STATE OF MICHIGAN

COURT OF APPEALS

HANDLEMAN COMPANY, HANDLEMAN CATEGORY MANAGEMENT COMPANY, HANDLEMAN ENTERTAINMENT RESOURCES, L.L.C., and HANLEY ADVERTISING COMPANY,	UNPUBLISHED September 21, 2010
Plaintiffs-Appellees,	
v	No. 291178 Court of Claims
DEPARTMENT OF TREASURY,	LC No. 07-000124-MT
Defendant-Appellant.	

Before: FORT HOOD, P.J., and BORRELLO and STEPHENS, JJ.

PER CURIAM.

In this case brought under Michigan's Single Business Tax Act (SBTA) MCL 208.1 *et seq.*, repealed by 2006 PA 325, plaintiffs appeal as of right from an order of the Court of Claims that granted in part and denied in part plaintiffs' motion for summary disposition and that granted in part and denied in part defendant's request for summary disposition. The court held that Handleman Entertainment Resources, LLC ("HER, LLC") and Handleman Category Management Company could be included in the Handleman consolidated group for the fiscal year ending April 30, 2006, but that Hanley Advertising Company was not to be included in the Handleman consolidated group for fiscal year ending April 30, 2006. We affirm.

Defendant argues on appeal that plaintiffs are not eligible to file a consolidated return because HER, LLC is not a corporation and because the collective group does not qualify as an "affiliated group" since HER, LLC does not issue "capital stock with voting rights" as required under MCL 208.3(1). We disagree.

We review de novo a trial court's decision on a motion for summary disposition and questions of statutory interpretation. *Collins v Comerica Bank*, 468 Mich 628, 631; 664 NW2d 713 (2003); *In re MCI Telecommunications*, 460 Mich 396, 413; 596 NW2d 164 (1999). A motion for summary disposition under MCR 2.116(C)(10) tests the factual sufficiency of the complaint. *Maiden v Rozwood*, 461 Mich 109, 120; 597 NW2d 817 (1999). Summary disposition should be granted under MCR 2.116(C)(10) if there is no genuine issue of material fact and the moving party is entitled to judgment as a matter of law. *Babula v Roberson*, 212 Mich App 45, 48; 536 NW2d 834 (1995).

Under the SBTA, an affiliated group is entitled to file a consolidated return. MCL 208.77. MCL 208.3(1) defines an affiliated group as:

> (1) "Affiliated group" means 2 or more United States corporations, 1 of which owns or controls, directly or indirectly, 80% or more of the capital stock with voting rights of the other United States corporation or United States corporations. As used in this subsection, "United States corporation" means a domestic corporation as those terms are defined in section 7701(a)(3) and (4) of the internal revenue code.

The SBTA relies, in large part, on the federal Internal Revenue Code (IRC). "For ease of administration . . . the SBTA uses the federal income tax system as a reference and starting point, and through various required additions and subtractions, converts the federal tax base into a consumption-type [value-added tax] VAT base." *Mobil Oil v Dep't of Treasury*, 422 Mich 473, 497; 373 NW2d 730 (1985). MCL 208.2 provides that terms used in the SBTA that are 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 year unless a different meaning is clearly required." Both MCL 208.3 and MCL 208.77 explicitly refer to Sections 7701(a)(3) and (4) of the IRC for a definition of "United States corporation." Those sections provide:

> (3) The term "corporation" includes associations, joint-stock companies, and insurance companies.
>
> (4) The term "domestic" when applied to a corporation or partnership means created or organized in the United States or under the law of the United States or of any State unless, in the case of a partnership, the Secretary provides otherwise by regulations. [IRC § 7701(a).]

The regulations for the above-mentioned section first indicate that, for federal tax purposes, a business entity is either a corporation or a partnership. IRC § 301.7701-2(a). A corporation is defined, in part, as: "An association (as determined under § 301.7701-3)." IRC § 301.7701-2(b)(2). IRC § 301.7701-3 provides:

> (a) *In general.* A business entity that is not classified as a corporation under section 301.7701-2(b)(1), (3), (4), (5), (6), (7), or (8) (an eligible entity) can elect its classification for federal tax purposes as provided in this section. An eligible entity with at least two members can elect to be classified as either an association (and thus a corporation under section 301.7701-2(b)(2)) or a partnership, and an eligible entity with a single owner can elect to be classified as an association or to be disregarded as an entity separate from its owner.

Thus, based on the language in the regulation above, a business entity that *elects* to be an association for federal tax purposes is considered a corporation under § 301.7701-2(b)(2). Nevertheless, "[n]either the SBTA nor the federal regulations require an entity to be consistent in its self-classification with respect to its state and federal tax filings for a given year." *Kmart Michigan Prop Services, LLC v Dep't of Treasury*, 283 Mich App 647, 655; 770 NW2d 915 (2009).

