TAXATION

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I. PROPERTY TAX CASES

A. Information Management Inc. v Robert Naftaly

In this case of first impression, arising from a classification appeal to the Michigan State Tax Commission, the Michigan Supreme Court determined that property classification decisions of the Michigan State Tax Commission were guaranteed judicial review and that such guarantee could not be eliminated by statute.[1] In doing so, the Michigan

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Supreme Court struck the final sentence of MCL section 211.34c(6), which had stated that final decisions of an administrative agency were not to be granted judicial review.[2] The court also found that MCL section 211.34c(6) was in violation of the guarantee of judicial review contained in article VI, section 28 of the Michigan Constitution.[3]

The case initially began as *Iron Mountain Information Management v. Naftaly*.[4] The sole issue before the supreme court was "whether circuit courts have subject matter jurisdiction over appeals from the State Tax Commission (STC) regarding property classifications."[5] For 2008, the local assessors had classified the property underlying the appeals as either industrial real property[6] or commercial personal property.[7] The plaintiffs sought to have the property reclassified as industrial personal property.[8] The reason for the reclassification was to permit the plaintiffs to obtain a Michigan Business Tax credit for property taxes paid on tax parcels classified as industrial personal property.[9] The STC denied the request to reclassify each property and the plaintiffs sought relief, which was granted in the various circuit courts.[10] The STC appealed these

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1.Midland Cogeneration Venture L.P. v. Naftaly, 489 Mich. 83, 87, 803 N.W.2d 674 (2011). It should be noted that members of the author's firm represented the plaintiff in this matter.

2. *Id.* at 87 (construing MICH. COMP. LAWS ANN. § 211.34c(6) (West 2005)).

3. *Id.*; MICH. CONST. art. VI, § 28.

4. Iron Mountain Info. Mgmt., Inc. v. Naftaly, 486 Mich. 1038, 783 N.W.2d 117 (2010); Midland Cogeneration Venture Ltd. P'ship v. Naftaly, 486 Mich 1038, 783 N.W.2d 118 (2010). This appeal involved nine consolidated cases owned by the plaintiffs. *See Midland Congregation*, 486 Mich. at 1038.

5. *Midland Cogeneration*, 489 Mich. at 87. "The State Tax Commission (STC) is comprised of three-members appointed by the Governor with the advice and consent of the Senate." MICH. DEPT. OF TREASURY, ABOUT THE STATE TAX COMMISSION, *available at* http://www.michigan.gov/treasury/0,4679,7-121-1751_2228-5666--,00.html (last visited Nov. 15, 2011). The STC has general supervision of the administration of the Property Tax Laws in Michigan and shall render such assistance and give such advice to assessors, as they deem necessary. MICH. COMP. LAWS ANN. § 211.150 (West Supp. 2007). The STC also is responsible for assessing certain state-assessed properties such as telephone companies and railroads. *Id.*

6. *Midland Congregation*, 489 Mich. at 87; *see also* MICH. COMP. LAWS ANN. § 211.34c(2)(d) (West 2005).

7. *Midland Congregation*, 489 Mich. at 87; *see also* MICH. COMP. LAWS ANN. § 211.34c(3)(c) (West 2005).

8. *See Midland Congregation*, 489 Mich. at 87.

9. *Id.* at 88 n.4; MICH. COMP. LAWS ANN. § 208.1413 (West 2005) provided "for credit against [a taxpayer's Michigan Business Tax] liability for personal property taxes paid on a tax parcel classified as industrial personal property." *Midland Congregation*, 489 Mich. at 88 n.4. In addition, property classified as industrial personal property also enjoyed a millage reduction due to an exemption from the taxes levied under the State Education Tax Act. *Id.*; *see also* MICH. COMP. LAWS ANN. § 380.1211 (West 2005).

