STATE OF MICHIGAN

COURT OF APPEALS

LARRY J. WINGET and ALICIA J. WINGET, Petitioners-Appellants,	UNPUBLISHED December 5, 2013
v	No. 302190 Tax Tribunal
DEPARTMENT OF TREASURY, Respondent-Appellee.	LC No. 00-319852

ON REMAND

Before: TALBOT, P.J., and WILDER and RIORDAN, JJ.

PER CURIAM.

Previously, in *Winget v Dep't of Treasury*, unpublished opinion per curiam of the Court of Appeals, issued October 16, 2012 (Docket No. 302190), we affirmed the order of the Michigan Tax Tribunal (MTT) affirming respondent's assessments for tax years 2001 and 2002. Our Supreme Court vacated our opinion and remanded for us to reconsider the issue in light of its decision in *Malpass v Dep't of Treasury*, 494 Mich 237; 833 NW2d 272 (2013). *Winget v Dep't of Treasury*, ___ Mich ___ (Docket No. 146218, order entered September 30, 2013). For the reasons set forth below, we again affirm.

Petitioner Larry Winget is the sole shareholder of several subchapter S corporations. Most of the S corporations operate exclusively within Michigan, but during the tax years at issue, two or three S corporations had multistate operations. Petitioners determined their Michigan income tax liability by combining the property, payroll, and sales figures for all of the S corporations to calculate a single apportionment percentage. Petitioners applied this apportionment percentage to each of the S corporations. After reviewing petitioners' tax returns for tax years 2001 and 2002, respondent concluded that petitioners should have calculated and applied separate apportionment percentages for each of the S corporations. The MTT ruled in favor of respondent, and petitioners now appeal.

In the absence of fraud, we review the MTT's decision for "misapplication of the law or adoption of a wrong principle." *Briggs Tax Serv, LLC v Detroit Pub Schs*, 485 Mich 69, 75; 780 NW2d 753 (2010). Issues of statutory interpretation are reviewed de novo. *Id*.

Under the federal constitution, a state is prohibited from imposing income tax on value earned outside the state's borders. *Container Corp of America v Franchise Tax Bd*, 463 US 159,

164; 103 S Ct 2933; 77 L Ed 2d 545 (1983). However, "[a] state is not required to isolate a business's intrastate activities from its interstate activities; instead, 'it may tax an apportioned sum of the corporation's multistate business *if the business is unitary*.'" *Malpass*, 494 Mich at 246, quoting *Allied-Signal, Inc v Dir, Div of Taxation*, 504 US 768, 772; 112 S Ct 2251; 119 L Ed 2d 533 (1992) (emphasis added). This unitary business principle "allows a state to 'tax multistate businesses on an apportionable share of the multistate business carried on in part in the taxing state.'" *Malpass*, 494 Mich at 246, quoting *Preston v Dep't of Treasury*, 292 Mich App 728, 733; 815 NW2d 781 (2011) (some quotation marks omitted).

Consistent with the unitary-business principle, MCL 206.103, during the relevant tax years, provided the following:

> Any taxpayer having income from business activity which is taxable both within and without this state, other than the rendering of purely personal services by an individual, shall allocate and apportion his net income as provided in this act.[1]

The apportionment formula is set forth in MCL 206.115. At the time relevant to this appeal, MCL 206.115 read as follows:

> 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.

"The property, payroll, and sales factors represent the percentage of the total property, payroll, or sales of the business used, paid, or made in this state." *Grunewald v Dep't of Treasury*, 104 Mich App 601, 606; 305 NW2d 269 (1981), citing MCL 206.116, MCL 206.119, MCL 206.121.

Petitioners argue that apportionment of "business income" under MCL 206.115 may be calculated by adding the property, payroll, and sales of multiple S corporations to establish a single property factor, a single payroll factor, and a single sales factor. While this is a valid method for apportionment, it is only available when the multistate businesses are "unitary."

