TAXATION

LYNN A. GANDHI†

Table of Contents

I. INTRODUCTION

This *Survey* period (June 1, 2008 – May 31, 2009) produced somewhat anemic results. There were many unpublished opinions.[1] There was also a perceived increase in the number of petitions for leave to appeal to the Michigan Supreme Court filed by the Department of Treasury, resulting in fewer final decisions.[2] Lastly, while the first set of Michigan Business Tax returns have been filed, there is an inherent time lag until the first cases challenging provisions of the tax will be filed and acted upon.[3] Subsequent *Survey* periods will, no doubt, make up for the slim pickings of this *Survey* period.

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† Partner, Honigman Miller Schwartz and Cohn; Adjunct Professor of Law, Wayne State University. B.A., 1983, Kalamazoo College; J.D., 1986, Wayne State University; L.L.M., 1997, New York University. Registered certified public accountant, Michigan; former in-house counsel, several Fortune 500 companies.

1. In 2008, the court of appeals issued published opinions in 40.1 percent of the cases it heard. At the circuit court level, less than two percent of civil cases were resolved by verdict. At the Michigan Court of Claims, the circuit court which hears tax matters are made, of the 132 dispositions during the survey period, only one was a bench verdict. Annual Report of the Michigan Supreme Court 2008, *available at* http://courts.michigan.gov/scao/resources/publications/reports/summaries.htm (last visited June 25, 2010).

2. *Id.*

3. This lag is inherent due to the filing due dates of returns provided for at M.C.L.A. section 208.1505. The first MBT returns are not due until April 30, 2009, and may be extended until December 31, 2009. Assessments will not be issued until the returns have been processed and reviewed. Taxpayers have thirty-five days from the issuance of a Final Assessment to file an appeal at the Michigan Tax Tribunal, or ninety days to file an appeal at the court of claims (Circuit Court of Ingham County). Constitutional challenges to the MBT must be filed within ninety days after the due date of the return, as extended.

II. SINGLE BUSINESS TAX

A. TMW Enterprises, Inc. v. Department of Treasury

In the case of *TMW Enterprises, Inc. v Department of Treasury,*[4] the issue before the Michigan Court of Appeals was whether, for purposes of the Single Business Tax casual sale exemption, a subchapter S corporation is a "corporation" within the meaning of section 3(3) of the Single Business Tax Act.[5] The matter was an appeal from the court of claims which had held that a subchapter S corporation is not a "corporation" for purposes of the Michigan Single Business Tax Act.[6] In overturning the court of claims, the court of appeals determined that a subchapter S corporation is a corporation for SBT purposes, and further noted that as a corporation, the taxpayer was precluded from claiming the casual transaction exclusion under the Single Business Tax Act.[7]

TMW Enterprises was a subchapter S corporation headquartered in Delaware with its principal office in Michigan.[8] The taxpayer had been engaged in the business of designing, manufacturing and assembling electrical distribution systems for vehicle and industrial applications.[9] Its design and manufacturing facilities were located in Michigan with assembly facilities located throughout the United States and Mexico.[10] The taxpayer did not dispute that it was subject to the Single Business Tax as it was engaged in business in Michigan.[11] In the mid-1990s, the taxpayer entered into a transaction to sell all of its manufacturing assets including the use of the taxpayer's name.[12] The taxpayer received a lump-sum payment at the time of the sale with later contingent payments to be received in the future.[13] After the sale, the taxpayer ceased its involvement in any designing, manufacturing or assembly activities, but did continue to own and manage the real estate associated with the facilities.[14] Upon a subsequent audit of the business, the taxpayer was

4. 285 Mich. App. 167, 775 N.W.2d 342 (2009). The author's firm represented the Petitioner, although the author was not engaged in the matter.

5. MICH. COMP. LAWS ANN. §§ 208.1-.145 (West 2009) (repealed 2006); *TMW*, 285 Mich. App. at 168, 775 N.W.2d at 344.

6. *TMW*, 285 Mich. App. at 170-71, 775 N.W.2d at 345.

7. *Id.* at 179, 775 N.W.2d at 349 (citing Guardian Photo, Inc. v. Dep't of Treasury, 243 Mich. App. 270, 279-80, 621 N.W.2d 233, 238 (2000)).

8. *Id.* at 168, 775 N.W.2d at 344.