10. *Midland Cogeneration*, 489 Mich. at 88.

circuit court judgments to the court of appeals.[11] The court of appeals reversed the circuit court judgments and remanded the cases, granting summary disposition in the STC's favor.[12] The court of appeals held that "MCL 211.34c(6) bars an appeal in the courts of an STC classification decision."[13] In its opinion, "the court of appeals rejected the plaintiff's claim that the statute violate[d] the constitutional guarantee of a direct appeal of administrative final decisions."[14] "The court [found] that, although . . . an appeal of classification decisions" cannot be taken in the courts, "the statute does not prevent . . . [the plaintiff from] seeking a refund at the Michigan Tax Tribunal."[15]

The supreme court noted that the General Property Tax Act (GPTA)[16] requires an annual classification by local assessors regarding real and personal property located in the local tax-assessing unit.[17] There are six established categories of real property: "agricultural, commercial, developmental, industrial, residential and timber cutover," and five categories of personal property: "agricultural, commercial, industrial, residential and utility."[18] A property owner may dispute the local tax assessor's classification on an annual basis by an appeal to the local board of review.[19] Appeals from a decision of the board are then taken to the STC not later than June 30th of the tax year.[20] Prior to *Midland Cogeneration Limited Partnership v. Naftaly*, the STC was given the authority to arbitrate the petition, and pursuant to MCL section 211.34c(6), it was believed that "a decision of the STC regarding property classification was final and no appeal [was] permitted."[21] The plaintiffs in *Midland Cogeneration* claimed that MCL section 211.34c(6)

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11. *Id.*

12. *Id.*

13. *Id.* "MCL 211.34c(6) provides in pertinent part: 'An appeal may not be taken from the decision of the State Tax Commission regarding classification complaint petitions and the State Tax Commission determination is final and binding for the year of the Petition.'" *Id.*

14. *Id.*

15. *Id.*

16. Michigan General Property Tax Act, MICH. COMP. LAWS ANN. § 211.1-.157 (West Supp. 2003).

17. *Midland Cogeneration*, 489 Mich. at 89.

18. *Id. See also* MICH. COMP. LAWS ANN. § 211.34c(2)(a)-(e).

19. *Midland Cogeneration*, 489 Mich. at 89; *see* MICH. COMP. LAWS ANN. § 211.34c(6). It is also noted that an assessor may also appeal a decision of the Board of Review. *Id.*

20. *Midland Cogeneration*, 489 Mich. at 89.

21. *Id.* However, MICH. COMP. LAWS ANN. § 211.34c(7) provides that "the Department of Treasury may appeal [a STC classification decision]...to the residential and small claims division of the Michigan [T]ax [T]ribunal." *Id.* at 90; *see* MICH. COMP. LAWS ANN. §211.34c(7).

violated article VI, section 28 of the Michigan Constitution, which provides:

> All final decisions, findings, rulings and orders of any administrative officer or agency existing under the constitution or by law, which are judicial or quasi-judicial and affect private rights or licenses, shall be subject to direct review by the courts as provided by law. This review shall include, as a minimum, the determination whether such final decisions, findings, rulings and orders are authorized by law . . . .[22]

The Michigan Supreme Court began its analysis by noting that the guarantee contained in article VI of the Michigan Constitution is not absolute.[23] The court held that in order for the guarantee to apply there were three requirements that must be met: "(1) the administrative decision must be a 'final decision' of [the] administrative agency, (2) the agency must have acted in a 'judicial or quasi-judicial' capacity, and (3) the decision must affect private rights or licenses."[24] The court then analyzed whether the decision of the STC met these three requirements.[25]

It was not contested that the STC "decisions are final decisions of an administrative agency."[26] The court found that the decisions of the STC were "quasi-judicial,"[27] as "the STC acts as an arbitrator adjudicating disputed claims," and "it is well settled that an arbitrator's function is quasi-judicial in nature."[28] Lastly, the court analyzed "whether STC classification decisions affect private rights."[29]

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22. *Midland Cogeneration*, 489 Mich. at 90.

