

AN ALERT FROM THE BDO STATE AND LOCAL TAX PRACTICE

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### SUBJECT

## MICHIGAN COURT OF APPEALS HOLDS THAT CONSTRUCTIVE OWNERSHIP RULES DO NOT APPLY TO THE DEFINITION OF UNITARY BUSINESS GROUP FOR MBT PURPOSES

### SUMMARY

On March 31, 2016, the Michigan Court of Appeals issued its decision in *LaBelle Management, Inc. v. Dep't of Treasury*, Docket No. 324062 (Mich. Ct. Appeal, Mar. 31, 2016), in which it reversed a decision of the Court of Claims. The Court of Appeals held that the taxpayer was not part of the same unitary business group with two entities for Michigan Business Tax ("MBT") purposes due to the absence of more than 50 percent direct or indirect ownership or control. The Court of Appeals rejected the Treasury and the Court of Claims' use of attribution (or constructive ownership) rules to conclude that the control test had been satisfied.

### DETAILS

#### *Background*

LaBelle Management, Inc. ("LaBelle Management") is a Michigan corporation that is primarily owned through direct ownership by brothers Barton and Douglas LaBelle, but neither brother directly owned more than 50 percent of LaBelle Management's common stock. Each brother also owned similar interests in Pixie, Inc. ("Pixie") and LaBelle Limited Partnership. LaBelle Management was a subsidiary of Pixie until Pixie sold all of its stock interests in LaBelle Management to the brothers on January 1, 2008. Thereafter, Pixie, Inc. reported MBT as a separate company.

During 2011 and 2012, the Treasury audited LaBelle Management's returns for the two MBT taxable periods at issue. As a result of the audit, the Treasury assessed MBT on the basis that LaBelle Management, Pixie, and LaBelle Limited Partnership should be treated as a unitary business group. The Treasury applied the attribution (or constructive ownership) rules in Revenue Admin.

### CONTACT:

#### ATLANTIC:

JONATHAN LISS, Tax Senior Director  
215-636-5502 / jliiss@bdo.com

JEREMY MIGLIARA, Tax Senior Director  
703-770-0596 / jmigliara@bdo.com

#### CENTRAL:

ANGELA ACOSTA, Tax Senior Director  
248-688-3313 / aacosta@bdo.com

NICK BOEGEL, Tax Senior Director  
414-615-6773 / nboegel@bdo.com

JOE CARR, Tax Principal  
312-616-3946 / jcarr@bdo.com

MARIANO SORI, Tax Partner  
312-616-4654 / msori@bdo.com

RICHARD SPENGLER, Tax Senior Director  
616-776-3687 / rspengler@bdo.com

#### NORTHEAST:

JANET BERNIER, Tax Principal  
212-515-5405 / jbernier@bdo.com

MATTHEW DYMENT, Tax Principal  
617-239-4130 / mdyment@bdo.com

#### SOUTHEAST:

ASHLEY MORRIS, Tax Senior Director  
919-278-1963 / amorris@bdo.com

SCOTT SMITH, Tax Senior Director  
615-493-5629 / ssmith@bdo.com

#### SOUTHWEST:

TOM SMITH, Tax Partner  
918-281-4080 / tasmith@bdo.com

GENE HEATLY, Tax Senior Director  
214-665-0716 / gheatly@bdo.com

#### WEST:

ROCKY CUMMINGS, Tax Partner  
415-490-3130 / rcummings@bdo.com

PAUL MCGOVERN, Tax Senior Director  
714-913-2592 / pmcgovern@bdo.com

Bulletin 2010-01, Michigan Business Tax Unitary Business Control Test (Feb. 5, 2010) to determine that the same person owns or controls, directly or indirectly, more than 50 percent of the ownership interest of LaBelle Management, Pixie and LaBelle Limited Partnership as required by the definition of “unitary business group” under Mich. Comp. Laws § 208.1117(6).

