

## Michigan Court of Appeals rules on indirect ownership for MBT unitary filing

### Overview

On March 29, 2016, in *LaBelle Management, Inc. v. Michigan Dep't of Treasury*, the Michigan Court of Appeals reversed a lower court decision, and held that three entities did not constitute a unitary business group for Michigan Business Tax (MBT) purposes, since there was a lack of requisite control.<sup>1</sup> The Michigan Department of Treasury (Treasury) sought to require LaBelle Management, Inc. and two related entities (all three owned 50% or less by two brothers) to file as a unitary business group for MBT purposes. Treasury's interpretation was that *constructive* ownership, as used in various federal contexts, was sufficient to satisfy the statutory requirement that one unitary member own directly or indirectly, more than 50 percent of the other related member(s).<sup>2</sup> The Michigan Court of Appeals disagreed with Treasury's interpretation and held, "indirect ownership in MCL 208.1117(6) means ownership through an intermediary, not ownership by operation of legal fiction, as [Treasury] urges."<sup>3</sup>

In this Tax Alert we summarize the Michigan Court of Appeals decision in *LaBelle Management, Inc. v. Michigan Dep't of Treasury* and provide some taxpayer considerations.

### Factual background

For the MBT tax years under consideration in this litigation, LaBelle Management, Inc. (Taxpayer), a Michigan corporation, was principally owned by Barton and Douglas LaBelle, two brothers—neither of whom owned more than 50 percent of Taxpayer's common stock. Pixie, Inc. (Pixie) and LaBelle Limited Partnership (LaBelle LP) were also owned by the LaBelle brothers, however, neither brother held more than a 50 percent common stock ownership in Pixie, or more than a 50 percent partnership interest in LaBelle LP. Taxpayer filed a separate MBT return rather than filing as a member of a unitary MBT return with Pixie and LaBelle LP.<sup>4</sup>

Treasury audited Taxpayer for the two tax years at issue and determined that it was part of a unitary business group with both Pixie and LaBelle LP. Taxpayer was therefore required to file a unitary MBT return including Pixie and LaBelle LP.<sup>5</sup> Treasury concluded that the three related entities, owned by the LaBelle brothers, indirectly owned each other—meeting the control element of the MBT's definition of "unitary business group."<sup>6</sup> Treasury's conclusion was supported by its own administrative guidance, Revenue Administrative Bulletin 2010-1, "Unitary Business Group Control Test," which states that "indirect ownership includes ownership through attribution...an ownership interest is indirectly owned by a person when that person constructively owns such an interest."<sup>7</sup>

The Michigan Court of Claims agreed with Treasury's interpretation of "indirect ownership," noting the Internal Revenue Code (IRC) Section 957 discussion of voting stock or value owned *or considered as owned* by United States shareholders was analogous to "the same attribution rules under IRC § 318 as are applied by [Treasury] to determine ownership interest under § 117 of the MBT."<sup>8</sup> The Court of Claims ruled that Taxpayer was required to file a unitary MBT return including Pixie and LaBelle LP.<sup>9</sup>

### "Constructive control" versus "indirect control"

Michigan Compiled Laws (MCL) 208.1117(6) defines "unitary business group" as "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...."<sup>10</sup> At issue before the Michigan Court of Appeals (the Court of Appeals) was "how to

<sup>1</sup> *LaBelle Management, Inc. v. Michigan Dep't of Treasury*, No. 324062 (Mich. Court of Appeals, published March 31, 2016). [Available here](#).

<sup>2</sup> See generally MICH. COMP. LAWS § 208.1117(6).

<sup>3</sup> *LaBelle Management* at 7. [Emphasis in quotation reflects text of opinion and was added by Michigan Court of Appeals.]

<sup>4</sup> *Id.* at 2. While Taxpayer at some prior point had been a subsidiary of Pixie, it is noted in the decision that on January 1, 2008, Pixie sold all of its interest in Taxpayer to the LaBelle brothers.

<sup>5</sup> *Id.*

<sup>6</sup> *Id.*

<sup>7</sup> Revenue Admin. Bull. 2010-1, at 7.

<sup>8</sup> *LaBelle Management, Inc. v. Michigan Dep't of Treasury*, No. 324062, p 2 (Mich. Court of Appeals, published March 31, 2016). See 26 I.R.C. 957.

