STATE OF MICHIGAN
DEPARTMENT OF ENERGY, LABOR AND ECONOMIC GROWTH
MICHIGAN TAX TRIBUNAL

The Estate of Thomas M Wheeler, *et al*,
Petitioners,

MTT Docket Nos. 343771, 343772, 343774, 343775

v

Tribunal Judge Presiding
Cynthia J Knoll

Michigan Department of Treasury,
Respondent.

ORDER GRANTING PETITIONERS' MOTION FOR SUMMARY DISPOSITION

ORDER DENYING RESPONDENT'S MOTION FOR SUMMARY DISPOSITION

FINAL OPINION AND JUDGMENT

SUMMARY

Petitioners, the Estate of Thomas M. Wheeler, Nicholas and Lisa J. Huzella, Patrick and Michaelon Wright, and Thomas R. and Patsy Wheeler, appeal Final Assessment Nos. J939193, J932896, J932903, and J939139 issued by Respondent, Michigan Department of Treasury, on March 6, 2008. [1] The Final Assessments are for individual income tax and reflect Respondent's determination that Petitioners were precluded from including a Michigan corporation's distributive share of income from a German partnership using the combined apportionment factors of the companies. The assessments are as follows:

Petitioner	Assessment No.	Tax Period	Tax	Interest*	Penalty
Estate of Wheeler	H939193	1993, 1994, and 1995	$822,283.00	$786,431.96	$81,082.00
Nicholas and Lisa J. Huzella	J932896	1995	$88,884.00	$84,579.91	$8,888.00
Nicholas and Lisa J. Huzella	J932896	1996	n/a	n/a	0.01
Patrick and Michaelon Wright	J932903	1995	$98,644.00	$93,863.85	$9.864.00
Patrick and Michaelon Wright	J932903	1996	n/a	0.01	n/a
Thomas R. and Patsy Wheeler	J939139	1993, 1994, and 1995	$200,688.00	$192,809.63	$20,069.00

*Interest accrued as of March 8, 2008.

[1] On January 5, 2009, Petitioners filed a Motion to Consolidate their cases, which was granted by the Tribunal on June 11, 2009.

Petitioners also request costs and attorney fees.

On January 15, 2010, Respondent filed a motion requesting the Tribunal grant summary disposition in its favor, pursuant to MCR 2.116(C)(8). On February 19, 2010, Petitioners filed a response in opposition to Respondent's Motion for Summary Disposition and a request for Oral Argument. Petitioners filed a Cross Motion for Summary Disposition on January 15, 2010. Respondent subsequently filed a reply brief on February 12, 2010. On March 2, 2010, the Tribunal entered an Order granting Petitioners' Request for Oral Argument. On April 13, 2010, the Tribunal heard oral argument on Petitioners' and Respondent's Motions to determine whether any genuine issues of material fact exist.

The Tribunal finds that Petitioners may include the pass-through income and the apportionment factors of the German partnerships in determining their Michigan taxable income. However, the Tribunal does not find an award of costs and attorney's fees appropriate in this instance.

BACKGROUND

The assessments in issue are the result of Petitioners reporting Michigan income from a domestic S Corporation, Electro-Wire Products, Inc. (Electro-Wire), which included its distributive share of partnership income from a German partnership, Temic Telefunken Kabelsatz, GmbH (TKG), based on the combined apportionment factors of both entities. Electro-Wire was engaged in the business of manufacturing and assembling electrical distribution systems for Ford Motor Company (Ford). On January 1, 1994, Electro-Wire acquired all of the business assets of a virtually identical manufacturing plant in Germany, i.e., TKG, which also manufactured and assembled electrical distribution systems, to expand its business opportunities internationally and to satisfy pressures from Ford to expand its operations globally. When Electro-Wire acquired the operations of TKG, it created two general partnerships to accomplish this transaction. One partnership was a holding partnership called Electro-Wire Products and the second was an operating partnership, TKG. Electro-Wire held a 99% partnership interest in Electro-Wire Products and Thomas M. Wheeler held the remaining 1% interest. Electro-Wire Products held a 99.5% partnership interest in TKG and Electro-Wire held the remaining 0.5% partnership interest.

Petitioners filed Michigan income tax returns for the years at issue, reporting their distributive net income from Electro-Wire, which included the pass-through income reported by the German partnerships. Petitioners also applied combined apportionment factors of both the S corporation and the partnerships in determining their Michigan taxable income. Respondent conducted an audit and determined that Petitioners' distributive net income is the combined S corporation and partnership income, but that only the apportionment factors of the S corporation should be used to determine the Michigan net income. Subsequently, Respondent revised its position, maintaining that neither the pass-through income nor the apportionment factors of the German partnerships should be included in Petitioners' Michigan income tax returns. Petitioners disagreed, arguing that the distributive income includes that of the unitary business of Electro-Wire/TKG and the apportionment factors must also be those of the unitary business.