9. *Id.* at 168-69, 775 N.W.2d at 344.

10. *Id.* at 169, 775 N.W.2d at 344.

11. *Id.* at 167, 775 N.W.2d at 344.

12. *TMW*, 285 Mich. App. at 167, 775 N.W.2d at 344.

13. *Id.*

14. *Id.*

assessed Single Business Tax on the gain from the asset sale.[15] The taxpayer had excluded such gain from its SBT base under the assumption that such gain qualified for exclusion from the SBT base as a casual transaction under the Single Business Tax Act.[16] The Department of Revenue determined that such gain did not qualify for exclusion as a casual transaction because the taxpayer was a corporation under the terms of the SBTA, and corporations were precluded from claiming the casual transaction exclusion.[17]

The taxpayer paid the assessment and filed a refund action in the court of claims.[18] The court of claims found that the SBTA was ambiguous as to whether a subchapter S corporation was entitled to claim the casual transaction exemption, or whether, like C corporations, they were precluded from the use of the exclusion.[19] The court of claims' basis for this perceived ambiguity was based on how corporations determined "business income" for purposes of the SBTA.[20] For corporations, the Michigan statute defines "business income" as federal taxable income.[21] For persons "other than corporations," business activity is used to calculate business income for purposes of the SBT.[22] This is because persons "other than corporations," such as partnerships and subchapter S corporations, are treated as pass-through entities, and all items of income and expense are passed-through to its members.[23] According to the court of claims, as subchapter S corporations do not have federal taxable income, they are required to calculate their SBT base based on business activity, and therefore are entitled to claim the casual transaction exclusion.[24]

Finding that the exclusion was available, the court of claims concurred with the taxpayer that its single asset sale constituted a casual transaction.[25] Treasury appealed the decision.[26]

With the issue being one of statutory construction, the court of appeals' review was de novo.[27] The Department argued that subchapter S

15. *Id.* at 169-70, 775 N.W.2d at 344-45.

16. *See id.* at 170, 775 N.W.2d at 344. The casual sale exemption is provided at MICH. COMP. LAWS ANN. § 208.4(1) (repealed 2007).

17. *TMW*, 285 Mich. App. at 170, 775 N.W.2d at 344-45.

18. *Id.* at 170, 775 N.W.2d at 345.

19. *See id.* at 171, 775 N.W.2d at 345.

20. *See id.*

21. *Id.* (citing MICH. COMP. LAWS ANN. § 208.3(3) (repealed 2007)).

22. *Id.*

23. *See* U.S.C.A. §§ 701-02 (West 2006).

24. *TMW*, 285 Mich. App. at 171, 775 N.W.2d at 345.

25. *Id.*

26. *Id.*

27. *Id.*

corporations are "corporations" within the plain and unambiguous meaning of the SBTA, and are not entitled to the casual transaction exclusion.[28] Therefore, the base inquiry is whether an S corporation was a corporation under the applicable provisions of the Single Business Tax Act.[29]

To determine liability under the SBT, the first step is the calculation of a taxpayer's "tax base."[30] "Business income" is further defined by statute as

> federal taxable income, except that for a person other than a corporation it means that part of federal taxable income derived from business activity. For a partnership, business income includes payments and items of income and expense, which are attributable to business activity for the partnership and separately reported to the partners.[31]

"Business activity" is further defined in the statute as "a transfer of legal or equitable title to or rental of property, whether real, personal, or mixed, tangible or intangible, or the performance of services, or a combination thereof, made or engaged in, or caused to be made or engaged in, within the state, whether intrastate, interstate, or foreign commerce, with the object of gain, benefit, or advantage . . . but shall not include . . . a casual transaction."[32] Thus, a taxpayer "other than a corporation," and a partnership, are entitled to exclude casual transactions from their tax bases.[33] The court of appeals noted that the Single Business Tax Act does not define the word corporation.[34] As acknowledged by prior Michigan case law, when a statute does not define a word, a standard dictionary definition may apply.[35] In addition, the court of appeals noted that *Black's Law Dictionary* makes no distinction between the different types of corporate entities.[36] Significant to the court of appeals was the legislature's "explicit choice not to

28. *Id.* at 172-73, 775 N.W.2d at 346.

29. *See id.* at 168, 775 N.W.2d at 344.

