STATE OF MICHIGAN

COURT OF CLAIMS

FLAGSTAR BANCORP, INC.,

Plaintiffs,

v

MICHIGAN DEPARTMENT OF TRASURY,

Defendants.
_____/

OPINION AND ORDER

Case No. 16-000273-MT

Hon. Colleen A. O'Brien

OPINION

This matter is before the Court on the parties' cross-motions for summary disposition pursuant to MCR 2.116(C)(10). For the reasons set forth herein, plaintiff's motion is DENIED and defendant's motion is GRANTED.

I. BACKGROUND

This matter arises from a dispute concerning a franchise tax deficiency assessed by defendant Michigan Department of Treasury (the Department) against plaintiff under the Michigan Business Tax (MBT) Act, MCL 208.1101 *et seq*., for tax years 2008 through 2011 (the tax years at issue).[1] The central issue before the Court is the appropriate method for calculating

[1] Plaintiff also raised an issue concerning tax years 2012 and 2013, but the parties resolved that issue by stipulation.

the tax base of a unitary business group (UBG)[2] comprised of financial institutions. The statutory provisions concerning taxation of financial entities under the MBT Act are set forth in Chapter 2B, MCL 208.1261 *et seq*. For purposes of the MBT Act, the term "financial institution" is defined to mean any of the following:

> (*i*) A bank holding company, a national bank, a state chartered bank, an office of thrift supervision chartered bank or thrift institution, a savings and loan holding company other than a diversified savings and loan holding company as defined in 12 USC 1467a(a)(F), or a federally chartered farm credit system institution.
>
> (*ii*) Any person, other than a person subject to the tax imposed under chapter 2A, [MCL 208.1235 *et seq*.,] who is directly or indirectly owned by an entity described in subparagraph (*i*) and is a member of the [UBG].
>
> (*iii*) A [UBG] of entities described in subparagraph (*i*) or (*ii*), or both. [MCL 208.1261(f).]

In lieu of the tax generally imposed by the MBT Act upon businesses operating within this state, financial institutions are subject to a franchise tax. MCL 208.1263(1) and (2). The franchise tax is assessed at the rate of 0.235% of the institution's tax base. MCL 208.1263(1). MCL 208.1265 provides the following with respect to determining a financial institution's tax base:

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[2] In *D'Agostini Land Co LLC v Dep't of Treasury*, 322 Mich App 545, 551; ___ NW2d ___ (2018), the Michigan Court of Appeals explained the nature of a UBG:

> In general, a [UBG] is a group of related U.S. persons whose business activities are sufficiently interdependent. To qualify as a [UBG], one member of the proposed group must own or control more than 50 percent of the other members and there must be a sufficient connection between the members to meet one of two relationship tests. If a group of businesses qualifies as a [UBG] in a particular tax year, then the group must file a unitary tax return for that year. Michigan, like several other states, has adopted the unitary-business-group concept in an effort to measure more accurately the related group's activities in the state. [Citations omitted.]

> (1) For a financial institution, tax base means the financial institution's net capital. Net capital means equity capital as computed in accordance with generally accepted accounting principles less goodwill and the average daily book value of United States obligations and Michigan obligations. If the financial institution does not maintain its books and records in accordance with generally accepted accounting principles, net capital shall be computed in accordance with the books and records used by the financial institution, so long as the method fairly reflects the financial institution's net capital for purposes of the tax levied by this chapter. Net capital does not include up to 125% of the minimum regulatory capitalization requirements of a person subject to the tax imposed under chapter 2A.
>
> (2) Net capital shall be determined by adding the financial institution's net capital as of the close of the current tax year and preceding 4 tax years and dividing the resulting sum by 5. If a financial institution has not been in existence for a period of 5 tax years, net capital shall be determined by adding together the financial institution's net capital for the number of tax years the financial institution has been in existence and dividing the resulting sum by the number of years the financial institution has been in existence. For purposes of this section, a partial year shall be treated as a full year.
>
> (3) For a [UBG] of financial institutions, net capital calculated under this section does not include the investment of 1 member of the [UBG] in another member of that [UBG].