<sup>9</sup> *Id.*

<sup>10</sup> *Id.* at 3. Quoting MICH. COMP. LAWS § 208.1117(6).

define ‘owns or controls...indirectly.’<sup>11</sup> Because the term “indirect control” is not defined, the MBT Act requires that “[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.”<sup>12</sup> The Court of Claims had looked to certain provisions of the IRC, and concluded that “indirect control” exists when more than 50 percent of a corporation’s voting stock or total value of stock is owned (within the meaning of section 958(a)), or is considered as owned by applying the rules of ownership of section 958(b).<sup>13</sup> The Court of Appeals took a different view, concluding that there was no federal income tax context that was analogous to MCL 208.1117(6).<sup>14</sup> Thus, in the absence of a comparable context, “the trial court should have resorted to normal rules of statutory construction to determine the meaning of the undefined term.”<sup>15</sup>

The Court of Appeals stated that “federal statutes and regulations are careful never to say that indirect ownership *means* constructive ownership and, in fact, at times expressly distinguish between the two....”<sup>16</sup> The Court of Appeals then looked to the plain and ordinary meaning of “indirect ownership,” as used in MCL 208.1117(6). Referencing a previous decision, the Court of Appeals invoked its ability to “consult dictionary definitions to give words their common and ordinary meaning.”<sup>17</sup> The Court of Appeals determined that “indirectly” means “a pathway that is not straight i.e., a course that does not proceed along a single line from one point to another, but instead, proceeds through an intermediate point.”<sup>18</sup>

Based on the plain meaning of “indirectly,” the Court of Appeals held that “indirect ownership” under MCL 208.1117(6) is “ownership *through an intermediary*, not ownership by operation of legal fiction as [Treasury] urges.”<sup>19</sup> The Court of Appeals reversed the Court of Claims decision, and found that the three related entities owned by the LaBelle brothers were not owned through an intermediary or otherwise, and therefore did not satisfy the control test necessary for inclusion in a MBT unitary business group.<sup>20</sup>

### Considerations

Taxpayers that have filed unitary MBT or unitary Michigan Corporate Income Tax<sup>21</sup> returns should review their organizational structure and consider whether the Michigan Court of Appeal’s narrow interpretation of “indirect” ownership in *LaBelle Management* potentially impacts their unitary filing group. As of the release date of this Tax Alert, this decision is subject to rehearing or reconsideration on motion to the Michigan Court of Appeals, and the period for filing an application for leave to the Michigan Supreme Court remains open.<sup>22</sup>

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<sup>11</sup> *Id.* Quoting MICH. COMP. LAWS § 208.1117(6).

<sup>12</sup> *Id.* at 4. Quoting MICH. COMP. LAWS § 208.1103. [Emphasis in quotation reflects text of opinion and was added by Michigan Court of Appeals.]

<sup>13</sup> *Id.* at 4. Quoting 26 I.R.C. 957.

<sup>14</sup> *LaBelle Management, Inc. v. Michigan Dep’t of Treasury*, No. 324062, p 6 (Mich. Court of Appeals, published March 31, 2016).

<sup>15</sup> *Id.* Citing *Town & Country Dodge, Inc. v. Michigan Dep’t of Treasury*, 362 NW2d 618 (1984).

<sup>16</sup> *Id.* at 6. [Emphasis in quotation reflects text of opinion and was added by Michigan Court of Appeals.]

<sup>17</sup> *Id.* at 7. Citing *Krohn v. Home-Owners Ins. Co.*, 802 NW2d 281, 289 (2011).

<sup>18</sup> *Id.*

<sup>19</sup> *Id.* [Emphasis in quotation reflects text of opinion and was added by Michigan Court of Appeals.]

<sup>20</sup> *LaBelle Management, Inc. v. Michigan Dep’t of Treasury*, No. 324062, p 8 (Mich. Court of Appeals, published March 31, 2016).

<sup>21</sup> While this decision only considered the statutory definition of “unitary business group” for MBT purposes, the Michigan Corporate Income Tax definition of “unitary business group” is essentially identical in its reference to “owns or controls, directly or indirectly.” MICH. COMP. LAWS § 206.611(6).

<sup>22</sup> Mich. Ct. R. 7.215(l) and 7.305(C)(2).

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