> [I]n order "for a business or individual to exercise multi-state apportionment, there must 'be 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 or a distinct business operation—which renders formula apportionment a reasonable method of taxation.'" *In re Estate of Wheeler*, [297 Mich App 411, 417; 825 NW2d 588 (2012), aff'd sub nom *Malpass*, 494 Mich 237, quoting *Container Corp*, 463 US at 166].

[1] Effective January 1, 2012, this statute was modified by replacing "as provided in this act" with "as provided in this part." 2011 PA 38.

In *Malpass*, the plaintiff individuals (i.e., natural persons) owned two separate S corporations. *Id*. at 242-243. Both were Michigan corporations, but one conducted its business in Michigan, and the other conducted its business in Oklahoma. *Id*. The "Michigan" S corporation had a net gain, while the "Oklahoma" S corporation had a net loss. *Id*. at 243. In their amended tax returns, the taxpayers treated the S corporations as a unitary business. *Id*. By treating the S corporations as a single unitary business, the taxpayers were able to substantially reduce their Michigan income tax obligations by applying the losses from the "Oklahoma" S corporation against their Michigan income. *Id*.

The Supreme Court noted that there were different apportionment formulas, including separate-entity reporting and combined reporting, and identified the question as being "whether the ITA prohibits individual taxpayers from using combined reporting." *Id.* at 247. It noted that (1) when an individual taxpayer derives income "from business activity both within and without this state, the ITA requires an individual taxpayer to 'allocate and apportion his net income,'" (2) all taxable income not attributable to another state must be allocated to this state, and (3) the allocation must be in accord with MCL 206.115, which applies to "all business income." *Id.* at 248. Further, it noted that while MCL 206.115 unambiguously provided for formulary apportionment, it was silent on the method to be used. The Supreme Court concluded that "the phrase, '[a]ll business income . . . shall be apportioned[,]' is certainly broad enough to encompass either of the approaches advocated by the parties." *Id.* at 249. Thus, it concluded that the ITA did not require separate-entity reporting and that "in the absence of a policy choice by the Legislature, . . . the ITA permits either reporting method." *Id.* at 251.

However, the *Malpass* Court did not eliminate the requirement that the businesses be unitary in order to apportion the income. It also did not indicate that all business that flowed through to the taxpayer would be regarded as a unitary business. In *Malpass*, it was not disputed that the businesses were unitary. *Id.* at 254. In *Wheeler*, the companion case accompanying *Malpass*, it was disputed. *Id.* at 255. And because the Supreme Court agreed that the businesses in *Wheeler* were unitary, it held that the apportionment was proper. *Id.* at 256-258. Thus, the Supreme Court made it clear that it was maintaining the requirement that businesses need to be unitary in order for a taxpayer to apportion under MCL 206.115.

In the present case, the Tax Tribunal found:

> [5.] d. The [hearing officer] was correct in finding that:
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> > "With regard to all of the entities at issue, other than generalized testimony that they were engaged in automotive related businesses, there are no facts to support a conclusion that the entities constitute a 'unitary' business. This suggests that even under the theory pursuant to which the original return was filed (excluding income and losses of non-unitary businesses) the factors should be combined only for those entities that are together engaged in a unitary business. However, the facts do not support a conclusion that they were so engaged."
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> * * *

f. Had Petitioners brought forth evidence of a unitary business enterprise for some or all of the S corporations, a different result may have been warranted.

6. Given the above, the Tribunal adopts the conclusion of the Proposed Opinion and Judgment finding Petitioners failed to prove that a unitary business existed between and amongst any of the S corporations. Therefore, Respondent was correct in determining Petitioners' taxable income is based on the business activities of each separate entity.

Since petitioners failed to establish that the S corporations comprised a unitary business, they were not entitled to use combined reporting.

Petitioners argue that, as resident individual taxpayers, MCL 206.110 and MCL 206.115 required allocation of all taxable business income in accord with the apportionment formula, regardless of whether their businesses were unitary. However, *Malpass* forecloses this possibility since it recognized that combined reporting could only occur if the businesses were unitary.

Affirmed.

/s/ Michael J. Talbot
/s/ Kurtis T. Wilder
/s/ Michael J. Riordan