S T A T E   O F   M I C H I G A N

C O U R T   O F   A P P E A L S

ROBERT B. AIKENS and ANN S. AIKENS, Plaintiffs-Appellants,	UNPUBLISHED January 28, 2014
v	No. 310528 Court of Claims
DEPARTMENT OF TREASURY, Defendant-Appellee.	LC No. 08-000081-MT

Before: SAWYER, P.J., and BECKERING and SHAPIRO, JJ.

PER CURIAM.

The trial court granted summary disposition in favor of defendant on plaintiffs' claim for refund of income tax paid. They now appeal and we reverse and remand.

Plaintiffs engaged in the development of various real estate projects over the years, operating through a number of pass-through entities. The instant tax dispute has its roots in one such project, a shopping mall in Florida, originally developed in 1968 and owned and operated through a partnership known as Pensacola Associates (Pensacola). The mall was the sole asset of Pensacola, whose sole business was to own and operate the mall.

In 1998, Pensacola decided to diversify its holdings. Specifically, it deeded ownership of the mall to the Simon Group Partnership (SG) in exchange for a limited partnership interest in SG. SG owns and operates a variety of properties throughout the United States, but none in Michigan during the time period relevant to this case. Accordingly, from 1998 to 2003, Pensacola's sole asset was its limited partnership interest in SG. In 2003, it was decided to liquidate Pensacola and the limited partnership shares in SG were distributed directly to the Pensacola partners, the bulk of which went to plaintiffs. In 2004, plaintiffs sold their SG limited partnership interest, receiving in exchange shares in a real estate investment trust (REIT). Plaintiffs reported this transaction on their 2004 federal income tax return, reporting it on Form 4797 as a gain from the sale of property used in a trade or business, in an amount in excess of $73 million. On their Michigan income tax return for that year, plaintiffs reported that none of that gain was apportionable to Michigan.[1] Defendant thereafter audited plaintiffs' 2004

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[1] According to plaintiffs, they did report a gain to 22 other states, representing those states in which SG owned property.

Michigan income tax return and determined that the income received from the sale of their partnership interest in SG was a capital gain on the sale of an investment and not business income. If treated as a capital gain on the sale of investment, the amount is taxable to plaintiffs as Michigan residents under the Michigan income tax; if treated as business income attributable to an out-of-state business, it is not taxable. Defendant assessed a tax (and interest) due in excess of $2.4 million. An informal conference on defendant's Intent to Assess resulted in the hearing referee siding with plaintiffs and recommending that the Intent to Assess be cancelled. Defendant did not adopt that recommendation.

Plaintiffs, having paid the tax under protest while seeking the informal conference, then instituted the instant action in the court of claims seeking a refund. The court of claims granted summary disposition in favor of defendant on the refund claim, as well as on some related claims. We reverse.

We review de novo both decisions on summary disposition motions, *Maskery v Univ of Mich Bd of Regents*, 468 Mich 609, 613; 664 NW2d 165 (2003), and questions of statutory interpretation, *Putkamer v Transamerica Ins*, 454 Mich 626, 631; 563 NW2d 863 (1997). Furthermore, any ambiguity in a tax statute is to be resolved in favor of the taxpayer. *Mich Bell Tel Co v Dep't of Treasury*, 445 Mich 470, 477; 518 NW2d 808 (1994).

The trial court correctly began its analysis by noting that this case turns on two essential questions: (1) whether this case involves business or nonbusiness income and (2) if this case involves nonbusiness income, whether it results from the sale of real property located out-of-state or the sale of intangible personal property. The trial court erred, however, by concluding that the income at issue represents nonbusiness income. Furthermore, it is undisputed that, if the income is properly classified as business income, from a business located out-of-state, then none of the income is taxable by Michigan.

MCL 206.4, as it existed in 2004, provides as follows:

> "Business income" means all income arising from transactions, activities, and sources in the regular course of the taxpayer's trade or business and includes the following:
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> (a) All income from tangible and intangible property if the acquisition, rental, management, or disposition of the property constitutes integral parts of the taxpayer's regular trade or business operations.
>
> (b) Gains or losses from stock and securities of any foreign or domestic corporation and dividend and interest income.
>
> (c) Income derived from isolated sales, leases, assignment, licenses, divisions, or other infrequently occurring dispositions, transfers, or transactions involving property if the property is or was used in the taxpayer's trade or business operation.
>
> (d) Income derived from the sale of a business.

