Introduction: The Unitary Business Principle

In general, the unitary business principle is a federal law doctrine that limits a state's ability to impose business tax on income or assets of a taxpayer that are not related to business activities conducted within the taxing state.

The Reynolds Metals Holding

In Reynolds Metals Company, LLC v. Dep’t of Treasury, the Michigan Court of Claims addressed the issue whether the Reynolds Metal Company ("Reynolds") could exclude from its SBT return a capital gain that Reynolds realized from the disposition of a wholly-owned subsidiary. In a summary disposition proceeding, the court held that Michigan could not impose SBT on the capital gain realized by Reynolds from the sale of its wholly-owned subsidiary, Reynolds Australia Aluminum, Ltd. ("RAAL"), because RAAL was not a part of the Reynolds unitary business.

Review of the Reynolds Metals Decision

The controversy in Reynolds centered around the disposition of RAAL and RAAL's ownership of a 56 percent interest in an Australian joint venture, Worsley. The value of RAAL was in large part attributable to the business activities of the Worsley joint venture. The Michigan Department of Treasury (the "Department") originally disregarded unitary business issues and sought to impose SBT on Reynolds' gain from the sale of RAAL because the gain was included in Reynolds' federal taxable income. After the court confirmed that the unitary business principle was applicable, the Department argued that Reynolds was "unitary" with Worsley through the 56 percent ownership of Worsley by its subsidiary, RAAL.

In its decision, the Court of Claims noted that the SBT is constrained by federal constitutional limitations, including the unitary business principle. The court also noted that the unitary business principle prevents state taxation of a gain from the disposition of an investment (e.g., an interest in a business) unless the investment is "unitary" with the taxpayer's business conducted within the taxing state.

The Court of Claims next outlined the unitary business principle as it applies to Michigan by analyzing and citing federal case law holding that a unitary business is evidenced by:

- functional integration;
- centralized management; and
- economies of scale.

In the court of claims' view, none of these "unitary business" elements were sufficiently evidenced to justify Michigan's imposition of SBT on Reynolds' gain from the disposition of RAAL. The court of claims noted that there was little or no functional integration or centralized management between Worsley and either Reynolds or its subsidiary RAAL. The court also found that any transactions between Worsley and Reynolds or RAAL were conducted at arms-length such that no economies of scale were created. Importantly, the Court of Claims reviewed all prior supreme court precedents and compared Reynolds to the taxpayer in Asarco, Inc v. Idaho State Tax Commission, a case in which the United States Supreme Court held that the taxpayer was not engaged in a unitary business.
Practical Implications of Reynolds

If the Reynolds holding stands, open SBT returns may need to be reviewed to determine whether gains that might have been included in the federal taxable income and, therefore, the SBT base might be subject to elimination. Gains from any non-unitary subsidiary could create potential refund opportunities. Moreover, while the Reynolds decision is an SBT case, the Court of Claims' analysis provides welcome and potentially helpful guidance with respect to the type of unitary business principle analysis that is required under Michigan's new Michigan Business Tax ("MBT").

Taxpayers with questions about these or other Michigan tax matters may contact Wayne D. Roberts at 616-776-7514, Steven E. Grob at 313-568-6582, or Sherrill D. Wolford at 313-568-6849.