Respondent held an informal conference on October 29, 2004. The Hearing Officer recommended that Petitioners' Michigan income from Electro-Wire be apportioned using the combined apportionment factors of both the S corporation and the German partnerships. Respondent rejected the Hearing Officer's recommendation and issued a Decision and Order of Determination indicating the same on March 28, 2007. Respondent then issued an Amended Decision and Order of Determination on December 7, 2007. Ultimately, the Final Assessment was issued on March 6, 2008, outlining Petitioners' income tax liabilities. On April 9, 2008, Petitioners paid all undisputed portions of the Final Assessments and filed the Petitions at issue, requesting cancellation of the tax, interest and penalties assessed by the Final Assessment, also seeking refunds, where appropriate, and costs and attorney's fees.

PETITIONERS' CONTENTIONS

Petitioners filed a motion for summary disposition, pursuant to MCR 2.116(C)(10), on both legal and factual claims. They contend that all arguments relating to the applicability of the Unitary Business Principle (UBP) for individual income tax purposes raise purely legal issues subject to disposition under MCR 2.116(C)(10).[2] Petitioners argue that the UBP applies to individual income tax in the state of Michigan. They further contend that "[t]he remaining issues – the existence of a unitary business as between Electro-Wire and TKG and the application of a negligence penalty – are mixed questions of law and fact." (PB, p. 2) Petitioners contend that the facts are not in dispute yet Respondent ". . . can offer no evidence to refute that Electro-Wire/TKG was unitary during the years in issue." (PB, p. 3)

Petitioners maintain that "[t]he essence of this case . . . is Petitioners' claim that, during the years in issue, Electro-Wire and TKG operated as a unitary business, thus requiring the income from the Electro-Wire/TKG unitary group to be apportioned using the factors of the unitary business group for Michigan individual income tax reporting." (PB, pp. 3 & 4) Petitioners explain that they received flow-through income from the Michigan S corporation, Electro-Wire. That distributable share of income included Electro-Wire's distributive share of income or loss from the business activities of the German partnerships (primarily TKG). Michigan income tax is imposed on the taxable income of every "person" other than a corporation, and Petitioners argue the income they received constitutes apportionable business income because it was earned from the unitary business activities of an S corporation and partnerships. Petitioners contend that even though the taxable person is an individual, the Michigan Income Tax Act (MITA) contemplates business income as being earned in multiple states and therefore apportionment is the legislatively required method for dividing taxable income from Petitioners' trade or business.[3]

In support of their position, Petitioners cite MCL 206.115 which states:

> All business income . . . shall be apportioned to this state by multiplying the income by a fraction, the numerator of which is the property factor, plus the payroll factor, plus the sales factor, and the denominator of which is 3.

[2] Petitioners' Brief in Support of Motion for Summary Disposition (PB), p. 1
[3] Petitioners cite MCL 206.103 and 206.115 to support their argument that business income must be apportioned, even when the taxable person is an individual.

Petitioners argue that "[t]he U.S. Supreme Court has held that the UBP *must* be applied when employing formulary apportionment to the income of a business enterprise that conducts its in-state and out-of-state operations as separately incorporated or unincorporated affiliates rather than as separate divisions of the same corporate entity."[4] (Emphasis in original) (PB, p. 15) Petitioners cite *Mobil Oil* for the premise that "the linchpin of apportionability in the field of state income taxation is the unitary business principle."[5] The Court acknowledged that ". . . while a state may specifically geographically source income to determine the taxable income earned within its borders, once the State adopts apportionment, the unitary business principle applies." (PB, p. 15)

Petitioners further contend that Michigan courts and the Tribunal have followed this unitary analysis adopted by the U.S. Supreme Court when applying formulary apportionment. Petitioners cite *Holloway Sand & Gravel Company v Department of Treasury*, 152 Mich App 823; 393 NW2d 921 (1986), where the Court of Appeals affirmed the Tribunal's determination that ". . . if a taxpayer's businesses are unitary, apportionment of its multistate business income is required for purposes of computing its Michigan income tax." (PB, p. 16) Petitioners also cite *Jaffe v Department of Treasury*, 172 Mich App 116; 431 NW2d 416 (1988) and *Glieberman v Michigan Department of Treasury*, 14 MTT 223 (2003), in support of this contention. Ultimately, Petitioners cite the aforementioned three Michigan cases to prove that ". . . if a taxpayer can establish a unitary relationship, apportionment of its multi-state business income is required for purposes of computing [their] Michigan income tax." (PB, pp. 18-19)

In response to Respondent's Motion for Summary Disposition, Petitioners state that "[t]his case is not a question of whether Petitioners may elect combined/consolidated reporting under a business level tax such as former MCL 208.77 or any other business entity statute as the Department contends. Rather, it is a question of whether, under the UBP, the two entities are conducting one single unitary business so that the calculation of taxable business income of the taxpayer's trade or business is the calculation of the taxable income of the single unitary business."[6] Petitioners argue that Respondent seeks to apply separate accounting; however, because Michigan has adopted apportionment, it has, in essence, rejected separate accounting.