30. *TMW*, 285 Mich. App. at 173, 775 N.W.2d at 346. M.C.L.A. section "9 defines 'tax base' to mean business income before apportionment or allocation as provided in Chapter 3, even if zero or negative." *Id.* at 174, 775 N.W.2d at 347 (quoting MICH. COMP. LAWS ANN. § 208.9 (repealed 2007)).

31. *Id.* (quoting MICH. COMP. LAWS ANN. § 208.3(3) (West 2010)).

32. *Id.* at 174-75, 775 N.W.2d at 347.

33. *Id.* at 175, 775 N.W.2d at 347.

34. *Id.* at 176, 775 N.W.2d at 348.

35. *TMW*, 285 Mich. App. at 176, 775 N.W.2d at 348 (citing Alvan Motor Freight, Inc. v. Dep't of Treasury, 281 Mich. App. 35, 43, 761 N.W.2d 269, 274 (2008)).

36. *Id.*

differentiate between different kinds of corporations."[37] Accordingly, the court of appeals held that a subchapter S Corporation is a corporation within the plain meaning of the SBTA, and is not entitled to the casual transaction exclusion.[38] The court of appeals also dismissed the taxpayer's argument that written guidance from Treasury over the years in the SBT return instructions could be relied upon.[39]

While it seems harsh not to be able to rely upon the return instructions, practitioners and taxpayers are again put on notice of the dim view in which the court of appeals holds Treasury's often self-serving guidance. As reiterated by the court frequently in these recent years, while the statute provides the Department the authority to issue rules regarding the administration on the tax laws, written guidance in the forms of Revenue Administrative Bulletins and return instructions which are not issued pursuant to the requirements of the Administrative Procedures Act do not carry the force of law.[40] In the absence of ambiguity in the statute, they have no bearing on the court's interpretation of statutory language and the court is not bound to follow an agency's interpretation of a statute.[41] With no ambiguity that subchapter S corporations are treated as corporations under the SBTA, the court of appeals found that it had no need to determine whether the asset sale constituted a casual transaction.

B. Manske v. Department of Treasury

In the case of *Manske v. Department of Treasury,*[42] the issue before the Michigan Court of Appeals was whether or not the Single Business Tax capital acquisition deduction (CAD) recapture provisions applied to a casual sale transaction.[43] In reviewing this decision, the court of

37. *Id.* "[R]ather, the Legislature simply used the word corporation." *Id.*

38. *Id.*

39. *Id.* at 179. The taxpayer was referring to the SBT return instructions (Form C-8000, Single Business Tax Annual Return) that instruct taxpayers to calculate their business income on the basis of federal income derived from business activities, just like partnerships. *Id.*

40. *See TMW Enterprises*, 285 Mich. App. at 178, 775 N.W.2d at 349.

41. *Id.*

42. 282 Mich. App. 464, 766 N.W.2d 300. The author's firm represented the Petitioner although the author was not engaged in the matter.

43. *Id.* at 465-66, 766 N.W.2d at 301. The capital acquisition deduction is contained at M.C.L.A. section 208.23(a). M.C.L.A. section 208.23(a) allows a taxpayer a full deduction from the SBT base for the cost of an asset in the previously taken year of acquisition. If the asset is later transferred, sold or disposed of prior to it being fully depreciated, an unused portion of the CAD previously taken must be recaptured and added back to the SBT base. MICH. COMP. LAWS ANN. § 208.23b(a) (West 2010).

appeals was also required to determine whether the court of claims was bound by a prior decision of the court of appeals under the law of case doctrine.[44] The court of appeals found that the court of claims erred when it denied a request for offset under the law of case doctrine.[45] The court of appeals reversed the court of claims and remanded for further proceedings.[46]

The tax issue centered on whether the Department of Treasury had incorrectly assessed SBT when it included in the taxpayer's tax base gain on real property that had been transferred in lieu of foreclosure.[47] The taxpayers had maintained that since the transfer constituted a "casual sale" transaction under the Single Business Tax Act,[48] and that any gain should not be included in the taxpayer's SBT base.[49] The court of claims had concluded that the transfer qualified as a casual sales transaction under M.C.L.A. section 208.4(1) and that any resulting gain should not have been included in the taxpayer's SBT base.[50] However, the Department refused to pay the refund due to the taxpayer, claiming that the court of claims had not addressed whether the Department was entitled to recapture the unused CAD that had been deducted on the assets.[51] The Department argued that it should be permitted to offset from the refund amount due to the taxpayer any CAD recapture required under the statute.[52] This is when the law of case doctrine intervened, as the court of claims had concluded that it was bound by the law of case doctrine to order a full refund without an offset for the recapture of any unused CAD amount, and thus, was precluded from any different result

