

A Single Member LLC Was Not Required to File As Disregarded Entity for Michigan Single Business Tax Purposes

In *Kmart Michigan Property Services, LLC v. Department of Treasury, Mich. Ct. App., Dkt. No. 282058, 05/12/2009*, (Kmart) the Michigan Court of Appeals ruled that a single member limited liability company (LLC) that had filed as a disregarded entity for federal tax purposes was not required to also file as a disregarded entity for Michigan Single Business Tax purposes. Therefore, the LLC could file a separate SBT return and the Department of Treasury (Treasury) could not require it to file with its corporate parent.

Single member LLC. The taxpayer, KMPS was a LLC formed in Michigan and wholly owned by its single member, Kmart Corporation. During the period at issue, KMPS had three employees and was responsible for winding up the business affairs of Builders Square, its former subsidiary, whose assets were sold to a third party. KMPS filed a SBT return for the fiscal year ending January 28, 1998. The Department audited KMPS for that fiscal year in connection with an audit of Kmart and determined that KMPS should not have filed a separate SBT return, but should have submitted their income, deductions, credits, assets and liabilities with those of Kmart, its parent corporation, for the tax year at issue. The Department determined that it would not accept KMPS's SBT return for the period at issue and would “disregard the entity and treat it as a division of its owner.”

At an informal conference, the referee determined that KMPS was not entitled to a refund for the tax year in issue, which would have been the result if the Department had permitted KMPS to file a separate SBT return. KMPS filed an appeal to the Tax Tribunal, and later filed a motion for summary disposition.

In its summary disposition motion, KMPS argued that it met the definition of a “person” under Mich. Comp. Laws Ann. § 208.6(1) qualifying it to file a separate SBT return for the period at issue. KMPS further argued that the Department improperly retroactively applied the guidance of its Michigan Revenue Administrative Bulletin 1999-9, 11/29/1999, and further that RAB 1999-9 lacked statutory authority and conflicted with the statute, rendering it invalid. The Department argued that KMPS was not a person under the SBT, but rather a single member LLC. In addition, the Department argued that because KMPS elected to be a nonentity for federal tax purposes for tax year 1998, it could not choose to be an entity for purposes of its state SBT filing.

The Tax Tribunal stated that revenue administrative bulletins deserve due deference from the courts, but are not binding legal authority, particularly if they contravene the applicable statute. The Tribunal stated further that KMPS's federal tax status was not determinative of whether it satisfied the definition of “person” under the SBT, because the SBT filing requirements are independent of the federal tax code and existed “long before the federal ‘check-the-box’ regulations” permitting a taxpayer to choose its entity status. Accordingly, the Tribunal found that KMPS was entitled to file a separate SBT return for the tax period at issue.

Disregarded entity. On appeal, the Court of Appeals noted that the Department argued before the Tribunal that KMPS was not a “person” but a single member LLC, such that the SBT required KMPS to file its SBT return as a disregarded entity. As a disregarded entity, a single member LLC is not taxed separately, but has its income attributed to its owner and the owner is then responsible for paying all taxes due. Therefore, the Department argued that KMPS should have been included in Kmart's SBT return rather than filing its own return. Under federal law, KMPS could elect to be taxed as a separate entity from Kmart, or to be a disregarded entity. For tax year 1998, KMPS elected to be a disregarded entity for federal purposes. The Department argued that Michigan's SBT uses the same “check-the-box” regulations that the federal income tax uses, relying on RAB 1999-9. Under the guidelines outlined in RAB 1999-9, KMPS was required to use the same entity status it had chosen for federal tax purposes with respect to its SBT filing.

Department RAB not binding. The Appeals Court agreed with the Tax Tribunal and held that the Department's policies as described in RAB 1999-9 do not have the force of a legal requirement. Michigan law makes a distinction between rules issued by the Department which have the force of law and explanatory guidelines. The court noted that the Department conceded to the Appeals Court that bulletins are considered “interpretative statements.” Therefore, KMPS was not legally required to follow the RAB.

Taxpayer could use different classification for state purposes. The Appeals Court also held that the Department's legal rationale for requiring KMPS to file as a disregarded entity was inconsistent with the plain language of the SBT. Neither the SBT nor the federal regulations require an entity to be consistent in its self-classification with respect to its state and federal tax filings for a given year. Mich. Comp. Laws Ann. § 208.2(2) provides that any term used in the SBT Act and not defined differently has 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. However, nothing in this provision indicates that entity classification elections in the federal tax code must be carried over to an entity's SBT filing. Rather, it simply provides that terms defined in the federal regulations have the same meaning when used in the SBT. There is no specific term at issue in this case and, therefore, no definition to find in the federal regulations. Consequently, the SBT's provisions regarding who must pay the SBT stand alone.

Under the SBT, KMPS was required to file a SBT return, regardless of its classification as a disregarded entity for federal tax purposes, because KMPS fit within the statutory definition of a “person” conducting business activity and the SBT required all persons conducting business activity in the state to file a SBT return. Therefore, the SBT does not support the requirement of RAB 1999-9 that an organization that is a disregarded entity for federal tax purposes for a given taxable period must also file as a disregarded entity for state tax purposes.

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