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STATE AND LOCAL TAX NEWSLETTER

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MBT: Unitary Business Group Study

GRAND RAPIDS, MI – Monday, September 15, 2008 – The Michigan Business Tax (MBT) is by far the most complicated state level tax in the United States. What makes the MBT extremely complicated and confusing for Michigan taxpayers is the “unitary business group” concept. This concept is new to Michigan. Many taxpayers do not know who is in the group and who is excluded. There is confusion on tax periods and accounting methods as well as due dates and who files the combined return. The control test and relationship test present additional confusion. EHTC has developed a solution—a systematic approach to reach the answers and effectively comply with the law.

MICHIGAN BUSINESS TAX Unitary Business Group Study

The Michigan Business Tax Act (MBTA) imposes the tax on a “unitary business group” defined as:

“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, 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

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value is determined by reviewing the totality of facts and circumstances of business activities and operations. [MCL 208.1117(6)]

"Taxpayer" is defined to mean "a person or a unitary business group liable for a tax, interest, or penalty under this act". [MCL 208.1117(5)] "Person" is defined to mean an individual, firm, bank, financial institution, insurance company, limited partnership, limited liability partnership, copartnership, partnership, joint venture, association, corporation, subchapter S corporation, limited liability company, receiver, estate, trust, or any other group or combination of groups acting as a unit. [MCL 208.1113(3)]

The combination of these three definitions makes a unitary filing mandatory. The definition of "person" significantly broadens those individuals or entities that may be included in a unitary filing. The definition of "taxpayer" means a "unitary business group" is one taxpayer and will file one tax return for the entire group.

A "unitary business group" is a group (two or more) of related "persons" whose business activities or operations are interdependent and satisfy both a *control test* and one of two *relationship tests*. Indirect ownership is generally determined by using Internal Revenue Code (IRC) section 318 or analogous authority. [Treasury FAQ U33]

Section 511 of the MBTA mandates that a "unitary business group" must file a combined return and provides for elimination of transactions between entities within the group.

The "unitary business group" concept and the combined return are new to Michigan taxpayers. The statutory provisions are extremely complicated and the underlying rules and regulations are difficult. The control test for indirect ownership, constructive ownership and the attribution rules are somewhat objective but very complex. The relationship test is mostly based on judicial interpretations and consequently very subjective. **[EHTC has responded to the problem facing Michigan taxpayers with the Unitary Business Group Study.](#)** A unitary filing of a combined return can be advantageous to a Michigan-based group of entities. In a unitary combined return, losses of one entity can be immediately used against the profits of the other entities; intercompany gross receipts derived from sales within the group can be eliminated thereby eliminating pyramiding; and credit limitations apply to the entire group thereby maximizing the utilization of credits. For some group of entities, especially for non-Michigan based entities, a

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unitary combined return filing may result in additional tax. The [Unitary Business Group Study](#) is designed to identify the pluses and minuses associated with a unitary combined filing and present tax planning ideas for tax minimization.

The [Unitary Business Group Study](#) includes the following fifteen steps:

1. Identify all entities that potentially could be part of a “unitary business group”. Review legal documentation and tax registrations to verify the name and federal identification.
2. Identify the direct ownership of each entity identified in the first step. Verify the direct ownership from business records and legal documents.
3. Apply the IRC Section 318 attribution rules to the entities and ownership identified in the first and second step. Determine entity ownership, for purposes of the control test, after application of the Section 318 attribution rules.
4. Apply the IRC Section 1563 rules on excluded ownership to the entity ownership, determined in the third step, after application of the Section 318 attribution rules. Determine entity ownership, for purposes of the control test, after application of both the Section 318 attribution rules and the Section 1563 rules on excluded ownership.
5. Apply the MBTA Section 117(6) *Control Test* to the direct and indirect entity ownership determined in the fourth step. Once it has been determined which entities have satisfied the *Control Test*, go to step six to determine if the relationship test has been satisfied.
6. For every entity identified in the fifth step, determine and document the existence of functional integration, centralized management, economies of scale and the extent of integration, contribution and dependency within members of the unitary business group by reviewing the totality of facts and circumstances of business activities and operations.
7. Determine which of those entities identified to satisfy the *Control Test* in the fifth step also satisfy the *Relationship Test* based on documentation found in the sixth step.

8. Exclude a foreign operating entity from any of the entities identified in the seventh step. The remaining entities comprise the “unitary business group”, go to step nine.
9. Identify the designated member for the unitary business group and determine the tax period for the “unitary business group” and which other entities’ tax years end within or on the same date as the designated member’s tax year end.
10. Compute the business income tax base, the modified gross receipts tax base and the applicable credits for each of the entities and for each of the tax periods identified in the ninth step.
11. Eliminate any business income attributable to another person within the group from the business income tax base, eliminate any modified gross receipts attributable to another person within the group from the modified gross receipts tax base, and eliminate any sales attributable to another person within the group from the apportionment formula.
12. Compute the Michigan Business Tax for the “unitary business group” including only those entities identified in the eighth step, for the tax period determined in the ninth step, after eliminations identified in the eleventh step.
13. Identify the components of the tax base, the contribution of each entity to the total tax (separate vs. combined), the tax credits earned by each entity and in total, and the extent of the tax effect of adding or deleting any of the entities from the unitary combined return.
14. Quantify the tax saving that could be derived from any of the alternative structures identified in the thirteenth step.
15. Document the findings of the [Unitary Business Group Study](#) in a written report for the taxpayer.

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



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