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44. *Manske*, 282 Mich. App. at 465, 766 N.W.2d at 301. The law-of-the-case doctrine requires that a question of law decided by an appellate court will not be decided differently on remand or in a subsequent appeal in the same case. *Id.* at 467, 766 N.W.2d at 302 (citing Grievance Adm'r v. Lopatin, 462 Mich. 235, 259, 612 N.W.2d 120, 133 (2000)).

45. *Id.* at 466, 766 N.W.2d at 301.

46. *Id.* at 468, 766 N.W.2d at 302.

47. *See id.* at 466, N.W.2d at 301.

48. MICH. COMP. LAWS ANN. §§ 208.1-208.145 (West 2010). A "casual sale" is defined under M.C.L.A. section 208.4(1) as "a transaction made or engaged in other than in the ordinary course of repeated and successive transactions of a like character, except that a transaction made or engaged in by a person that is incidental to that person's regular business activity is a business activity within the meaning of the act. MICH. COMP. LAWS ANN. § 208.4(1) (West 2010). Note, under the Michigan Business Tax Act, effective January 1, 2008, there is no provision defining a "casual sale." MICH. COMP. LAWS ANN. § 208.1107 (West 2010).

49. *Manske*, 282 Mich. App. at 466, 766 N.W.2d at 301.

50. *Id.*

51. *Id.* at 466-67, 766 N.W.2d at 301-02.

52. *Id.* at 467, 766 N.W.2d at 302.

in a subsequent appeal.[53] The court of appeals found that the law of case doctrine did not apply to the CAD recapture issue, and absent an error, remanded the case back to the court of claims to address the Department's ability to offset the refund claim by the CAD recapture.[54] While it is a curious looking result indeed to allow CAD recapture on transfer deemed a casual sales transaction, one must keep in mind that the CAD recapture provisions require recapture whether or not such transfer results in gain or loss.[55] The profitability of the transaction is not an element of the recapture provision.[56]

The court of appeals reviewed de novo the question of whether or not CAD recapture could apply in a casual transaction.[57] The parties agreed that the full CAD deduction had been taken in the year the assets were acquired.[58] According to M.C.L.A. section 208.9(4)(c), if property for which a CAD deduction was taken is *transferred* before the personal property is fully depreciated, the unused portion of the CAD taken must be recaptured.[59] The court of appeals noted that nothing in the statutory provisions of the language of the CAD recapture provision suggested that adjustments for CAD recapture would not apply to transfers that qualify as a casual transaction.[60] Absent legislative guidance or authority on the issue, the court indicated it would not read such an exception into the statute.[61]

The taxpayer also argued that there had not been a CAD recapture triggering event, as the disposition of the property had not given rise to true proceeds being received by the taxpayer, given that the transfer was performed pursuant to providing a deed in lieu of foreclosure.[62] The court of appeals acknowledged that although the taxpayers did not

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53. *Id.* The ITC recapture provision of the MBT is similarly drafted. MICH. COMP. LAWS ANN. 208.1403(3)(d) (West 2010).

54. *Id.* at 468, 766 N.W.2d at 302.

55. *See Manske*, 282 Mich. App. at 469, 766 N.W.2d at 303.

56. *Id.*

57. *Id.* at 467, 766 N.W.2d at 302.

58. *See id.* at 469, 766 N.W.2d at 302.

59. MICH. COMP. LAWS ANN. § 208.23b(a) (West 2010). This section provides:

> If the cost of an asset was paid or accrued in a tax year ending before March 31, 1999 . . . add the gross proceeds or benefit derived from the sale or other disposition of the tangible assets described in Section 23(a) minus the gain and plus the loss from the sale reflected in federal taxable income and minus the gain from the sale or other disposition added to the tax base.

Id.

60. *Manske*, 282 Mich. App. at 469-70, 766 N.W.2d at 303.

