indirect owner of more than 50% of the ownership interest in the other companies because the first company (corporation) is deemed to own all the stock owned by its 50% or greater shareholders.

EXAMPLE: If unrelated shareholders "A" and "B" each own individually 50% of the outstanding stock in Corporation X, Corporation Y and Corporation Z, is the MBT control test satisfied?

On the first pass, the answer is "NO" for the reason stated in FAQ U6: As the subject persons ("A" and "B") are described as nonrelated and each owning 50% of the group, the control test in section 117(6) is not met. Thus, these entities do not comprise a unitary business group. [Treasury FAQ U6]

Some practitioners believe, when IRC Section 318(a)(3)(C) is applied, Corporation X will be deemed to own all of the stock owned by its 50% or greater shareholders. Therefore, after application of the attribution rule, Corporation X will own 100% of the outstanding stock in Corporation Y and Corporation Z.

Resolution of this question or the inconsistent application of IRC Section 318(a)(3) is of great importance to tax practitioners because the 50%/50% brother sister type of entity structure is very common among small and medium size business groups.

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 will be happy to be of assistance.

Sincerely,

Ed Kisscorni, CPA/MBA



**BUSINESS STRATEGISTS
CERTIFIED PUBLIC ACCOUNTANTS**

ECHELBARGER, HIMEBAUGH, TAMM & Co., P.C.

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

(616)575-3482 / ehhc@ehhc.com / www.ehhc.com/

www.MichiganStateandLocalTax.com

-

Notice:

To ensure compliance with Treasury Department regulations, we inform you that any tax advice that may be contained in this communication (including any attachments) is not intended or written to be used, and cannot be used, for the purpose of (i) avoiding tax-related penalties under the Internal Revenue Code or applicable state or local tax law provisions or (ii) promoting, marketing, or recommending to another party any tax-related matters addressed herein.

The contents of this email and any attachments to it contain privileged and confidential information from Echelbarger, Himebaugh, Tamm & Co., P.C. This information is only for the viewing or use of the intended recipient. If you are not the intended recipient, you are hereby notified that any disclosure, copying, distribution or use of, or the taking of any action in reliance upon, the information contained in this email, or any of the attachments to this email, is strictly prohibited and that this email and all of the attachments to this email, if any, must be immediately returned to Echelbarger, Himebaugh, Tamm & Co., P.C. or destroyed and, in either case, this email and all attachments to this email must be immediately deleted from your computer without making any copies hereof. If you have received this email in error, please notify Echelbarger, Himebaugh, Tamm & Co., P.C. by email immediately.