Petitioners contend that not only does the UBP apply for apportioning business income, including the business income of a non-US entity, but that the activities of Electro-Wire and TKG were almost immediately intertwined when TKG was acquired such that they were a unitary business enterprise. Petitioners explain that the post-acquisition ownership structure was an important element in Electro-Wire's plan to immediately integrate its business with TKG and to immediately begin reaping the economic benefits of a unitary relationship. They contend that the structure allowed for centralized management by Electro-Wire and permitted it to take a vital role in TKG's operations and functions. (PB, p. 7)

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[4] See e.g. *Butler Bros v McColgen*, 315 US 501, 508-509; 62 S Ct 701; 86 L Ed 891 (1942), holding that separate accounting may fail to account for contributions to income resulting from functional integration, centralized management, and economies of scale.

[5] *Mobil Oil Corporation v Commissioner of Taxes of Vermont*, 445 US 425, 440; 100 S Ct 1223 (1980)

[6] Petitioners' Brief in Opposition to Respondent's Motion for Summary Disposition (PR), p. 1

Petitioners state that:

> The Court of Appeals in *Holloway* and *Jaffe* and this Tribunal in *Glieberman, Holloway,* and *Jaffe* . . . have identified and applied five factors, extracted from prominent unitary business/apportionment formula decisions of the U.S. Supreme Court, that this Tribunal must consider in determining whether a business is unitary or discrete: (1) economic realities; (2) functional integration; (3) centralized management; (4) economies of scale; and (5) substantial mutual interdependence.[7]

Petitioners contend that Electro-Wire and TKG meet all of the five criteria and are therefore unitary.

Petitioners contend that the factors supporting Electro-Wire's selection of TKG for expansion in Europe "foreshadowed what immediately became a truly unitary relationship." (PB, p. 6) TKG manufactured and assembled electrical distribution systems and had similar products, processes and manufacturing equipment as Electro-Wire. Ford was an existing customer of TKG and TKG had certain products in which it was the sole supplier to Ford. TKG also had substantial non-Ford business, principally with Mercedes Benz and BMW, which arguably presented opportunities to Electro-Wire for customer diversification in Europe and opened up potential business opportunities with these companies in the U.S. (PB, p. 7)

In addressing the five factors specifically, Petitioners maintain that the companies' economic realities, or the regularly conducted activities of the two businesses, were identical. Petitioners also assert that there was sufficient functional integration between the companies as Electro-Wire assumed critical support service provided to TKG. Further, Electro-Wire viewed TKG as any other plant or production facility within the Electro-Wire facility network, and as such, the management was centralized. The companies became economically interrelated when the knowledge, experience, and expertise of the businesses were commingled. Economies of scale was further established when Electro-Wire was required to establish global capability and thus its economic survival depended on its acquisition of TKG to remain a supplier to Ford. Finally, Petitioners contend that the companies were mutually interdependent after the acquisition because Electro-Wire's expertise was integrated into TKG through the centralized management that ensued. As such, Petitioners maintain Electro-Wire and TKG were unitary companies and properly calculated their apportioned business income.

Petitioners further claim they elected to apportion under MCL 205.581, Article III under the Uniform Division of Income for Tax Purposes Act (UDITPA). This section provides that ". . . a taxpayer may elect to apportion and allocate his income for Michigan income tax purposes under the provisions of UDITPA . . . [which] incorporates the unitary business concept for apportionment and provides for apportionment of the business income of a unitary business using the combined factors of the unitary business." (PB, p. 30) Petitioners contend that they notified Respondent of their election to apportion and allocate income under UDITPA at the

[7] Petitioners' Brief, p. 25 citing *Holloway, supra* at 831; *Jaffe, supra* at 119; *Glieberman, supra* at 3.

informal conference. (PB, p. 31) Petitioners also assert that at the informal conference, they requested, in the alternative, apportionment relief under MCL 206.195.[8]

Finally, Petitioners argue that the negligence penalty imposed should be waived because Petitioners exercised reasonable care in making their determinations of tax liability.

RESPONDENT'S CONTENTIONS

Respondent filed its Motion for Summary Disposition pursuant to MCR 2.116(C)(8) ". . . on the basis the Petitions in these consolidated matters fail to state a claim on which relief can be granted because the Legislature has not permitted the filing of individual income tax returns on a combined basis for multiple entities . . . including entities that have no business activity in the United States." [9] Respondent initially raises two issues: 1) Are individual taxpayers, at their own discretion, allowed to file combined returns for multiple entities, and 2) If individual taxpayers are allowed to file combined returns for multiple entities are they allowed to file on a worldwide basis, including in their returns income from companies that operate exclusively outside the United States.[10]

Respondent stipulates that the UBP is applicable to individuals under the income tax statutes but that the principle applies on a single-entity basis. Respondent contends that the Legislature has not authorized the filing of individual income tax returns on a combined basis for multiple entities. It maintains that "where the Legislature intends to allow or require the filing of combined returns for multiple entities, it knows how to do so." (RB, p. 8) It argues that the MITA "does not allow combined multi-entity apportionment for individual income taxes and . . . does not allow a Michigan taxpayer to include entities with no business activity in the United States in a combined filing."[11] Respondent contends that the MITA, repealed in MCL 206.335, expressly authorized corporations to file combined returns apportioning multiple entities, but it did not provide the same for individuals.[12] Respondent further contends that because ". . . the Legislature specifically included language in the [M]ITA authorizing Treasury to permit or require corporations to file on a combined basis but included no such language regarding individual filers, the use of combined multi-entity apportionment for individuals is prohibited pursuant to the legal maxim *expression unius est exclusion alterius.*"[13] (RR, p. 3)