61. *Id.* at 470, 766 N.W.2d at 303 (citing Roberts v. Mecosta County Gen. Hosp., 446 Mich. 57, 63, 642 N.W.2d 663, 667 (2002)).

62. *Id.*

receive cash, they clearly received a benefit through the satisfaction of a debt in excess of an adjusted basis of property that was given in lieu.[63] By avoiding foreclosure, the taxpayer reduced its overall debt exposure and saved itself the cost of expenses normally associated with foreclosure.[64] The court remanded the case back to the court of claims for further proceedings to set off the refund due to the taxpayer by the amount of the CAD recapture.[65]

It is clear that the taxpayer did receive a benefit.[66] However, one wonders whether if, absent a refund claim pending before the Department of Treasury, the Treasury would have pursued this matter purely based on the CAD recapture deduction. Given the current economic times, one cannot fault Treasury for proceeding to collect or set-off all refunds with amounts that are owed. The court acknowledged that while the taxpayer had lost its sole asset and went out of business, there had still been a benefit received, and no one escapes the taxman.[67] In addition, set-off of the recapture prior to the payment of the refund eliminates the even harsher result of having to chase after prior officers (as responsible parties) to recoup the recapture. From a practical viewpoint, the recapture of CAD cannot be predicated upon the later transfer or disposition of the assets resulting in gain. Indeed, it is rare that the sale of used equipment results in financial gain, or that used machinery is sold for greater than its remaining book basis. Requiring gain prior to recapture provisions being triggered would place the Treasury in the position of having to audit such transactions, perhaps on an asset-by-asset basis, to determine the correct amount of recapture.

C. Kmart Michigan Property Services, L.L.C. v. Department of Treasury

In what was the most interesting tax case for the *Survey* period, the Michigan Court of Appeals held that a single member limited liability company (SMLLC), treated as a disregarded entity for federal income tax purpose, could, nonetheless, be considered a "person" for purposes of the Michigan Single Business Tax (SBT).[68] As a person, the SMLLC would be entitled to file a separate SBT return, and its items of income deductions, credits, assets and liabilities were not required to be included

63. *Id.* The taxpayer was liable for a debt of $12,964,083.00 on property with an adjusted basis of $8,251,603.00. *Id.*

64. *Id.*

65. *Manske*, 282 Mich. App. at 470, 766 N.W.2d at 303.

66. *Id.*

67. *Id.*

68. Kmart Mich. Prop. Servs., L.L.C. v. Dep't of Treasury, 283 Mich. App. 647, 655-56, 770 N.W.2d 915, 920 (2009).

in its parents' SBT return.[69] This case is significant in that it has changed the long held view that SMLLC's are not considered separate SBT filers.

The taxpayer was Kmart Michigan Property Services, L.L.C. (KMPS), a Michigan limited liability company, whose sole member was Kmart Corp.[70] During the tax period before the court KMPS was responsible for winding up the business affairs of its former subsidiary whose assets had been sold to a third party.[71] For its fiscal year ending January 28, 1998, KMPS filed a separate SBT return, which indicated that a refund was due to the taxpayer.[72] Prior to the payment of the refund, the Department of Treasury audited Kmart Corporation and determined that KMPS should not have filed a separate SBT return, but rather should have included its items of income, deductions, credits, assets and liabilities with those of its parent company, Kmart Corporation.[73] The Department refused to accept KMPS's separate SBT return and insisted that KMPS be treated as a division of its owner.[74]

At an informal conference before the Department of Treasury's hearing referee, the referee concurred with the Department's position and found that KMPS was a not entitled to a refund.[75] KMPS filed an appeal to the Michigan Tax Tribunal and submitted a Motion for Summary Disposition, arguing that it met the definition of "person" under the Single Business Tax Act (SBTA). The Department's position was that KMPS, as a single member L.L.C., was not a person under the SBTA.[76] The Department believed that KMPS's election for treated as a non-entity for federal income tax purposes must be recognized under the provisions of the SBTA, and should be binding for SBT filing purposes.[77] KMPS should not be allowed to choose to be a separate entity for purposes of filing its own SBT return.[78]

The Tax Tribunal had found that a taxpayer's federal tax status was not determinative of whether or not it satisfied the definition of "persons" contained within the SBTA.[79] The Tax Tribunal wrote that the SBTA filing requirements are independent of the federal tax code, and

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69. *Id.* at 654-56, 770 N.W.2d at 919-20.

