

MBT-Unitary Business Group - Control & Relationship Tests

Under the Michigan Business Tax ("MBT") effective from January 1, 2008 a unitary business group is a single taxpayer and must file a combined return. Described below in brief are the tests that will aid a business group in determining if their operations satisfy the criteria for a unitary business. Under MBT, a unitary business group is two or more persons that satisfy both a control test and one of two relationship tests. Foreign persons and foreign operating entities cannot be included in a unitary business group.

UNITARY BUSINESS GROUP DEFINED

Under the MBT, a unitary business group is defined 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 with voting rights or ownership interests that confer comparable rights to voting rights of the other United States persons, and that has business activities or operations which result in a flow of value between or among persons included in the unitary business group or has business activities or operations that are integrated with, are dependent upon, or contribute to each other. For purposes of this subsection, flow of value is determined by reviewing the totality of facts and circumstances of business activities and operations. Thus, a group of U.S. persons must meet both a control test and one of two relationship tests before that group will be a unitary business group.

CONTROL TEST

If the same person (and/or any related persons) holds directly or indirectly more than 50% of the voting control of a corporation (a "parent corporation"), that person shall be considered to hold indirectly any stock or other interest in ownership or control in a lower-tier corporation (a "subsidiary corporation") that is directly or indirectly held by the parent corporation. Thus, by way of illustration, a parent corporation and any one or more corporations (whether or not in a direct chain) connected through direct or indirect stock ownership, where more than 50% of the voting control of each subsidiary corporation is directly or indirectly owned by a corporation (and/or any related persons), are treated as commonly owned or under common ownership, and subject to inclusion in a combined group.

THE TWO ALTERNATIVE RELATIONSHIP TESTS

The definition of a unitary business group requires, in addition to satisfying the control test, that the group of persons have business activities or operations that either:

1. Result in a flow of value between or among persons in the group, **or**
2. Are integrated with, dependent upon, or contribute to each other.

A taxpayer need only meet one of the two alternative tests to satisfy the relationship test.

Flow of Value Test

The United States Supreme Court described a unitary business as a functionally integrated enterprise whose parts are mutually interdependent such that there is a flow of value between them. There must exist some sharing or exchange of value not capable of precise identification or measurement beyond the mere flow of funds arising out of a passive investment. In determining whether a flow of value exists, a relevant question in the inquiry is whether contributions to income resulted from "functional integration," "centralization of management," and "economies of scale." No one fact is determinative of whether functional integration, centralization of management or economies of scale exist. Rather, the statute requires that the totality of facts and circumstances surrounding the business activities and operations be weighed and examined for cumulative effect.

Contribution/Dependency Test

The alternate "contribution/dependency" relationship test asks whether business activities are integrated with, dependent upon or contribute to each other. Business activities that are dependent upon or that contribute to the income or value of the whole demonstrate operations that are engaged in a unitary business. The focus is on whether one entity's business activity is dependent on the business activity of another entity or whether the activity of one entity contributes to the activity or operations of another entity. This occurs under many of the same circumstances as the flow of value test. Where the facts indicate that business activities are conducted and

managed under one centralized system there is evidence that the entities are dependent upon each other or that they contribute to each other such that the elements of a unitary business group are present.

Instant Unity: When a Unitary Relationship is Established

Whether the unitary relationship can arise "instantly" is dependent on the surrounding facts and circumstances. Instant unity refers to the situation where a new entity is acquired or formed by another entity and the new entity establishes a unitary relationship the instant the entity is formed or the stock or assets are acquired. A unitary relationship may take time to develop whenever an entity acquires another. This may be so even if the entities are in the same business and are complementary. Many times, the integration of the acquired entity will occur over a period of time and it will continue to operate independently. Such autonomous operation may require a longer period of time for the unitary relationship to develop. In contrast, the acquisition of an entity where there was a pre-existing relationship may support a finding of an instant unitary relationship.

On the other hand, when a new entity is formed, there may be a financial infusion of capital, the transfer of personnel, transfer of intangibles and knowledge, pooling of expertise, pooled marketing and shared use of established policies, procedures and administrative plans. These factors would tend to support a conclusion that an "instant" unitary relationship exists.

CONCLUSION

As states face record budget shortage, they are looking for additional sources of revenue. In addition to raising corporate tax rates, more and more states are moving towards combined reporting. With so many states seeking revenues from multiple sources to meet budget deficits, a move to combined reporting remains a potential in almost any separate filing state. It is important therefore for the taxpayer to understand complexities of indentifying if business group qualifies as unitary and as a result becomes liable to file a combined return. Presented above are the tests which Michigan Department of Treasury adheres to for determining unitary status, but most other states following combined reporting subscribe similar guidelines.

Source: Michigan Department of Treasury

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