Respondent cites *Michigan Assoc of Home Builders v Michigan Dep't of Labor and Economic Growth,* 481 Mich 496; 750 NW2d 593 (2008) to support this hypothesis. In *Michigan Assoc of Home Builders,* the Supreme Court of Michigan held that the express authorization of expansion of the record for contested cases, combined with the lack of such authorization for non-contested cases, barred the expansion of the record in non-contested cases. Simply put, Respondent

[8] Petitioners' Petitions, pp. 9 & 10
[9] Respondent's Motion for Summary Disposition
[10] Respondent's Brief in Support of Summary Disposition (RB), p. iii
[11] Respondent's Brief in Response to Petitioner's Motion for Summary Disposition (RR), p. 2
[12] MCL 206.335, repealed by 1975 PA 233, when the Legislature adopted the Single Business Tax Act.
[13] Defined as "[a] canon of construction holding that to express or include one thing implies the exclusion of the other, or of the alternative." Black's Law Dictionary (8th ed).

contends that because the Legislature expressly authorized Treasury to allow or require corporations to file combined returns and did not expressly allow non-corporations to file combined returns, non-corporations (including individuals) cannot file returns using combined multi-entity apportionment.

Respondent also points to the Single Business Tax Act (SBTA) and the Michigan Business Tax Act (MBTA) in support of its argument that the Legislature did not intend for individuals to file income tax returns using combined multi-entity apportionment. Specifically, Respondent refers to MCL 208.77,[14] which authorized Respondent to "permit or require the filing of combined returns for multiple entities, again for only corporations, under the SBTA." (RB, p. 6) It further looks to the MBTA, which expressly requires unitary business groups to file a combined return pursuant to MCL 208.1511.

Respondent maintains that the MITA "applies the unitary business principle on a single-entity basis in the filing of individual income taxes under [M]ITA 115, requiring apportionment of business income[15] to Michigan using property, payroll and sales factors." (RB, p. 7) Respondent stipulates that it does not contest whether the unitary business principle is applicable to individual income tax returns. "Section 115 of the Act requiring apportionment of the business income is just a straightforward application of the unitary business principle. The more subtle question and the question before this Tribunal is whether or not that applies to multi-entity apportionment."[16] Respondent argues it does not.

Respondent contends that Petitioners' reliance on *Holloway, Jaffe, and Glieberman* is misplaced. Specifically, Respondent argues that *Holloway* involved a corporation in existence at a time when the MITA specifically authorized combined multi-entity filings for corporations. Further, *Holloway* and *Jaffe* did not involve multi-entity filings and Respondent argues that *Glieberman* failed to recognize the nature of the decisions in *Holloway* and *Jaffe*, on which it relied.

Respondent further asserts that the MITA does not allow multiple-entity apportionment that includes companies that have no business activity in the United States. It contends that "[w]hile this form of apportionment is allowed under Supreme Court case law, there are very few states that use this approach and almost all of those that have used it have taken steps to pull back to a water's-edge formula." (RB, p. 10) Respondent argues that its long standing interpretation of the MITA apportionment statutes should not be expanded to include foreign companies with no business activity in Michigan or anywhere in the United States. It maintains that "[a]mong the problems that Michigan will encounter if the Tribunal expansively interprets Michigan apportionment statutes to include the payroll, property and sales of foreign companies that are operating exclusively in Europe are:

- The payroll, property and sales factor distortions that occur because of valuation differences.

[14] Repealed by 2006 PA 326, § 1.
[15] "Business income" means "all income arising from transactions, activities, and sources in the regular course of the taxpayer's trade or business . . . ." MCL 206.4(2)
[16] Transcript of Oral Argument (Trans), p. 34

- The factor distortions caused by accounting differences and foreign currency fluctuation.
- The ability of Treasury to access the books and records of wholly separate German Companies." (RB, p. 10)

Respondent further argues that Petitioners have failed to establish through affidavits and other materials that they are entitled to judgment as a matter of law in regard to whether Electro-Wire and TKG are unitary. Respondent supports this statement by noting that Electro-Wire acquired TKG in 1994 and sold the companies in 1995; therefore, the short period of time the companies were purportedly intertwined is definitive in its conclusion that the companies were not unitary businesses. Respondent maintains that Petitioners do not meet the test for determining whether businesses are unitary based on the totality of the circumstances evaluated under the enumerated five factors. (RR, p. 7)