This Court has recently considered the tangential issue of whether an LLC could be taxed as a corporation for state law purposes. *Alliance Obstetrics & Gynecology v Dep't of Treasury*, 285 Mich App 284, 285; 776 NW2d 160 (2009). In *Alliance*, the plaintiff argued that its federal election to be taxed as a corporation did not mandate its state tax treatment, and thus did not prevent it from being taxed as an individual entity, which allowed it to take advantage of the small business credit under the SBTA. *Id*. at 285. In contrast, the defendant interpreted the SBTA small business tax credit as adopting the federal "check-the-box" system, asserting that the plaintiff's decision to be treated as a corporation for federal tax purpose was a binding classification for SBTA purposes, which would disqualify the plaintiff from obtaining the small business credit. *Id.*

The *Alliance* Court agreed with the plaintiff. The Court first recognized that "corporation" was not defined in the SBTA, and it declined to adopt the federal IRC definition. *Id.* at 287. The Court concluded that an organization could not be forced to be taxed as an entity that is inconsistent with its business structure, regardless of its federal filing classification. *Id.* at 288. The Court further stated that "plaintiff is an LLC, and LLCs are not corporations under Michigan law." *Id.*

Like the plaintiff in *Alliance*, plaintiff HER, LLC is an LLC that chose to be taxed as a corporation for federal tax purposes. However, this is where the cases diverge. In the instant case, plaintiffs are seeking to continue to be considered a corporation for state tax purposes. Also unlike *Alliance*, this case deals with a direct tax and not a tax credit, thus providing a different level of deference in how the statute is construed. Moreover, the tax credit statute in *Alliance*, MCL 208.36, did not specifically state that the federal IRC would govern for purposes of the definition of a "corporation," whereas both sections at issue here included language that the definition of a corporation should be found in the IRC.

"Tax laws generally will not be extended in scope by implication or forced construction. When there is doubt, tax laws are to be construed in favor of the taxpayer." *Sharper Image Corp v Dep't of Treasury*, 216 Mich App 698, 702; 550 NW2d 596 (1996). When a tax statute grants tax credits or exemptions, the statute is to be narrowly construed in favor of the taxing authority because such statutes reduce the amount of tax imposed. *Alliance*, 285 Mich App at 286. Thus, to the extent that plaintiffs are challenging their tax liability, the tax laws are to be construed in their favor. And to the extent that the plaintiff in *Alliance* was challenging the tax *credit*, it was appropriate for the Court to construe that law in favor of the defendant.

The goal in statutory construction is to discern and give effect to the Legislature's intent. *Neal v Wilkes*, 470 Mich 661, 665; 685 NW2d 648 (2004). The intent of the Legislature is most reliably evidenced through the words used in the statute. *Id*. If the language in the statute is unambiguous, judicial construction is neither required nor permitted. *Nastal v Henderson & Assoc Investigations, Inc*, 471 Mich 712, 720; 691 NW2d 1 (2005), citing *Sun Valley Foods Co v Ward*, 460 Mich 230, 236; 596 NW2d 119 (1999). However, if a statute is ambiguous, judicial construction is appropriate. *Adrian School Dist v Michigan Pub School Employees Retirement Sys*, 458 Mich 326, 332; 582 NW2d 767 (1998). A statute is ambiguous "only if it 'irreconcilably conflict(s)' with another provision or when it is *equally* susceptible to more than a single meaning." *Fluor Enterprises, Inc v Dep't of Treasury*, 477 Mich 170, 177-178 n 3; 730 NW2d 722 (2007) (emphasis in original), quoting *Lansing Mayor v Pub Service Comm*, 470 Mich 154, 166; 680 NW2d 840 (2004).

"[T]his Court 'must follow the rule of law established by a prior published decision. . . .'" See *People v Petros*, 198 Mich App 401, 407 FN3; 499 NW2d 784 (1993), quoting Administrative Order No 1990-6, 436 Mich lxxxiv. However, because of the differences in the language of the SBTA section at issue in *Alliance*, MCL 208.36, and the relevant SBTA language at issue in this case, MCL 208.3 and MCL 208.77, this Court is not bound by the *Alliance* decision. The rule of law established in *Alliance* need not be extended to a factual scenario dealing with a direct tax, but instead should be limited to the specific tax credit at issue in that case. Therefore, because the statute at issue in this case specifically points to the IRC for the definition of a corporation, that definition should govern. Thus, plaintiff HER, LLC may be considered a corporation based on its election to be an association for federal tax purposes under IRC § 7701(a)(3).

