STATE OF MICHIGAN

COURT OF CLAIMS

TCF NATIONAL BANK v DEP'T OF TREASURY

Case No. **16-000191-MT** **Hon. Colleen A. O'Brien**

ORDER

The parties having filed cross-motions for summary disposition pursuant to MCR 2.116(C)(10);

IT IS HEREBY ORDERED that Plaintiff's motion for summary disposition is DENIED.

IT IS FURTHER ORDERED that Defendant's motion for summary disposition is GRANTED.

Colleen A. O'Brien, Judge

STATE OF MICHIGAN

COURT OF CLAIMS

TCF NATIONAL BANK,

Plaintiff,

V

Case No. 16-000191-MT

DEPARTMENT OF TREASURY, STATE OF MICHIGAN,

Hon. Colleen A. O'Brien

Defendant.

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, defendant's motion is GRANTED and plaintiff's motion is DENIED.

I. BACKGROUND

This matter arises from a dispute concerning a franchise tax deficiency assessed under the Michigan Business Tax (MBT) Act, MCL 208.1101 *et seq.*, for the tax year ending December 31, 2008. The central issue before the Court is the appropriate method for calculating the tax base of a unitary business group (UBG)[1] comprised of financial institutions. The statutory

[1] 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

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 determination of the financial institution's tax base:

> (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.

> 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.]

(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 federally chartered bank operating in Michigan. Acting as the "designated member"[2] of a 16-member[3] UBG of financial institutions, plaintiff filed a 2008 MBT return on behalf of the UBG. Plaintiff identified each member of the UBG, along with four fictional "elimination" entities that were used to account for investments made among the UBG members pursuant to MCL 208.1265(3).

The dispute in this case arose after defendant Michigan Department of Treasury (the Department) initiated a two-year audit of plaintiff's franchise taxes under the MBT Act.[4] The Department disagreed with plaintiff's "net capital" tax base calculations and, after recalculating and making adjustments, issued a Notice of Intent to Assess applying tax to a net capital tax base that was nearly double the amount that plaintiff had reported on the 2008 return. Plaintiff subsequently filed a complaint in this Court challenging the lawfulness of this assessment. By

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[2] 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.

[3] An additional member was later added to the UBG, but the new member's inclusion has no bearing on the matter before this Court.

[4] The audit was for the 2008 and 2009 tax years, but, as previously indicated, only the 2008 tax year is at issue.

way of cross-motions for summary disposition, plaintiff and the Department both urge this Court to reject the method of calculating net capital employed by the opposing party as inconsistent with the statutory mandates set forth 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

Based on the parties' motions for summary disposition, the calculation method used by each party was unclear. To facilitate a proper resolution of the case, this Court ordered the parties to complete an illustrative computation consistent with each party's position on how plaintiff's tax base should be computed within the meaning of MCL 208.1265. This Court provided the parties with a hypothetical UBG of financial institutions, and ordered the parties to calculate the fictional UBG's tax base and explain their calculation methods.

The parties' supplemental briefing demonstrates that, although plaintiff couches its argument in terms of MCL 208.1265(3)—the provision dealing with the elimination of intramember investments between members of the same UBG of financial institutions—the

parties' actual dispute relates to MCL 208.1265(2), also known as the averaging provision. Namely, while the parties agree that a UBG's net capital is determined by adding together each individual member's net capital, the parties disagree whether the averaging provision applies before or after this is done.

The Department applied MCL 208.1265(2) at the member level, meaning *before* the members' net capitals were 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); (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 MCL 208.1265(2) should apply *after* the members' net capitals are added together—meaning it should apply at the UBG level—because, otherwise, the UBG's net capital includes intramember investments in violation of MCL 208.1265(3). According to plaintiff, the UBG's net capital is calculated as follows: (1) using generally accepted accounting principles (GAAP) as required by MCL 208.1265(1), subsidiaries of a parent member are rolled into the parent, which eliminates all members of the UBG except for the parent member; (2) this effectively eliminates intramember investment as required by MCL 208.1265(3), and the result is the UBG's net capital for the current year; (3) this is done for

each year that the UBG has been in existence, up to five years; (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, MCL 208.1265(2), and the resulting average is the UBG's net capital. Plaintiff contends that its method eliminates intramember investments, whereas "[b]ecause the Department averaged the Net Capital of each member individually, rather than as a single person, investments made into subsidiaries are not completely and wholly eliminated as required by the MBT" Act. In other words, plaintiff contends that based on MCL 208.1265(3), the averaging provision can only apply *after* the members' net capitals are added together.

Initially, the Court rejects plaintiff's contention that applying MCL 208.1265(2) at the member level violates MCL 208.1265(3). The Department's audit papers clearly reflect that, when calculating the net capital of plaintiff's UBG, the Department eliminated intramember investment before applying MCL 208.1265(2).[5] Plaintiff does not explain how the eliminations made by the Department did not eliminate intramember investment; indeed, some members of plaintiff's UBG had net capitals in the negative billions after the Department's eliminations. Moreover, plaintiff does not support its assertion that applying the averaging provision at the member level violates MCL 208.1265(3); while plaintiff frequently makes this assertion in its briefs, it provides no explanation for why it believes this to be true. As best this Court can discern, plaintiff contends that intramember investment must be included in the UBG's net

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

capital when MCL 208.1265(2) is applied at the member level because the UBG's resulting net capital is higher when the averaging provision is applied at the member level compared to when it is applied at the UBG level. However, mathematically, this is an obvious result of applying the averaging provision at the member level[6] and does not necessarily mean that intramember investments were included in the UBG's resulting net capital.