Plaintiff is a publicly traded full service community bank with various locations throughout Michigan. Acting as the "designated member"[3] of a 13-member[4] UBG of financial institutions, plaintiff filed MBT returns for 2008 through 2011 on behalf of the UBG. In December 2013, the Department began an audit of plaintiff's liability under the MBT Act for the tax years at issue. On March 5, 2015, the Department issued a Notice of Refund Adjustment to plaintiff, showing corrections the Department made to plaintiff's reported tax base that

[3] According to the instructions for form 4580 (the MBT UBG combined filing schedule for standard members), the "designated member" is a UBG member that has a nexus with Michigan and files the combined MBT return on behalf of the UBG. "Designated member" is not a term used in the relevant statutory provisions.

[4] The initial audit paperwork in this case identified a 14th member, but that member was removed after the parties agreed that it was improperly included.

significantly increased plaintiff's tax liability. After an informal conference on March 15, 2016, the Department issued a Decision and Order of Determination dated August 10, 2016, affirming its adjustments. Plaintiff subsequently filed this action.

Before the Court, plaintiff argues that the Department incorrectly applied MCL 208.1265 when calculating plaintiff's tax base. Specifically, plaintiff argues that the Department incorrectly applied MCL 208.1265(2)—the averaging provision—to plaintiff's MBT returns. The Department applied MCL 208.1265(2) at the member level, meaning that it applied the averaging provision to each individual member and, from there, determined the UBG's net capital. Plaintiff contends that the Department should have applied MCL 208.1265(2) at the UBG level, meaning that it should have first calculated the UBG's net capital and applied the averaging provision to that. By way of cross-motions for summary disposition, plaintiff and the Department urge this Court to reject the other's method for calculating net capital as inconsistent with the statutory mandates in MCL 208.1265.

II. STANDARD OF REVIEW

"Summary disposition is appropriate under MCR 2.116(C)(10) if there is no genuine issue regarding any material fact and the moving party is entitled to judgment as a matter of law." *Zaher v Miotke*, 300 Mich App 132, 139; 832 NW2d 266 (2013) (quotation marks and citation omitted). The Court analyzes the motion by considering "the pleadings, admissions, affidavits, and other relevant documentary evidence of record in the light most favorable to the nonmoving party to determine whether any genuine issue of material fact exists to warrant a trial." *Id*. (quotation marks and citation omitted).

III. ANALYSIS

A. TAX BASE CALCULATION

The Court holds that the Department correctly applied the averaging provision at the member level. Based on the parties' briefing, it is clear that the parties agree that the UBG's net capital is determined by adding together each individual member's net capital, and that their disagreement centers on whether the averaging provision applies before or after this is done.

The Department contends that the averaging provision applies *before* the members' net capitals are added together. According to the Department, the UBG's net capital is calculated as follows: (1) each individual member's net capital is computed under MCL 208.1265(1)[5]; (2) intramember investments are eliminated from each member's net capital pursuant to MCL 208.1265(3); (3) this is done for each member for each year that the member existed up to five years; (4) each member adds its net capital for the current year and previous four years and divides the resulting sum by five, or if the member has been in existence for less than five years, then the member adds its net capitals for every year it has been in existence and divides the sum by the number of years the member has existed, see MCL 208.1265(2); and (5) all of the members' resulting net capitals under MCL 208.1265(2) are added together and the final sum is the UBG's net capital.

Plaintiff, on the other hand, contends that the averaging provision applies *after* the member's net capitals are added together. According to plaintiff, the UBG's net capital is calculated as follows: (1) the net capital of every member is combined using generally accepted

[5] The Department accepted plaintiff's calculations of its members' net capital, and the parties do not dispute that these calculations were done in accordance with generally accepted accounting principles (GAAP). Plaintiff's argument that the Department ignored GAAP in its computations under MCL 208.1265(1) is thus incorrect.

accounting principles (GAAP) under MCL 208.1265(1) to determine the UBG's net capital; (2) using GAAP to calculate the UBG's net capital will necessarily eliminate intramember investment under MCL 208.1265(3); (3) this is done for each year the UBG has existed up to five years; and (4) the UBG's net capital for the current year is added to the UBG's net capital of the last four years and divided by five, or if the UBG has been in existence for less than five years, the UBG's net capital is added to the net capital of all the years that the UBG has been in existence and then divided by the number of years that the UBG has existed, see MCL 208.1265(2).