Respondent contends that the ". . . economic reality is that [Petitioners] did not develop an American company and German companies that were bound together by the shared development of a uniform product and customer base. In fact, the German companies already were functioning in this business without any 'flow of value' from the American company." (RR, p. 8) Respondent further contends that there was not sufficient functional integration because there was no reliance by either Electro-Wire or TKG on each other for a supply of goods and there was not a pooling of products or services. Further, Respondent argues the management was not centralized because Electro-Wire did not engage in day-to-day management of TKG. Respondent also questions Petitioners' assertion that economies of scale were accomplished through Electro-Wire's acquisition. Specifically, Respondent states that ". . . the German companies purchased their own raw materials and other supplies form (sic) local suppliers. Further, the companies had no savings from consolidation of payroll, pensions, health care or pooled banking." (RR, p. 9) Finally, Respondent asserts that there was not substantial mutual interdependence between the companies. Respondent argues that TKG was already an established company that ran independently from Electro-Wire. Respondent concludes that Electro-Wire and TKG are not unitary and therefore Petitioners' Motion should be denied.

Respondent concedes that if it included the business income or losses of TKG in calculating Petitioners' business income it did so in error. Respondent contends that it recognized this potential error during discovery, indicated it to Petitioners' counsel, and requested Petitioners' tax returns for the years at issue so the inappropriate income or losses could be backed out of the calculations. Petitioners have not provided the necessary documentation.

Respondent further contends that the negligence penalty is supported because ". . . there was no reasonable basis for the Wheelers to conclude that they could file combined returns apportioning their income from the American and German companies." (RR, p. 12) Therefore, the negligence penalty should be affirmed.

FINDINGS OF FACT

Based on Petitioners' briefs, exhibits, affidavits, and oral argument, the Tribunal finds the following facts:

Electro-Wire's survival was dependent upon its relationship with its primary customer (80% of its sales), Ford. In response to pressures from Ford to have a worldwide presence, Electro-Wire's management felt that time was of the essence and they could not afford the lengthy process of an internal global expansion with a "Greenfield" operation. They determined that it needed to acquire an existing business within Europe that met certain characteristics including similar products, processes and equipment. They also looked for a business that had Ford as a customer and could accommodate a design and engineering interface with Ford Europe, and they wanted a business with a customer base beyond Ford to help it diversify and be less reliant on Ford. Electro-Wire identified a German subsidiary of Daimler Benz, TKG, as an appropriate fit and Electro-Wire consummated its acquisition of TKG on January 1, 1994.

The underlying activities of Electro-Wire and TKG were identical. Their markets were identical; they had a common customer within the marketplace, and the two entities had manufacturing activities in low cost countries to reduce labor costs. All material business decisions of Electro-Wire and TKG were made by Electro-Wire's officers/managers. Despite using local material suppliers and service providers, both entities used copper wire as a material component to their manufacturing process. TKG's presence and success in Europe was critical to Electro-Wire, without which Electro-Wire most likely would have been eliminated as one of Ford's suppliers.

As part of the Daimler Group, TKG did not maintain within its organization many of the functions of a stand-alone entity or that of a full service supplier. After its acquisition by Electro-Wire, TKG severed ties with Daimler Group and all functions and services were primarily supplied through Electro-Wire's key management employees in the U.S., who provided executive oversight and responsibility for TKG's business affairs. The management of TKG in Germany was performed the same as all other operating facilities of Electro-Wire; that is, each production facility was centrally managed and retained minimal staff. While some sales and marketing activities were conducted by TKG due to the proximity to its principle customers, final sales decisions and all product development and engineering were performed centrally at Electro-Wire's division headquarters in the U.S.

TKG's overall management decisions including marketing strategies/business development, price/cost estimating/quoting, financial and capital budgeting, product engineering, etc., were centralized and made in the U.S. by Electro-Wire managers to promote uniformity. Electro-Wire not only hired and fired all officers and managers for its U.S. operations, but also made final hiring decisions for TKG in Germany. Petitioners provided a percentage breakdown of time that seven joint officers/managers spent on matters related to TKG. The percentages ranged from 15% to 100%. TKG's accounting records were maintained separately but integrated into Electro-Wire's financial system at the end of each month for a consolidated set of financial statements.

An economic interrelationship existed between the operations of Electro-Wire and TKG based on a transfer of knowledge and expertise with respect to the manufacturing of electrical distribution systems. Various functions or departments (employees) of Electro-Wire were utilized in operating and enhancing TKG's business, avoiding the need to hire additional personnel at TKG to acquire such knowledge or expertise. Among others, TKG utilized the following resources of Electro-Wire: business development/sales and marketing, design and engineering, cost estimating, program management, supervision of manufacturing operations and processes, finance, and quality. TKG began to incorporate Electro-Wire's component manufacturing capabilities into existing and new products developed in Europe. On the flip side, Electro-Wire benefited by TKG's relationships with non-Ford customers, providing it with opportunities to identify and bid on new automotive and heavy truck business in the U.S., specifically BMW in Spartanburg, South Carolina.

TKG was critical to Electro-Wire's economic survival in that Ford, its largest and primary customer, would have eliminated Electro-Wire as one of its four remaining global wire harness suppliers without the TKG international operations. There existed a substantial flow of value from Electro-Wire to TKG on both an economic interrelationship and facilitation of each other's businesses based upon a transfer of knowledge and expertise. Electro-Wire's success was clearly dependent upon the stability and success of TKG.