The trial court rejected plaintiffs' argument that the sale of their partnership interest fell within subdivisions (a), (c) and (d). The trial court concluded that there were "two fatal flaws" in their argument, specifically:

> First, when they executed the warranty deed transferring the mall to the SG Partnership, Plaintiffs explicitly granted to the SG Partnership all of their "right, title, and interest in and to" the mall. Accordingly, as of the end of January 1998, Plaintiffs no longer owned any business property. Second, Plaintiffs exchanged the mall for a limited partnership interest in SG Partnership. Pursuant to the Limited Partnership Agreement executed by the parties in connection with this exchange, owners of a limited partnership interest were barred from taking part in the management of the SG Partnership's business or transacting any business in the SG Partnership's name, and had no power to sign documents for or otherwise bind the SG Partnership. Moreover, also pursuant to this Agreement, each owner of a limited partnership expressly acknowledged that the partnership interest was obtained for investment purposes only. [Footnote references to the record omitted.]

The trial court concluded that this leads to the conclusion that "as of February 1998, Plaintiffs no longer either owned property or were engaged in a trade or business operation." Thus, according to the trial court, the sale of the limited partnership interest constituted non-business income. But the trial court's analysis itself suffers from two fatal flaws: it ignores a decision of this Court and a decision of the Michigan Supreme Court.

In *Grunewald v Dep't of Treasury*, 104 Mich App 601; 305 NW2d 269 (1981), the plaintiffs were Michigan residents and limited partners in Liberty Park Development Company, which owned and operated an apartment building in Pennsylvania. Liberty Park sustained losses in two years and plaintiffs claimed those losses on their Michigan income tax return. Defendant rejected the deduction, claiming that they were business losses attributable to Pennsylvania, not Michigan. This Court upheld defendant's position in *Grunewald*. In doing so, the Court, *id.* at 605, noted as follows:

> The taxpayers do not argue on appeal that the limited partnership income was nonbusiness income. Such income has been treated as business income in other jurisdictions, *Collins v Skelton*, 256 Ark 955; 512 SW2d 542 (1974), *Friedell v Comm'r of Taxation*, 270 NW2d 763 (Minn, 1978), and we hold such treatment was proper in the instant case.

Had the taxpayers' position in *Grunewald* been treated as merely owning an intangible investment, as the trial court in the case at bar would hold, then the *Grunewald* taxpayers presumably would have been entitled to deduct their investment loss. It is only because it was treated as business income (or, in that case, a loss) attributed to out-of-state activity that they were unable to take the deduction on their Michigan income tax return.

This analysis is further supported by the Supreme Court's decision in *Chocola v Dep't of Treasury*, 422 Mich 229; 369 NW2d 843 (1985). In *Chocola*, the taxpayers were Michigan residents who owned stock in out-of-state subchapter S corporations.[2] *Id.* at 232-233. They sought to exclude from their Michigan income tax returns their distributable income from those corporations. *Id.* The Supreme Court upheld the taxpayers' position. While much of the *Chocola* decision turned on specific statutes and regulations as they relate to subchapter S corporations, two specific points are nevertheless relevant here. First, the Court specifically refers to our decision in *Grunewald*, stating that subchapter "S corporations enjoy unique characteristics that provide a compelling analogy to partnerships, which produce apportionable business income in the hands of member partners, see *Grunewald v Dep't of Treasury*, 104 Mich App 601; 305 NW2d 269 (1981)." *Chocola*, 422 Mich at 243. Second, after reviewing those characteristics, the Court then states that the "combined effect of the foregoing characteristics renders a subchapter S shareholder more like a *participant* in the corporation's business and less like a mere *passive investor* . . . ." *Chocola*, 422 Mich at 244 (emphasis in original). It is important to note that none of those characteristics involved any active involvement in the operation of the business. Thus, it would seem unnecessary to be actively involved in a business to be considered a participant rather than a passive investor.

Accordingly, we must reject the trial court's conclusion that plaintiffs were no longer engaged in a trade or business merely because their status had changed to that of limited partner. And, because under MCL 206.4 income from the sale of a business or business property constitutes "business income," we must conclude that plaintiffs' sale of their limited partnership interest in SG represents "business income," none of which is attributable to Michigan. In short, the hearing referee correctly analyzed this case and the trial court should have granted summary disposition to plaintiffs.

In light of our determination of this issue, we need not address plaintiffs' remaining issues: whether they are entitled to credit for tax paid to Massachusetts arising from this sale and whether they are entitled to adjust the basis of their gain based upon deductions that they had taken in prior tax years on their federal tax returns (but not on their Michigan returns) and now had to recapture on their federal return upon the sale.

Reversed and remanded to the court of claims with instruction to enter judgment in favor of plaintiffs. We do not retain jurisdiction. Plaintiffs may tax costs.

/s/ David H. Sawyer
/s/ Jane M. Beckering
/s/ Douglas B. Shapiro

[2] Under the federal Internal Revenue Code, corporations electing subchapter S status do not pay income tax at the corporate level. Rather, it is paid at the shareholder level. Thus, for tax purposes, they are essentially treated like partnerships. *Chocola*, 422 Mich at 236.