MCL 208.1265(2) does not specify where it applies when calculating a financial institution's tax base. Thus, this Court must interpret the statute to discern whether the Legislature intended the averaging provision to apply before or after the members' net capitals are added together. "The judiciary's objective when interpreting a statute is to discern and give effect to the intent of the Legislature. Once the intent of the Legislature is discovered, it must prevail regardless of any rule of statutory construction to the contrary." *Menard Inc v Dep't of Treasury*, 302 Mich App 467, 471; 838 NW2d 736 (2013). The starting point for this inquiry is the plain language of the statute. *Id*.

As explained earlier, MCL 208.1261(f) provides that "financial institution" can refer to three different entities: certain banks and holding companies; an entity owned directly or indirectly by such banks and holding companies; *or* a UBG of such banks, holding companies, and entities. Thus, MCL 208.1265(2) could reasonably be read as requiring that "[n]et capital . . . be determined by adding the [the UBG's *or* the individual member's] net capital as of the close of the current tax year and preceding 4 tax years and dividing the resulting sum by 5."

So at first glance, the use of "financial institution" in the first sentence of MCL 208.1265(2) appears to create an ambiguity on the face of the statute.

However, "[s]tatutory provisions cannot be read in isolation, but must be read in context, giving meaning and effect to the act as a whole." *Vayda v Co of Lake*, 321 Mich App 686, 697; 909 NW2d 874 (2017). By its plain language, MCL 208.1265(2) concerns a financial institution's "net capital," which, pursuant to MCL 208.1265(1),

> means equity capital as computed in accordance with generally accepted accounting principles *less goodwill and the average daily book value of United States obligations and Michigan obligations*. *If the financial institution does not maintain its books and records in accordance with generally accepted accounting principles, net capital shall be computed in accordance with the books and records used by the financial institution*, so long as the method fairly reflects the financial institution's net capital for purposes of the tax levied by this chapter.

Clearly then, computing "net capital" under MCL 208.1265 requires reference to a financial institution's goodwill, its average daily book value of United States and Michigan obligations, and reference to its books and records. A UBG is not a separate and distinct legal entity, but rather is "purely a creation of tax law." *D'Agostini Land Co LLC v Dep't of Treasury*, 322 Mich App 545, 551; ___ NW2d ___ (2018). As a creation of tax law and not a separate and distinct legal entity, a UBG does not have goodwill or United States obligations and Michigan obligations. Nor does a UBG keep its own books and records in accordance with GAAP. Instead, all of these things are computed, recorded, and kept by the UBG's individual members. Thus, "the financial institution's net capital" referred to in MCL 208.1265(1) cannot refer to a UBG's net capital, despite that "financial institution" may refer to a UBG. See MCL 208.1261(f)(*iii*). And when reading MCL 208.1265(1) and (2) together, *Vayda*, 321 Mich App at 697, the Court concludes that the Legislature intended for "the financial institution's net capital" referenced in MCL 208.1265(2) to be the same as "the financial institution's net capital"

calculated in § 1265(1), which as explained cannot be a UBG's net capital.[6] Because MCL 208.1265(2) is not referring to a UBG's net capital, the Court rejects plaintiff's interpretation that the averaging provision applies at the UBG level. In contrast, a UBG's individual members do have goodwill, United States and Michigan obligations, and keep books and records. Therefore, "the financial institution's net capital" referenced in MCL 208.1265(1) and (2) can refer to an individual member's net capital, see MCL 208.1261(f)(*ii*), Because MCL 208.1265(2) cannot refer to a UBG's net capital but can refer to an individual member's net capital, this Court concludes that the Department correctly applied MCL 208.1265(2) at the member level.

The Court further notes that the second sentence of MCL 208.1265(2) provides that the net capital of a financial institution that has not been "in existence" for five years is determined by adding its actual net capital for the years it has been "in existence" and dividing the resulting sum by the number of years the financial institution has existed. Because a UBG is a creation of tax law, it has never been "in existence" on its own. Thus, interpreting the first sentence of MCL 208.1265(2) as referring to a UBG would render the second sentence of that section nugatory, which courts are to avoid whenever possible. See *State Farm Fire & Cas Co v Old Republic Ins Co*, 466 Mich 142, 146; 644 NW2d 715 (2002). In contrast, an individual member of a UBG does have its own separate and distinct legal existence. Thus, unlike plaintiff's interpretation of

[6] Plaintiff contends that because all of the members of the UBG in this case are wholly owned subsidiaries of plaintiff, those members are "rolled into [p]laintiff" using GAAP, and the resulting net capital of plaintiff is the UBG's net capital. Plaintiff argues that, in this way, the UBG has "books and records" and "United States obligations and Michigan obligations." But even under plaintiff's interpretation, the records and obligations would be plaintiff's records and obligations, not the UBG's. A UBG is still only a creation of tax law and does not have a separate legal existence with corresponding obligations or records. While plaintiff is the designated member of its UBG, it is still only a member, see MCL 208.1261(f)(*ii*), not the UBG itself, see MCL 208.1261(f)(*iii*); MCL 208.1117(6).