Electro-Wire sold substantially all of its assets in 1995.

APPLICABLE LAW

A motion for summary disposition under MCR 2.116(C)(10) tests the factual support for a claim and must identify those issues regarding which the moving party asserts there is no genuine issue of material fact. Under subsection (C)(10), a motion for summary disposition will be granted if the documentary evidence demonstrates that there is no genuine issue of material fact, and the moving party is entitled to judgment as a matter of law. *Smith v Globe Life Insurance*, 460 Mich 446, 454-455; 597 NW2d 28 (1999). In the event, however, it is determined that an asserted claim can be supported by evidence at trial, a motion under subsection (C)(10) will be denied. *Arbelius v Poletti*, 188 Mich App 14; 469 NW2d 436 (1991).

The Michigan Supreme Court has established that a court must consider affidavits, pleadings, depositions, admissions, and documentary evidence filed by the parties in the light most favorable to the non-moving party. *Quinto v Cross & Peters Co*, 451 Mich 358, 362-63; 547 NW2d 314 (1996) (citing MCR 2.116(G)(5)). The moving party bears the initial burden of supporting his position by presenting his documentary evidence for the court to consider. *Neubacher v Globe Furniture Rentals*, 205 Mich App 418, 420; 522 NW2d 335 (1994). The burden then shifts to the opposing party to establish that a genuine issue of disputed fact exists. *Id*. Where the burden of proof at trial on a dispositive issue rests on a nonmoving party, the nonmoving party may not rely on mere allegations or denials in pleadings, but must go beyond the pleadings to set forth specific facts showing that a genuine issue of material fact exists. *McCart v J Walter Thompson*, 437 Mich 109, 115; 469 NW2d 284 (1991). If the opposing party fails to present documentary evidence establishing the existence of a material factual dispute, the

motion is properly granted. *McCormic v Auto Club Ins Ass'n*, 202 Mich App 233, 237; 507 NW2d 741 (1992).

Respondent also moves for summary disposition pursuant MCR 2.116(C)(8), which provides for the granting of the motion if "the opposing party has failed to state a claim on which relief can be granted." Motions for summary disposition under MCR 2.116(C)(8) are to be decided on the pleadings alone. Summary disposition should be granted when the claim, based solely on the pleadings, is so clearly unenforceable that no factual development could possibly justify a right to recovery. *Transamerica Ins Group v Michigan Catastrophic Claims Ass'n*, 202 Mich App 514, 516; 509 NW2d 540 (1993). In reviewing a motion for summary disposition under section (C)(8), the court must accept as true all factual allegations in support of a claim, as well as all inferences that can fairly be drawn from the facts. *Meyerhoff v Turner Construction Co*, 202 Mich App 499, 502; 509 NW2d 847 (1993).

CONCLUSIONS OF LAW

Michigan imposes an income tax upon "the taxable income of every person other than a corporation."[17] In this case, the "persons" subject to tax are individuals and the estate of an individual. Business income of individuals must be apportioned if earned both within and without Michigan. Section 4 of the MITA, MCL 206.4(2) defines "business income" as "income arising from transactions, activities and sources in the regular course of the taxpayer's trade or business and includes all income from tangible and intangible property if the acquisition, rental, management, or disposition of the property constitutes integral parts of the taxpayer's regular trade or business operations." There is nothing in the statute that limits a taxpayer's trade or business solely to activities carried on within a single entity.

The first issue in this appeal is whether the UBP applies to Michigan's Income Tax Act. However, the parties, at oral argument, have agreed that the unitary business principle is applicable to individuals under MITA section 115, which provides:

> All business income, other than income from transportation services shall be apportioned to this state by multiplying the income by a fraction, the numerator of which is the property factor plus the payroll factor plus the sales factor, and the denominator of which is 3.[18]

Although Respondent concedes that the UBP does apply to individual income tax, it argues the concept only applies at a separate legal entity level. This contradicts the fundamental meaning of the principle as it is not something that is distinguished by the entity but rather by the total business activity – the taxpayer's business activity. Respondent provides no rational explanation as to why it must be applied at the entity level except to argue that Respondent has never interpreted it that way. Respondent also argues that the Legislature did not choose to tax foreign source income. However, the statute says "[f]or a resident individual, estate or trust, **all taxable**

[17] MCL 206.51
[18] MCL 206.115

income from any source whatsoever, except that attributable to another state . . . is allocated to this state." (Emphasis added)[19] Taxable income is defined under MCL 206.30 as "adjusted gross income as defined in the internal revenue code. . ." subject to certain adjustments. None of those adjustments exclude distributive share of income or loss from a flow through entity located or generating income outside the U.S. Further, the term "state" is defined as "any state of the United States, the District of Columbia, the Commonwealth of Puerto Rico, any territory or possession of the United States and **any foreign country**, or political subdivision, thereof." [20] [Emphasis added] The Tribunal finds Respondent's arguments are meritless; Respondent has failed to persuade the Tribunal that the UBP applies on a separate legal entity level only.