Plaintiff's related argument that MCL 208.1265 requires the Department to wholly eliminate subsidiary members of a UBG is similarly meritless because it reads MCL 208.1265(3) too broadly. Plaintiff argues that, pursuant to GAAP, subsidiary members are "required" to "be 'eliminated,' " thereby eliminating intramember investment, before applying MCL 208.1265(2). However, MCL 208.1265(3) makes no mention of GAAP.[7] MCL 208.1265(3) only requires the elimination of intramember investment in a UBG of financial institutions; it does not *require* the elimination of every subsidiary member. While a member may be eliminated under MCL 208.1265(3) if the member is composed entirely of intramember investment,[8] if the member's

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[6] Simply, MCL 208.1265(2) averages, at most, five years. If applied at the UBG level and the UBG has been in existence for five years, all members' net capitals would be divided by five. However, if applied at the member level and the UBG has been in existence for five years, every member that has been in existence for less than five years will be divided by a number less than five, which leads to a higher resulting average (e.g., for any positive number "X," $^{X}/_{5} < {}^{X}/_{3}$).

[7] Plaintiff appears to argue that MCL 208.1265(1)'s mention of GAAP mandates that all subsidiary members be eliminated, thereby eliminating intramember investment. However, if this Court interprets MCL 208.1265(1) as requiring the elimination of intramember investments, then MCL 208.1265(3) would be surplusage. Whenever possible, courts are to avoid interpretations that render parts of a statute nugatory or surplusage. See *State Farm Fire & Cas Co v Old Republic Ins Co*, 466 Mich 142, 146; 644 NW2d 715 (2002).

[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 previously stated, the parties do not adequately raise or argue the issue of

net capital includes equity that was not gained from intramember investment, then MCL 208.1265(3) cannot "eliminate" that member because, by its plain language, MCL 208.1265(3) only eliminates intramember investments. For these reasons, the Court finds plaintiff's argument—that applying MCL 208.1265(2) at the member level necessarily includes intramember investment in the UBG's resulting net capital—to be unpersuasive.

However, this does not resolve whether the Department properly applied the averaging provision at the member level. 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."

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whether intramember-investment eliminations are taken at the investor or the investee level, so the issue is waived.

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. 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.[9]

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 MCL 208.1265(2), the Department's interpretation and application of the statute does not render

[9] The Court recognizes that, under plaintiff's methods for calculating a UBG's net capital, the UBG's net capital is equivalent to the parent's net capital and, in this way, could arguably have "books and records," "goodwill," and "United States obligations and Michigan obligations." However, such an argument fails because those books and records, goodwill, and United States and Michigan obligations would be plaintiff's, and plaintiff is only a member of the UBG, see MCL 208.1261(f)(*ii*), not the UBG itself, see MCL 208.1261(f)(*iii*).

any part of the statute nugatory. This supports that the Department correctly applied MCL 208.1265(2) at the member level.

The Court rejects plaintiff's argument that, when read as a whole, MCL 208.1265 must be referring to a UBG and not the members of a UBG because "[e]very time the [MBT Act] refers to a 'financial institution,' it refers to the tax base for a single 'financial institution' not multiple financial institutions." As stated earlier, "financial institution" can refer to either a UBG or an individual member of a UBG, see MCL 208.1261(f)(*ii*) and (*iii*), and its use—singular or plural—is inconclusive. And contrary to plaintiff's position, there is evidence that supports that "financial institution" as used in MCL 208.1265(2) refers to an individual UBG member: (1) when the statute is read as a whole, it is clear that the Legislature intended for "the financial institution's net capital" in MCL 208.1265(1)—and used in MCL 208.1265(2)—to not refer to a UBG's net capital, and (2) defining "financial institution" in MCL 208.1265(2) as a UBG renders the second sentence of that statute nugatory. In light of the evidence showing the Legislature's intent that "financial institution" in MCL 208.1265(2) refers to an individual member of a UBG and not a UBG itself, the Court is unpersuaded that the Legislature's use of the singular "financial institution" evidences a contrary intent. 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.").[10]

[10] In a footnote, plaintiff contends that "if a UBG exists, the correct definition of 'financial institution' is set forth in MCL 208.1261[(f)](*iii*), as that definition expressly includes a group of entities as defined in (*i*) and (*ii*), which is exactly what we have here." Plaintiff's reasoning for this conclusion is unclear. Nothing in the MBT Act indicates that MCL 208.1261(f)(*iii*) *must* apply when a UBG is at issue, so the Court rejects plaintiff's contention otherwise.

Likewise, this Court finds unpersuasive plaintiff's argument that the Department's improperly applied GAAP when calculating net capital. The only reference to GAAP is in MCL 208.1265(1), which states, "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." The Department properly applied this section to determine the net capital of each member of plaintiff's UBG. The Department accepted the net capital of each member of plaintiff's UBG as provided by plaintiff. Neither the Department nor plaintiff disputes that these net capitals were calculated in accordance with GAAP. Thus, the Court rejects plaintiff's argument that the Department ignored MCL 208.1265(1) and failed to apply GAAP when calculating net capital.

Lastly, plaintiff argues that, at worst, the statute is silent—and therefore ambiguous—on where the averaging provision applies, and ambiguous statutes must 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 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.[11]

B. EQUAL PROTECTION

In its complaint, plaintiff also challenges MCL 208.1265 on equal protection grounds, 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 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

[11] Plaintiff contends that this result is "absurd" because it is nonsensical for the "average" net capital of a UBG to be "higher . . . than each and every tax year used in the formula[.]" 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 each and every tax year used in the formula[.]"

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. In fact, 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. 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.

Dated: July 10, 2018

Colleen A. O'Brien, Judge