MCL 208.1265(2), the Department's interpretation and application of the statute does not render any part of the statute nugatory. This supports that the Department correctly applied MCL 208.1265(2) at the member level.

Plaintiff argues that the Court should focus on the Legislature's use of "the" in MCL 208.1265(2) to conclude that the statute focuses on a single financial institution, which in this case—plaintiff contends—means the UBG. Initially, the Court notes that plaintiff's argument in this regard is cursory; plaintiff simply asserts that "financial institution" can refer to a UBG, see MCL 208.1261(f)(*iii*), so MCL 208.1265's use of "the financial institution" *must* refer to a UBG. This ignores that MCL 208.1261(f)(*ii*) states that "financial institution" can refer to a UBG's individual member, effectively rendering the term ambiguous. Regardless, while this Court recognizes that the Legislature's use of "the" instead of "a" can be significant, see *Robinson v City of Detroit*, 462 Mich 439, 460-462; 613 NW2d 307 (2000), the Court cannot simply ignore that statutes are to be read as a whole and the Legislature clearly intended for "the financial institution's net capital" as used in MCL 208.1265(1) to not refer to a UBG's net capital; the fact that defining "financial institution" in MCL 208.1265(2) as a UBG renders the second sentence of that statute nugatory; nor, particularly, the fact that the Legislature's use of "financial institution" in MCL 208.1265(2) is inconclusive and can refer to either a UBG or a UBG's individual member, see MCL 208.1261(f)(*ii*) and (*iii*). Thus, in light of the evidence showing the Legislature's intent for "financial institution" in MCL 208.1265(2) to refer to a UBG's individual member, the Court is unpersuaded that the Legislature's use of "the" instead of "a" mandates a different conclusion. See *Menard Inc*, 302 Mich App at 471 ("Once the intent of the Legislature is discovered, it must prevail regardless of any rule of statutory construction to the contrary.").

Plaintiff also argues that the Department's interpretation ignores MCL 208.1265(3) because it does not eliminate intramember investment. However, this contention is factually incorrect, as the Department's audit papers clearly show that it eliminated intramember investment.[7] Moreover, plaintiff's argument appears to read MCL 208.1265(3) too broadly; plaintiff argues that all members must be "eliminated" pursuant to MCL 208.1265(3), but that may only be true if the member's net capital was composed entirely on intramember investment.[8] If a member's net capital included equity that was not gained from intramember investment, MCL 208.1265(3) does not mandate that the member be "eliminated" because, by its plain language, MCL 208.1265(3) only eliminates intramember investment.

Lastly, plaintiff argues that because "financial institution" can refer to either a UBG or a UBG's individual members, the statute is ambiguous and should be construed in favor of the taxpayer. See *Mich Bell Tel Co v Dep't of Treasury*, 445 Mich 470, 477; 518 NW2d 808 (1994) ("[A]mbiguities in the language of a tax statute are to be resolved in favor of the taxpayer."). However, as explained, the Court concludes that the statute is not ambiguous because, when read as a whole, the Legislature's intent is clear. See *Menard Inc*, 302 Mich App at 471. Moreover, the Department clearly had the authority to administer the tax imposed by the MBT Act, MCL 208.1513(1), and to prescribe forms for taxpayers to use to comply with the MBT Act, MCL

[7] The parties do not contest whether these eliminations were to take place at the investor level or the investee level, so this issue is waived and the Court will not address it.

[8] This "may" only be true because whether a member is effectively "eliminated" by applying MCL 208.1265(3) is dependent on whether intramember investments are eliminated at the investor or the investee level. If eliminated at the investee level, a member who is composed entirely of intramember investment would have a net capital of zero after applying MCL 208.1265(3). But as stated, the parties do not adequately raise the issue of whether intramember-investment eliminations are taken at the investor or the investee level, so it is waived.