70. *Id.* at 648, 770 N.W.2d at 916.

71. *Id.* That subsidiary had been Builders Square.

72. *Id.*

73. *Id.*

74. *Kmart*, 283 Mich. App. at 648, 770 N.W.2d at 916.

75. *Id.* at 649, 770 N.W.2d at 916.

76. *Id.* at 649, 770 N.W.2d at 917.

77. Treasury's belief in this requirement is the subject of Revenue Administrative Bulletin 1999-9. *Id.*

78. *Id.*

79. *Id.* at 649-50, 770 N.W.2d at 917.

were in effect well before the federal "check the box" regulations came into existence.[80] Therefore, the tribunal found that taxpayer was entitled to file a separate SBT return.[81] Treasury appealed.[82] As the facts were not in dispute, the court of appeals' review was limited to whether the Tax Tribunal had made an error of law or adopted a wrong principle.[83]

The court of appeals began its analysis with the definition of "person" as contained within the SBTA.[84] In reviewing the definition, the court noted that the tribunal had concluded that an L.L.C., although not precisely identified within the SBTA, fits within the statutory definition of "person" whether or not it has one or more members.[85] The court of appeals looked to the federal treasury regulations that permit certain organizations that have a single owner to choose to be recognized, or disregarded, as entities separate from their owners.[86] Under the default classification contained in the federal regulations, unless an entity elects otherwise, it shall be disregarded as an entity separate from its owner if it has a single owner.[87] The court of appeals noted that these federal regulations do not make special provisions for domestic entities that are L.L.C.'s (or whose members are L.L.C.'s).[88] Thus, it was clear, that under the federal regulations, KMPS could elect to be treated as an entity separate from Kmart Corporation.[89] While both parties agreed that for the tax year in issue KMPS had elected to be a disregarded entity for federal tax purposes, the parties differed as to whether this classification must be followed for SBT purposes.[90] The Department relied upon Revenue

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80. *Kmart*, 283 Mich. App. at 650, 770 N.W.2d at 917.

81. *Id.*

82. *Id.* at 648, 770 N.W.2d at 916.

83. *Id.* at 650, 770 N.W.2d at 917.

84. *Id.* at 651, 770 N.W.2d at 918; *see* MICH. COMP. LAWS ANN. § 208.6(1) (West 2010), *repealed* by MICH. COMP. LAWS ANN. §§ 208.151-.154 (West 2010).

85. *Id.* at 652, 770 N.W.2d at 918.

86. *Kmart*, 283 Mich. App. at 652, 770 N.W.2d at 918. 26 C.F.R. § 301.7701-3(a) (West 2010) provides in pertinent part:

> A business entity that is not classified as a corporation under Section 301.7701-2(b)(1), (3), (4), (5), (6), (7), or (8) (an eligible entity) can elect its classification for federal tax purposes as provided in this section. An eligible entity . . . with a single owner can elect to be classified as an association or to be disregarded as an entity separate from its owner.

Id.

87. 26 C.F.R. § 301.7701-3(a) (West 2010).

88. *Kmart*, 283 Mich. App. at 652-53, 770 N.W.2d at 918.

89. *Id.* at 653, 770 N.W.2d at 918.

90. *Id.*

Administrative Bulletin (RAB) 1999-9,[91] which purported to follow the federal regulations.[92]

The court of appeals noted that RAB 1999-9 provides in pertinent part:[93]

> Michigan conforms to federal checked box regulations [26 CFR] [Section 301.7701-1 thru Section 301.7701-3] for SBT purposes. The entity election or default classification for filing the federal income tax return is effective for all components of the SBT return that are related to federal income tax. . . . A taxpayer who elects entity classification at the federal level shall file the Michigan Single Business Tax return on the same basis and reflect the same tax consequences.
>
> In the case of a disregarded entity, the single member files the return and indicates its legal organization. The member filing the return should attach a statement to the return listing the single member entity(s) included in the return.[94]

If KMPS had followed the guidelines as provided in the RAB, it would not have filed a separate SBT return from Kmart Properties.[95] The court of appeals stated (noting that the tribunal had done similarly), that the Department's policies as described in the RAB do not have the force of a legal requirement.[96] While the Department is permitted statutorily to "periodically issue bulletins that index and explain current Department interpretation of a current state laws," such bulletins do not constitute rules, and do not have the force of law.[97] The court of appeals concurred with the Tax Tribunal that KMPS was not legally required to follow RAB 1999-9.[98] The court concluded that the Department's legal rationale

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91. Michigan Dep't of the Treasury, *Effect of Federal Entity Classification Election on Michigan Taxes*, REVENUE ADMIN. BULL. 1999-9, *available at* http://www.michigan.gov-/documents/rab99-9_109073_7.pdf (last visited June 25, 2010).