The remaining issues for the Tribunal to decide are (1) whether the unitary business principle, as applied to the Michigan income tax, requires combining the apportionment factors of separate legal entities, one of which was not in and of itself doing business in Michigan and (2) whether the business activities of Electro-Wire and TKG were sufficient during the years at issue to result in a unitary business.

It is well established that business income is generally apportioned between Michigan and other states rather than allocated. Specifically, "[a]ny taxpayer having income from **business activity** which is taxable **both within and without this state** . . . shall allocate and apportion his **net income** as provided in this act."[21] [Emphasis added] While, as a general principle a state may not tax value earned outside of its borders, it has been long established that the income of a business operating in interstate commerce is not immune from fairly apportioned state taxation. *Mobil Oil Corporation v Commissioner of Taxes of Vermont*, 445 US 425 (1980). The Due Process clause of the Fourteenth Amendment imposes two requirements on a state in order to tax income generated in interstate commerce: (1) a minimal connection between the interstate activities and the taxing state and; (2) a rational relationship between the incomes attributed to the state and the intrastate values of the enterprise. *Mobil, supra* at 437-38. For purposes of satisfying the Due Process clause, the "linchpin of apportionability in the field of state income taxation is the unitary business principle" which requires that the taxpayer's intrastate and extra state activities form part of a single unitary business. *Id.*, at 439.

The question becomes what factors are used to apportion business income. The definition of business income indicates that business income is apportioned based on the taxpayer's "trade or business." To the extent that the trade or business constitutes a unitary business conducted in one or more states and/or by one or more legal entities, it is the apportionment factors of that unitary business that are utilized to apportion the income to Michigan. Even though TKG had no business activities in Michigan on a separate entity basis, it was the unitary relationship with Electro-Wire (which had business activities in Michigan) that represents the trade or business of Petitioners and the UBP to determine Petitioners' apportioned business income is mandatory.

On the one hand, Respondent claims the UBP does not apply because the legislature chose not to apply the tax to the fullest degree allowable under the Constitution, but then states "we clearly

[19] MCL 206.110(1)
[20] MCL 206.20
[21] MCL 206.103

recognize the UBP applies to the individual income tax to the extent of apportionment required by the statute, but the legislature has never authorized combining factors from separate entities and certainly the constitution does not require it." (Trans, p. 70) Respondent also claims that it allows the application of the unitary business principle, by allowing apportionment of the non-German income, but that the principle cannot be allowed to combine the factors of multiple companies.

The U.S. Supreme Court cases are clear; neither the taxpayer nor the revenue authorities can pick and choose what income goes into the unitary business. The unitary business group is determined, and then all of the income is combined and the combined factors are applied to that income.

In both *Holloway, supra* and *Jaffe, supra,* the Michigan Court of Appeals adopted the unitary principle applying the five-factor test enumerated in *Holloway* to determine if the necessary connection was present. *Holloway* involved a claim that a Michigan sand and gravel business and a division of its business in Texas were unitary. Although the Court of Appeals concluded that there was not sufficient evidence to treat the two businesses as unitary, it affirmed the Tribunal's determination that if a taxpayer's businesses are unitary, apportionment of its multistate business income is required for purposes of computing its Michigan income tax.

Further, in *Jaffe, supra* the Tribunal and the Court of Appeals applied the UBP to the MITA. *Jaffe* involved two businesses, one an advertising business in Michigan and the other a cattle business in Texas. The taxpayer argued the businesses were unitary and sought to offset the losses of the cattle business against the profits of his advertising business. The Tribunal held that a unitary business may apportion its net business income through the adoption of The Uniform Division of Income for Tax Purposes Act (UDITPA). The taxpayer was unable to establish its businesses were unitary; however, the Tribunal and Court of Appeals concluded that if the taxpayer's businesses were unitary, apportionment of its multi-state business income is required for purposes of computing its Michigan individual income tax. In *Glieberman*, s*upra,* the Tribunal again held that if the businesses were unitary, application of the apportionment formula would be appropriate.

Respondent argues that foreign source income cannot be taxed under Michigan law and that it can be geographically sourced. It further argues that "the Michigan Legislature has not chosen to allow the combining of overseas entities in calculating individual income tax liability." (Trans, p. 43) Respondent argues that there is a constitutional limit on the State's authority to tax and that limit has been made clear by the U.S. Supreme Court, but "the State has not chosen to tax to the constitutional limit" that it could. (Trans, pp. 41 & 42) Respondent argues that "[w]hile this form of apportionment is allowed under Supreme Court case law, there are very few states that use this approach and almost all of those that have used it have taken steps to pull back to a water's-edge formula." (RB, p. 10) This is seen in the enactment of the new Michigan Business Tax. The Tribunal finds Respondent's contentions meritless. The U.S. Supreme Court in *Mobil Oil, supra,* decided that even though income is from a foreign source, if it is part of a unitary business, the only way to properly determine the amount of the income is to look at the income of the unitary business in its entirety. *Mobil Oil* is clear; foreign source income is included in the

tax base of a unitary business unless a state statute expressly excludes it. There is no express Michigan statute that excludes foreign source income; as such the factors of a unitary business shall be used on a world-wide basis.