208.1513(3). It is also established that "[a]gencies have the authority to interpret the statutes they are bound to administer and enforce." *By Lo Oil Co v Dep't of Treasury*, 267 Mich App 19, 46; 703 NW2d 822 (2005). While these forms and an agency's interpretation of a statute are not binding on the courts, they should generally not be overruled absent cogent reasons. See *In re Complaint of Rovas*, 482 Mich 90, 103; 754 NW2d 259 (2008). Here, the Department's interpretation of MCL 208.1265 does not conflict with the plain language of the statute, and this Court can discern no cogent reason to overrule the Department's interpretation. Compare *Ashley Capital, LLC v Dep't of Treasury*, 314 Mich App 1, 11; 884 NW2d 848 (2015). To the contrary—and as explained—the Department's interpretation of MCL 208.1265 is the only interpretation that comports with the statute's plain language when read as a whole. Accordingly, this Court concludes that the Department's interpretation of MCL 208.1265 is proper and MCL 208.1265(2) applies at the member level.[9]

B. EQUAL PROTECTION

Count II of plaintiff's complaint raises an equal protection claim, arguing that the Department's interpretation of MCL 208.1265 and method of calculating plaintiff's tax base discriminates against taxpayers with subsidiaries. Specifically, plaintiff contends that the Department's interpretation and application of MCL 208.1265 is unconstitutional as applied to plaintiff's UBG because it resulted in inconsistent tax treatment for a parent entity that has

[9] Plaintiff contends that this result is "absurd" because it is nonsensical for the "average" net capital of a UBG to be "higher than the highest number for each of the years being averaged." However, as explained, "the financial institution" referred to in MCL 208.1265(2) does not refer to a UBG, so plaintiff's argument that this "average" is absurd misunderstands the relevant "average" that the statute is taking. MCL 208.1265(2) applies to individual members—not UBGs—and the "average" for a member's net capital calculated under that section is never "higher than the highest number for each of the years being averaged."

subsidiaries that were formed after the parent company and have been in existence for less than five years.

"When reviewing the validity of state legislation or other official action that is challenged as denying equal protection, the threshold inquiry is whether plaintiff was treated differently from a similarly situated entity." *Shepherd Montessori Ctr Milan v Ann Arbor Charter Twp*, 486 Mich 311, 318; 783 NW2d 695 (2010). "Statutes are presumed constitutional," *Phillips v Mirac, Inc*, 470 Mich 415, 422; 685 NW2d 174 (2004), and "the party challenging the statute has the burden of proving its invalidity," *People v Sadows*, 283 Mich App 65, 67; 768 NW2d 93 (2009).

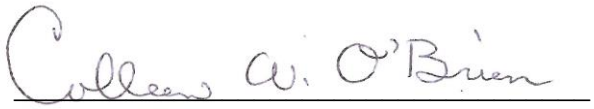
Plaintiff has not satisfied its burden of rebutting the constitutionality of the statute because MCL 208.1265, and the Department's interpretation and application of the same, does not treat similarly situated taxpayers differently. Plaintiff has not demonstrated how the Department applied the statute differently to plaintiff than it did to similarly situated taxpayers. Indeed, as best this Court can discern from plaintiff's briefing, plaintiff concedes that the Department uniformly applied MCL 208.1265 to all financial-institution UBGs; for all UBGs of financial institutions, the Department applied MCL 208.1265(2) at the member level. Plaintiff's argument is that the Department's application of MCL 208.1265 leads to different results for some UBGs with members in existence for less than five years compared to UBGs without any members in existence for less than five years. However, this argument necessarily fails because equal protection does "not require that persons in different circumstances be treated the same." *Syntex Labs v Dep't of Treasury*, 233 Mich App 286, 290; 590 NW2d 612 (1998).

IV. CONCLUSION

For the foregoing reasons, the Court holds that defendant properly interpreted and applied MCL 208.1265 by calculating the average net capital of plaintiff's UBG at the member level and plaintiff has failed to demonstrate an equal protection violation. Accordingly, defendant's motion for summary disposition is GRANTED and plaintiff's motion for summary disposition is DENIED.

This order resolves the last pending claim and closes the case.

July 9, 2018



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