92. *See supra* note 91.

93. *Kmart*, 283 Mich. App. at 653, 770 N.W.2d at 919.

94. *Id.* RAB 1999-9 also notes:

> Under Treasury regs, section 301.7701-2, if a single member entity is disregarded for federal income tax purposes, its activities are included as a part of the owner's activities and the respective sole proprietorship, branch, or division of the owner. Therefore, income, deductions, credits, assets and liabilities of a single member entity that have a nexus with Michigan, who elects to be disregarded as an entity for federal income tax purposes, are deemed to be those of the owner . . . .

Id.

95. *Kmart*, 283 Mich. App. at 654, 770 N.W.2d at 919.

96. *Id.*

97. *Id.*

98. *Id.*

was inconsistent with the SBTA, which does not require an entity's classification for federal income tax purposes to be consistent with its classification for SBT filing purposes.[99] The terms used in the SBTA and not specifically defined are not required to be given their federal tax meanings.[100] The court noted in dicta that, as there were no specific terms at issue in this case, there was no need to defer to the federal regulations for a specific definition.[101]

Given the plain language of the statute, the court of appeals held that the SBTA's provisions treat a SMLLC as an entity required to pay SBT on its activities performed within the State.[102] As such, it is a "person," as the term is defined within the SBTA, and is permitted to file a separate SBT return.[103] The court of appeals noted that it did not find any support in the law for the requirement that the entity must file based on how it is treated for federal income tax purposes.[104] Finding that the tribunal made no error of law, the court of appeals upheld the Tax Tribunal's decision.[105] The Michigan Supreme Court denied the Department's application for leave to appeal.[106]

For practitioners the most interesting aspect of this case is that long-settled expectations in the filing treatment of single member entities have completely changed. Hundreds of SBT returns have been filed in which the single member of an L.L.C. has included the L.L.C. within its SBT return following the guidance of RAB 1999-9. The issue is of limited duration when one considers the repeal of the SBT and the Michigan Business Tax treatment of SMLLCs (which would include a SMLLC in the unitary business group as its sole member).[107] Whether the Department will apply the decision retrospectively to open tax years is of major interest to many taxpayers, who may have either refund opportunities, or the exposure for additional tax due, or simply additional compliance requirements.

One aspect of a retroactive application is that if a separate return is deemed to be required to be filed, many SMLLC's may find that the four-year statute of limitations will not have begun to run. If such single member L.L.C.s were included in the sole members' SBT return, no

99. *Id.* at 655, 770 N.W.2d at 919-20.

100. *Id.*

101. *Kmart*, 283 Mich. App. at 655, 770 N.W.2d at 920.

102. *Id.* at 655-56, 770 N.W.2d at 920.

103. *Id.* at 656, 770 N.W.2d at 920.

104. *Id.*

105. *Id.*

106. Kmart Mich. Prop. Servs., L.L.C. v. Dep't of Treasury, 485 Mich. 898, 772 N.W.2d 421 (2009).

107. Unless the relationship test of M.C.L. section 208.1117(b) was not met.

separate return would have been filed. Absent a return filing, there is a question of whether or not the statute of limitations has commenced.[108] One alternative to consider is whether the inclusion of a single member L.L.C. on an affiliation schedule of its sole member would constitute a "filing" for purposes of commencing the statute of limitations. For some single member L.L.C.s, the result in *Kmart* could present a refund opportunity. If original returns for these single-member L.L.C.s were never filled, there could be an enhanced refund claim period.

The Department will need to consider administrative costs associated with a retroactive application of the *Kmart* decision.[109] As always, taxpayers that may be positively affected by the court of appeals decision should consider filing proactive refund claims as soon as possible.[110] Lastly, the case is also of note as the court of appeals, yet again, has rejected the use of the Department's interpretation. Taxpayers and practitioners should be aware of the legal status afforded to such guidance by the courts, whether contained within an RAB or other informal guidance issued by the Department.

