Published on *The National Law Review* https://natlawreview.com

Michigan Tax Tribunal Holds That Parent Properly Excluded its Wholly Owned Subsidiary from its Unitary Business Group Return

Article By:

Irwin M. Slomka

Challenging a state corporate tax determination of a unitary business relationship between related corporations can be difficult. However, a recent decision of the Michigan Tax Tribunal shows that with good facts a business can rebut a unitary business finding and successfully avoid having to file on a unitary combined basis. *TTI, Inc. v. Michigan Dep't of Treasury*, Mich. Tax Trib., No. 21-002481 (Oct. 17, 2023).

The Facts: TTI, Inc. ("TTI") is a Delaware corporation headquartered in Fort Worth, Texas that sells electronic components to original equipment manufacturers throughout the United States. In 2000, it acquired Mouser Electronics, Inc. ("Mouser"), a company that also sells electronic components, but instead to product developers and engineers through catalog and online sales, as its wholly owned subsidiary. After the acquisition, TTI and Mouser maintained separate headquarters, sales offices, warehouses and distribution facilities.

TTI included Mouser in its originally filed Michigan corporate income tax returns for the years 2013 through 2016 as part of its unitary business group. TTI later amended those returns – and amended its unitary returns filed in eleven other states – to exclude Mouser, resulting in refund claims. Following an audit, the Michigan Department of Treasury

("Department") issued notices of Intent to Assess based on the Department's view that Mouser was engaged in a unitary business with TTI. This litigation followed.

The Dispute: TTI asserted that Mouser and TTI did not meet the definition of a "unitary business group" under Michigan law and, therefore, the two entities did not have to be combined. In relevant part, a Michigan "unitary business group" exists where there are "business activities or operations" between or among substantially owned group members which either (i) results in a "flow of value" between or among those group members ("flow of value test") or (ii) "are integrated with, are dependent upon, or contribute to each other." ("contribution/dependency test"). MCL 206.611(6). The Department claimed that both tests were met.

The Tribunal Decision: The Tax Tribunal concluded that TTI met its burden of proving that neither the flow of value test nor the contribution/dependency test was met.

1. ***Flow of Value Test***. The Tribunal held that the flow of value test was not satisfied, finding an insignificant level of functional integration, centralized management and economies of scale. On the question of functional integration, the Department pointed to "significant intercompany sales" from TTI to Mouser of more than $20 million annually. The Tribunal was of the view that this "paints a skewed picture" since such sales represented only 1% to 1.5% of TTI's revenues. Similarly, Mouser's sales to TTI represented only 1% of Mouser's global sales. Therefore, intercompany sales were not significant. The Tribunal was also not persuaded by the Department's inference that there was "cost savings" when one entity sold inventory to the other, noting that each acquired its inventory from third-party manufacturers and suppliers, which likely included a mark-up so that intercompany purchases reflected the same third-party markup resulting in no cost savings.

The decision is somewhat less clear on the question of intercompany loans and receivables. While there were no direct loans between the two companies, there were unspecified intercompany receivables. However, in the absence of direct evidence of what the receivables pertained to or any discussion of the issue in the Department's legal brief, the Tribunal concluded that the receivables reflected accounting entries for normal intercompany transactions, such as intercompany sales, and should not be considered separately from intercompany sales.

The Tribunal found no centralized management, noting that, while the two companies shared the same CEO/Chair and Secretary/Treasurer, overall each company's operations and management were independent of the other. The Tribunal also concluded that the existence of a few shared employee benefits programs – for instance, a shared health insurance plan and 401(k) plan, and a single business insurance policy, the costs of which were borne respectively by each entity – did not rise to the level of a significant reduction in the costs of operations or administrative functions.

2. ***Contribution/Dependency Relationship Test***. The Tribunal found that the three-part alternative "contribution/dependency relationship" test for a unitary business group also was not met. Looking at each of the three factors separately – "integration with," "dependence upon" or "contribution to" each other – the Tribunal first found that the integration analysis for the "flow of value" test (discussed above) was no different than under the contribution test and supported TTI's position. As for the dependence factor, the Tribunal concluded that while a wholly owned subsidiary is necessarily subordinate to its parent, that relationship alone cannot satisfy the dependence test as it would negate the criteria for determining a unitary business group in the first place. Finally, the Tribunal gave no weight to an internal company memo sent to TTI employees in 2000 discussing the acquisition of Mouser, which the Department contended was evidence of a unitary relationship, noting that the Department failed to adequately explain how the memo was relevant to the years in issue, more than a decade

later.

While unitary business tax disputes are necessarily dependent on the particular facts, this Michigan decision demonstrates that the burden of proof is not insurmountable even where the law broadly defines a unitary business, and even in the face of millions of dollars of intercompany sales and some level of officer overlap.

National Law Review, Volume XIII, Number 320