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Draft RAB on Unitary Control Test Released

Revenue Administrative Bulletin 2009-DRAFT Unitary Business Group Control Test

The Michigan Department of Treasury (Department) has circulated a draft of its Revenue Administrative Bulletin on the unitary business group control test. Taxpayers and other interested persons currently have until August 31, 2009 to provide comments to the Department. The RAB is intended to be effective retroactively to January 1, 2009. The draft RAB proposes changes to the Department's prior interpretation of the unitary business group control test. The following is a summary of key provisions.

Under the draft RAB, a person is deemed to satisfy the control test when it owns or controls, directly or indirectly, more than 50% of the ownership interest with voting or comparable rights of another person. This more than 50% requirement can be met via either (1) more than 50% of the total combined voting power or (2) more than 50% of the total value of all ownership interests with voting (or comparable) rights.

Voting Agreements - In determining whether ownership interests owned by a person possess the necessary voting (or comparable) rights, the Department will consider all the facts and circumstances. The Department may disregard documents evidencing formal voting rights and review the effect of any express or implied agreement. Granting of proxies and options could affect whether or not a person has (or lacks) sufficient control. Documents pertaining to proxies and options should be reviewed in light of this guidance.

Brother-Sister Controlled Groups - The Department now believes that brother-sister groups of entities may satisfy the control test even if unrelated individuals each own 50%, and not more, of each entity.

Entity in More Than One Controlled Group - If an entity is a member of more than one controlled group, the entity will be treated as a member of the group to which it satisfies the relationship test. If it satisfies the relationship test with more than one group, it must make an election as to which group it wishes to be treated as a member. Such election will remain in effect until the unitary relationship is discontinued or revoked with the approval of the Department.

Indirect Ownership and Attribution - The Department has indicated that it will apply its consideration of indirect ownership differently, depending upon choice of entity. This application does not appear to be supported by statute and is inconsistent with other MBT provisions. We note that this may pose significant concerns to clients with foreign parents and family-owned controlled groups.

90 Day Limitation on Filing Constitutional Challenges to the MBT - In light of the above, we remind our clients again that there is a strict 90-day statute of limitations to filing constitutional challenges to tax levies, commencing with the date set for the return filing. Clients should keep this in mind as they finalize their 2008 MBT returns.

A copy of the draft RAB can be downloaded at <http://www.honigman.com/files/Uploads/Documents/MBT/RAB2009UBGControlTesttoBTAG062609.pdf>. Please contact your Honigman SALT professional for assistance submitting comments.

Michigan Court of Appeals Rules That the Federal Check-the-Box Regulations Do Not Apply to Michigan's SBT

In *Kmart Michigan Property Services, LLC v Department of Treasury* (Kmart Services),¹ the Michigan Court of Appeals recently ruled that the federal "check-the-box" regulations (Federal Regulations) do not apply to the

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Michigan Single Business Tax (SBT) Act. The Kmart Services decision rejected the Michigan Department of Treasury's (Department) Revenue Administrative Bulletin (RAB) 1999-9.² Under the Department's RAB 1999-9, if a single member unincorporated entity is disregarded as an entity separate from its owner for federal income tax purposes, the single member entity must be treated as a branch, division or sole proprietor for SBT purposes. In rejecting the RAB, the Court of Appeals ruled that the Federal Regulations applicable to single member limited liability companies (LLCs) do not apply to the Michigan SBT Act.

On June 23, 2009, the Department appealed the Court of Appeals' decision to the Michigan Supreme Court.³ In its Application For Leave To Appeal to the Supreme Court, the Department requests that leave to appeal be granted because "the Court of Appeals' decision ... upset[s] the settled expectations and tax planning of many taxpayers, and create uncertainty [in] the tax payment process...." (Application, p 1).

While there will be "winners" and "losers" under the *Kmart Services* decision, many taxpayers will be surprised to learn that their reliance on the Department's RAB 1999-9 was misplaced. Unfortunately, taxpayer reliance on the Department's RAB may be no defense to action taken by the Department to apply Kmart Services retroactively to impose single business taxes on single member LLCs and their owners.

Even though the Department has appealed the Court of Appeals' decision to the Supreme Court, the Department is presently considering how to apply the Court of Appeals' decision (prospectively vs. retroactively) and whether the decision applies to single member LLCs under the Michigan Business Tax (MBT) Act.

The MBT Act replaced the SBT Act effective for tax periods beginning on or after January 1, 2008. In its "frequently asked questions and answers" (FAQs) applicable to the MBT Act, the Department announced that the Federal Regulations apply to single member LLCs.

Under the Michigan Revenue Act, generally there is a 4 year statute of limitations applicable to the Department's efforts to assess SBT taxes against taxpayers. Similarly, there is a four year statute of limitations that generally applies to refund claims. Unfortunately, for those single member LLCs who relied upon RAB 1999-9 and were included in their owners' SBT returns, a serious question arises as to whether the single member LLC can now rely upon the four year statute of limitations (or other legal theories) to bar collection and assessment action by the Department. For these LLCs, it is possible that they will be subject to SBT assessments for all "open" tax years going back to the January 1997 effective date of RAB 1999-9.

For some single member LLCs, however, the result in *Kmart Services* may present an SBT refund opportunity and, since these LLCs did not file their "own" SBT returns, these "taxpayers" may be able to claim refunds for all open SBT tax years.

If *Kmart Services* is applied retroactively by the Department, the owners of single member LLCs will be burdened with compliance costs to prepare and file "separate" amended SBT returns to remove the income, credits, deductions, etc. of their single member LLCs from the owner's tax return. Additional compliance costs will also be incurred to prepare "separate" SBT returns for the single member LLC.

Finally, the answers to the issues raised in this article will not be known until after the Supreme Court acts on the Department's pending Application For Leave To Appeal. In the meantime, taxpayers that may be beneficially affected by the Court of Appeals' decision should consider filing protective refund claims with the Department of Treasury.

¹*Kmart Michigan Property Services, LLC v Department of Treasury (Court of Appeals Case No. 282058; May 12, 2009).*

²RAB 1999-9 (dated November 29, 1999, but effective January 1, 1997).

³*Kmart Michigan Property Services, LLC v Department of Treasury (Michigan Supreme Court Case No. 139110).*