23. *Id.* at 91.

24. *Id.*

25. *Id.*

26. *Id.*

27. *Id.* at 92. The court employed the term "quasi-judicial" very broadly, and noted "[w]hen the power is conferred by statute upon a commission such as the public utilities, or a board such as the department of labor and industry, to ascertain facts and make orders founded thereon, they are at times referred to as *quasi*-judicial bodies . . . ." *Id.* (quoting People *ex rel.* Clardy v. Balch, 268 Mich. 196, 200, 255 N.W. 762 (1934)). The court also referred to the definition of 'quasi-judicial' contained in Black's Law Dictionary, which provides the following definition: "A term applied to the action, discretion, etc., of public administrative officers, who are required to investigate facts, or ascertain the existence of facts, and draw conclusions from them, as a basis for their official action, and to exercise discretion of a judicial nature." *Id.* (citing Pletz v. Secretary of State, 125 Mich. App. 355, 351-52, 336 N.W.2d 7789 (1983) (quoting BLACK'S LAW DICTIONARY 1411 (4th ed. 1951))).

28. *Midland Cogeneration*, 489 Mich. at 92. "The STC resolves disputed factual claims on a case-by-case basis [that] entails an evaluation of evidence and dispute resolution." *Id.* Because these are both quasi-judicial functions, the STC decision

The court began with the definition of private rights.[30] The court stated that while "[t]axpayers do not have a vested right in a tax statute or in a continuance of any tax law,"[31] taxpayers do have a "private right to ensure that their property is taxed the same as similarly situated property."[32] As an erroneous classification would result in an erroneous tax assessment, and "could impermissibly increase their tax burden," a decision on classification would affect taxpayers' private rights.[33] Thus, the court found that decisions on classification are final quasi-judicial decisions affecting private rights, and shall be subject to review by the court as provided by law under article IV of the Michigan Constitution.[34]

The defendants had argued that the term "provided by law" should be interpreted "to mean[] that the Legislature has the authority to limit the jurisdiction of circuit courts."[35] The court disagreed as to that interpretation. The supreme court found that the Michigan Constitution mandates review, and that as written, MCL section 211.24c(6) "was a complete prohibition of court review of STC classification decision[s]."[36] The supreme court also found that the court of appeals erred in its interpretation of MCL 211.34c(6) and that the legislature "may not eradicate a constitutional guarantee in reliance on the language 'as provided by law.'"[37] The court also noted that the defendants "failed to make a persuasive case that [a] 'mechanism exist[ed]'" which would

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qualified as quasi-judicial. *Id.*; *see also* Boraks v. Am. Arbitration Ass'n, 205 Mich. App. 149, 151, 517 N.W.2d 771 (1994); Int'l Union, United Auto., Aerospace & Agric. Implement Workers of Am. v. Greyhound Lines, Inc., 701 F.2d 1181, 1185 (6th Cir. 1983).

29. *Midland Cogeneration*, 489 Mich. at 92. Although it generally must be determined whether licenses are also affected, the court did not address the issue since there was no license in question in the case at bar. *Id.*

30. *Id.* Once again, the court turned to Black's Law Dictionary to define the term 'private right' as "a personal right, as opposed to a right of the public or the state." *Id.* at 93; BLACK'S LAW DICTIONARY 1348 (8th ed. 2004). The term 'right' is defined as "[t]he interest, claim, or ownership that one has in tangible or intangible property." BLACK'S LAW DICTIONARY at 1347, definition 5.

31. *Midland Cogeneration*, 489 Mich. at 92 (citing Detroit v. Walker, 445 Mich. 682, 703, 520 N.W.2d 135 (1994)).

32. *Id.* at 92-93. *See* MICH. CONST. art. IX, § 3 (requiring the legislature to provide for uniform taxation of property).