LaBelle Management paid the assessed tax under protest, and filed a lawsuit in the Michigan Court of Claims. Both parties brought cross-motions for summary judgment. The Court of Claims granted the Treasury’s motion and denied LaBelle Management’s. The Court of Claims found Internal Revenue Code (“IRC”) § 957, which defines “controlled foreign corporation” for purposes of international taxation, to be “contextually analogous” to Mich. Comp. Laws § 208.1117(6). Both provisions refer to more than 50 percent ownership, and IRC § 957 applies the same attribution (or constructive ownership) rules under IRC § 318 as Revenue Admin. Bulletin 2010-01.

LaBelle Management filed an appeal and a motion for summary judgment with the Court of Appeals.

### ***The Court of Appeals’ Holding and Analysis***

The Court of Appeals held that the Court of Claims erred in using the “contextually analogous” federal income tax definition of constructive ownership or control. The Court of Appeals reasoned that, as emphasized by the Michigan Supreme Court in *Town & Country Dodge, Inc. v. Dep’t of Treasury*, 362 N.W.2d. 618 (Mich. 1984), Mich. Comp. Laws § 208.1103 allows for the adoption of a federal income tax definition in the case of an undefined MBT term such as “indirect ownership or control,” but only if used in a comparable context for federal income tax purposes. Where no comparable context for federal income tax purposes exists, the ordinary and primarily understood meaning must be used. The Court of Claims had noted the absence in the federal income tax law of a context comparable to Mich. Comp. Laws § 208.1117(6). Accordingly, the Court of Claims should have applied the ordinary and primarily understood meaning of indirect ownership.

In addition, the Court of Appeals found the Court of Claims’ use of constructive ownership rules under IRC § 957 to be misplaced. IRC § 957 looks at whether more than 50 percent of a corporation’s voting stock or total value is *owned* within the meaning of IRC § 958(a), or is *considered as owned* (i.e., not true ownership or a legal fiction) by applying the constructive ownership rules under IRC § 958(b). IRC § 958 itself identifies three types of ownership: direct and indirect ownership under IRC § 958(a), and constructive ownership under IRC 958(b). First, IRC § 958(a) would be the correct section to apply because it uses the direct and indirect terminology as found in Mich. Comp. Laws § 208.1117(6). Next, IRC § 958 only defines “stock owned,” and merely *applies* the rules of constructive ownership to indirect ownership without defining that term. Lastly, the federal statutes and regulations are replete with examples that illustrate the proposition that indirect ownership and constructive ownership are two different concepts, and at times expressly distinguish between the two ownership types, and do not broadly apply rules of constructive ownership anytime indirect ownership is used.

Given the lack of a comparable federal context, the court then examined the definitions of indirect and indirectly (i.e., indirectly is the adverbial form of indirect) in New Oxford American Dictionary (3d ed.), Merriam-Webster’s Collegiate Dictionary (11th ed.), Black’s Law Dictionary (10th ed.) to find the plain and ordinary meaning of indirect ownership to apply in the case of Mich. Comp. Laws § 208.1117(6). The court held, based on the definitions in the aforementioned texts, indirect ownership in Mich. Comp. Laws § 208.1117(6) means “ownership *through an intermediary*, not ownership by operation of legal fiction,” which does not exist under the facts of this case. Therefore, neither brother owns or controls, directly or indirectly, more than 50 percent of LaBelle Management, Pixie or LaBelle Limited Partnership as required by the definition of “unitary business group” under Mich. Comp. Laws § 208.1117(6).

## BDO INSIGHTS

- ▶ The Court of Appeals' decision is presently subject to reversal on reconsideration or appeal to the Michigan Supreme Court.
- ▶ A taxpayer that applied the attribution (or constructive ownership) rules in Revenue Admin. Bulletin 2010-01 for purposes of determining the existence of a unitary business group for MBT purposes, should consider whether they may benefit from filing a refund claim (or a protective refund claim in the event the Court of Appeals grants a motion for reconsideration or the matter is appealed to the Michigan Supreme Court) under Michigan's four-year statute of limitations.
- ▶ The reasoning applied by the court in *LaBelle Management* may apply for Corporate Income Tax ("CIT") purposes given that, for CIT purposes, Michigan does not define indirect ownership and adopted statutory provisions very similar to those MBT statutory provisions relevant in this case. If so, a similar refund (or protective refund) opportunity may exist for CIT purposes.

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