The next inquiry is whether plaintiffs are an "affiliated group" that controls "80% or more of the capital stock with voting rights of the other United States corporation or United States corporations." Again, according to MCL 208.2, terms used in the SBTA that are 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 year unless a different meaning is clearly required." There is no comparable use of "capital stock with voting rights" in the IRC, although it does state that "[t]he term "stock" includes shares in an association, joint-stock company, or insurance company." IRC § 7701(a)(7). Therefore, the shares in HER, LLC can be considered stock for purposes of MCL 208.3.

The full phrase "capital stock with voting rights" is a designation used exclusively for a traditional corporation, since other business entities will not issue stock with voting rights. An LLC, for example, will have varying membership interests (shares), depending on how the operating agreement has been structured. Here, defendant does not argue that Handleman Company does not control 80 percent of HER, LLC and Handleman Category Management Company; it merely asserts that the LLC does not have capital stock with voting rights, and therefore these companies cannot be considered an affiliated group.

The MCL 208.3(1) definition of an affiliated group is ambiguous in regard to how an association without voting stock should be taxed. On one hand, the statute specifically points to the IRC for its definition of a United States corporation, which includes an association. As discussed above, an LLC can be an association if it elects to be taxed as a corporation for federal tax purposes. On the other hand, the statute also requires one corporation to have "80% or more of the capital stock with voting rights" of a second corporation in order to have an affiliated group.

Defendant argues that to read MCL 208.3 to include an LLC as a corporation would render the words "capital" and "with voting rights" nugatory. Plaintiffs counter argue that to exclude the subset of "associations" from the definition of "corporation," would cause the language within the statute that points to IRC §§ 7701(a)(3) and (4) to be surplusage.

In construing a statute, this Court must presume that every word has some meaning, and this Court should avoid any construction that would render any part of a statute surplusage or nugatory. *Jenkins v Patel*, 471 Mich 158, 167; 684 NW2d 346 (2004); *People v Borchard-Ruhland*, 460 Mich 278, 285; 597 NW2d 1 (1999). However, because of the language of the SBTA, the construction proposed by defendant would cause there to be surplusage language in

the statute. The alternate reading of MCL 208.3, which would exclude all associations from being corporations, would entirely disregard the statutory language that points to the federal definition of "corporation."

The modifier used in this statute "with voting rights" presumably ensures that the first corporation has actual control over the second corporation. An entity with 80 percent stock in a second company is meaningless if the stock is nonvoting stock. To have control, it is imperative that the stock has voting rights. Without a vote, there is no control. In the same manner, an LLC with membership interests that do not provide control to the members would not meet this requirement. Clearly, the Legislature has written the SBTA to include inconsistent language, thus requiring judicial construction.

A statute should be construed "'as a whole to harmonize its provisions and carry out the purpose of the Legislature.'" *Nowell v Titan Ins Co*, 466 Mich 478, 482 n 5; 648 NW2d 157 (2002), quoting *Macomb Co Prosecutor v Murphy*, 464 Mich 149, 159; 627 NW2d 247 (2001). "Statutes should be construed so as to prevent absurd results, injustice, or prejudice to the public interest." *McAuley v Gen Motors Corp*, 457 Mich 513, 518; 578 NW2d 282 (1998), citing *Franges v Gen Motors Corp*, 404 Mich 590, 612; 274 NW2d 392 (1979); see also *Detroit Int'l Bridge Co v Commodities Export Co*, 279 Mich App 662, 675; 760 NW2d 565 (2008) ("a statute need not be applied literally if no reasonable lawmaker could have conceived of the ensuing result").

In reading this statute from that perspective, the Legislature pointed to the IRC for a definition of "corporation," which includes associations in the class of corporations, even though they do not issue "capital stock with voting rights." Because the statute specifically points to the federal code for guidance relative to what a corporation is, it would be unreasonable to presume that the Legislature did not intend to use that definition. When there is doubt, tax laws are to be construed in favor of the taxpayer. *Sharper Image Corp*, 216 Mich App at 702. Thus, in an effort to reconcile this seeming inconsistency, and to examine the statute as a whole in accordance with the IRC, MCL 208.2, we read the definition of an affiliated group to include both traditional corporations and associations, provided that one corporation/association has an 80 percent control over another.[1]

In their complaint, plaintiffs submitted that Handleman Company owned at least an 80 percent interest in Handleman Category Management Company and HER, LLC. Defendant failed to counter the assertion of 80 percent ownership of Handleman Category Management Company and HER, LLC; it merely contended that plaintiffs did not meet the "affiliated group" requirement since HER, LLC did not issue capital stock with voting rights.

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[1] We also note that this construction of the statute is consistent with the legislative purpose. Facilitation of consolidated filing was designed to encourage multistate corporations to remain in this state or to build new production facilities in Michigan. *W R Grace & Co v Dep't of Treasury*, 115 Mich App 69, 72; 320 NW2d 62 (1982).

Affirmed.

/s/ Karen M. Fort Hood
/s/ Stephen L. Borrello
/s/ Cynthia Diane Stephens