Addendum: On March 31, 2010, Governor Granholm signed into law Public Act 38 of 2010 regarding the department's February 5, 2010 Notice to Taxpayers in response to the court of appeals' decision in *Kmart*.[111] The Notice to Taxpayers had indicated that disregarded entities would be required to file SBT returns for all open tax years, and that amended returns would be required from the LLC owners that had included the disregarded entities in their returns.[112] The estimated

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108. The four-year statute of limitation is contained at MICH. COMP. LAWS ANN., section 205.27a(2) (West 2010).

109. *See Kmart*, 283 Mich. App. at 647, 770 N.W.2d 915.

110. The author of this article, to ensure compliance with IRS requirements, must highlight to the readers that any tax advice contained in this article was not intended or written to be used, and cannot be used, by any person for the purpose of avoiding tax-related penalties or promotion, marketing or recommending to another person any transaction or matter addressed in this article.

111. Michigan Legislature, HB 5937, http://www.legislature.mi.gov/%28S%2842d34be41cqqbyqhhg0a2q45%29%29/mileg.aspx?page=getObject&objectName=2010-HB-5937 (last visited June 25, 2010); *see also*, Michigan Department of Treasury, Rescinded: Notice to Taxpayers Regarding *Kmart Michigan Property Services LLC v Dep't of Treasury*, The Single Business Tax, RAB 1999-9, and RAB 2000-5 (April 12, 2010), www.michigan.gov/.../Kmart_Notice_Retroactive_Application_Amended_Returns_1_31 0402_7.pdf.

112. *Michigan: Governor to Sign "Kmart Fix" Legislation Refund Claims May Need to Be Filed Promptly*, TAXNEWSFLASH-UNITED STATES (Mar. 30, 2010), http://www.us.kpmg.com/microsite/taxnewsflash/2010/Mar/10152.html.

administrative burden associated with these filings was staggering.[113] The Public Act returns taxpayers back to the pre-*Kmart* status quo and eliminates the need for any new or amended SBT returns. The Act did preserve the refund claims for taxpayers who had exhausted all rights of appeal prior to February 12, 2010.[114]

III. STATE REAL ESTATE TRANSFER TAX: 2008 PUBLIC ACT 473

It is necessary to highlight the enactment of 2008 Public Act 473[115] during the *Survey* period. Public Act 473 of 2008 amended the state real estate transfer tax act to impose the transfer tax on not just transfers of real property, but also on transfers of a "controlling interest" in an entity, if ninety percent or more of the value of the entity is in commercial, residential or industrial real estate.[116] A "controlling interest" is defined under the Act to include ownership of eighty percent of the stock of a corporation or of eighty percent of the membership interests of a limited liability company.[117] The result of this new law is that the common practice of assigning 100 percent of a membership interest in an entity formed to consummate a real estate sale will now be subject to the state real estate transfer tax as if the property were conveyed directly by deed.

The act is retroactive to January 1, 2007, which leaves open the state's pursuit of transfer tax on transactions completed in prior years (2007 and 2008).[118] Exemptions are permitted for certain transfers, such as those affecting dissolution, and transfers where the true ownership does not change.[119] The Act does not address how to treat installment sales and whether the transfer tax applies only to a transfer that may exceed the eighty percent requirement or if the tax would apply to all prior transfers of interest. These changes are sure to generate controversies that will be covered in subsequent *Survey* periods.

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113. *See* Senate Fiscal Agency, HB 5937: Analysis as Reported from Committee, Mar. 25, 2009, http://www.legislature.mi.gov/%28S%28kkgf5tiyamrv4w45k5plul22%29%29/mileg.aspx?page=getobject&objectname=2010-HB-5937&query=on.

114. Michigan Department of Treasury Notice to Taxpayers, February 5, 2010.

115. Public Act No. 473 (2008) (codified as amended at MICH. COMP. LAWS ANN. §§ 207.522-523, 207.526 (West 2010).

116. MICH. COMP. LAWS ANN. § 207.523 (West 2010).

117. MICH. COMP. LAWS ANN. § 207.522(a) (West 2010).

118. MICH. COMP. LAWS ANN. § 207.522.

119. MICH. COMP. LAWS ANN. § 207.526(a) – (w) (West 2010).