The Tribunal must now consider whether Electro-Wire and TKG were engaged in a unitary business during the years at issue. Petitioners submitted affidavits of Bruce Landino, Executive Vice President, and John Sammut, Director of Business Development for TKG, along with a 22-page analysis demonstrating that Electro-Wire and TKG were engaged in a unitary business during the years at issue. Petitioners applied each of the five factors delineated in *Holloway* and reiterated in *Jaffe* to the relationship between Electro-Wire and TKG. Respondent did not object or otherwise attempt to dispute the credibility of the affidavits. Petitioners effectively demonstrated the existence of a unitary business between the two businesses based on the five unitary factors.

Based on the Tribunal's findings of fact, Petitioners have established that they met at least four of the five factors. First, the businesses must have economic realities, meaning the regularly conducted activities were related to each other. The underlying activities of Electro-Wire and TKG were identical. TKG's presence and success in Europe was critical to Electro-Wire, without which Electro-Wire most likely would have been eliminated as one of Ford's suppliers. Electro-Wire would not have been a viable entity without its relationship with TKG. The regularly conducted businesses of the two entities were obviously related.

Next, the business must have functional integration or a blending of business functions to promote a unitary relationship. All functions and services were primarily supplied through Electro-Wire's key management employees in the U.S. who provided executive oversight and responsibility for TKG's business affairs. The business functions of the two entities were blended to create one unitary business.

Electro-Wire and TKG's management must also be centralized. TKG's overall management decisions, including marketing strategies/business development, price/cost estimating/quoting, financial and capital budgeting, product engineering, etc., were centralized and made in the U.S. by Electro-Wire managers. There is a significant overlap of officers and managers resulting in centralized management.

Further, the consolidated operations and overlap in functions and activities of the businesses resulted in a tangible economic benefit to TKG and Electro-wire (i.e., economies of scale). Economies of scale exist when companies combine efforts to achieve significantly lower unit costs by spreading fixed costs over a greater volume.[22] An economic interrelationship existed between the operations of Electro-Wire and TKG based on a transfer of knowledge and expertise with respect to the manufacturing of electrical distribution systems. Clearly, the facts demonstrate that the business relationship between the two entities resulted in significant benefits, the least of which was economic survival.

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[22] *Reynolds Metals Company, LLC v Department of Treasury*, Court of Claims 08-68-MT, p. 8

Finally, the businesses must prove there was substantial material interdependence. TKG was critical to Electro-Wire's economic survival in that Ford, its largest and primary customer, would have eliminated Electro-Wire as one of its suppliers without the TKG international operations. Electro-Wire's success was clearly dependent upon the stability and success of TKG. The evidence is unclear as to whether TKG was dependent on Electro-Wire and if so, to what extent.

Holloway does not make clear whether all factors must be satisfied, but *Jaffe* held that the existence of only one was insufficient. The Tribunal concludes that Petitioners have sufficiently proven that four of the five factors have been met and Electro-Wire and TKG are unitary businesses.

Respondent, in its response to Petitioners' Motion for Summary Disposition, argued that:

> It is important to note that the American company acquired the German companies in 1994 and the Wheelers sold the companies in 1995. The question is whether the three entities became so intertwined in such a short period of time that the task of assigning income among the various states becomes difficult, if not impossible.

The Tribunal concludes that Respondent's argument is meritless as this time period is not determinative of whether Electro-Wire and TKG were unitary. The Tribunal has analyzed the relevant factors and Petitioners' evidence and determined that Electro-Wire and TKG were unitary during the period at issue. The Tribunal further concludes that Petitioners properly utilized the apportionment factors of the entire unitary business to apportion their income to the State of Michigan.

Since the Tribunal has determined that the UBP applies to income taxes, Petitioners' foreign source income is includable, and Electro-Wire and TKG are unitary, it is unnecessary to consider Petitioners' alternative contention that it properly determined their apportioned income from the unitary group because it elected to apportion under MCL 205.582, Article III (UDITPA). Further, Respondent raised a new issue regarding whether Petitioners may file combined income tax returns. Petitioners have indicated that they do not seek combined filing of their income tax returns. As such, the Tribunal finds that analysis of this issue is unnecessary.

Notwithstanding the above, costs do not appear to be warranted under the current circumstances of the case.

JUDGMENT

IT IS ORDERED that Petitioners' Motion for Summary Disposition is GRANTED.

IT IS FURTHER ORDERED that Respondent's Motion for Summary Disposition is DENIED.

IT IS FURTHER ORDERED that Respondent's Final Assessment Nos. J939193, J932896, J932903, and J939139 are CANCELLED.

IT IS FURTHER ORDERED that the officer charged with refunding the affected taxes, interest, or penalties shall issue any applicable refunds within 28 days of the entry of this Final Opinion and Judgment.

MICHIGAN TAX TRIBUNAL

By Cynthia J Knoll

Entered: January 5, 2011
cjk/sms