33. *Midland Cogeneration*, 489 Mich. at 93.

34. *Id.* at 97.

35. *Id.* This is the argument that the court of appeals had adopted in its holding that M.C.L.A. § 211.34c(6) does not permit an appeal of an STC classification decision, relying solely on the supreme court's decision in *McAvoy v. H. B. Sherman Co.*, 401 Mich. 419, 443, 258 N.W.2d 414 (1977). *See Midland Cogeneration*, 489 Mich. at 94.

36. *Midland Cogeneration*, 489 Mich. at 94.

37. *Id.*

provide an alternative form of appeal.[38] While a taxpayer could pay the tax and seek a refund in the Michigan Tax Tribunal, there is no language in the "Tax Tribunal Act [that] grants the Tax Tribunal jurisdiction over STC classification decisions."[39]

The court held that eliminating an appeal of a final administration that is quasi-judicial in nature and affects private rights was against the guarantee contained in article IV of the Michigan Constitution.[40] In looking for the cure to this defect, the supreme court lastly determined whether or not the entire statute was unconstitutional, or if the last sentence was severable.[41] The court found that "[t]he subsection consists of four sentences [with t]he first three dictating the process by which a property owner may protest" a classification determination.[42] It was only the fourth and final sentence of MCL section 211.34c(6) that restricts judicial review of STC classification, and thus, only the final sentence of the statute needed to be severed and declared unconstitutional, permitting the remainder of the statute to remain in full force and effect.[43]

Thus, only after legal wrangling and anguish, and the harsh realities that occur when litigation becomes too personal and emotional, do taxpayers in Michigan finally receive judicial recognition of the constitutional protections they have always claimed were due. While it may seem preposterous that the STC has continued its regime of supreme authority for as long as it has, what is even more amazing is the apparent lack of willingness of the current and prior administrations to listen to taxpayer and practitioner concerns regarding the organization and administration of an important state tax agency. The STC has operated in a world of its own, answering to no authority, and without affording taxpayers the constitutional protections now strongly acknowledged by the Michigan Supreme Court. In these times of "process improvements" and "best practices" one can only commend our supreme court for setting straight the limits to which government can operate, while serving those who demand a fair and just government.

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38. *Id.* at 95.

39. *Id.* In fact, the supreme court noted that the Tax Tribunal has previously ruled that it lacks jurisdiction over STC classification decisions. *Id.* (citing Midland Cogeneration Venture Ltd. P'ship v. City of Midland, No. 383162 (Mich. Tax Trib. Apr. 21, 2010)).

40. *Id.*

41. *Id.*

42. *Midland Cogeneration*, 489 Mich. at 96.

43. *Id.*

B. Walter Toebe Construction Company v. Department of Treasury

This is another case regarding the classification of personal property, and will not be the last. Again, the increase in litigation surrounding real and personal property classification is mainly due to the valuable nature of the refundable Michigan Business Tax credit (and before that, the Single Business Tax Credit) for property classified as industrial personal property.[44] With the demise of both the Single Business Tax (SBT) and the Michigan Business Tax (MBT), as well as the proposed phased elimination of personal property taxes,[45] these cases will eventually dissipate. Until then, taxpayers and the STC will continue to squabble over the classification of both real and personal property.

In *Walter Toebe Construction Company*,[46] both the petitioner before the Michigan Tax Tribunal and the local assessor "agree[d] that the property in question should have been classified as industrial personal property[, rather than commercial personal property,] for the tax year 2006."[47]

Petitioner filed its 2006 Single Business Tax Return claiming a tax credit for the statutory permitted percentage of tax that it claimed it had paid on industrial personal property.[48] The Michigan Department of Treasury sent a notice to petitioner disallowing the claimed credit.[49] The petitioner responded that the taxes paid qualified for the credit, as the property fit the definition of 'industrial personal property' within the General Property Tax Act (GPTA),[50] and requested an informal

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44. MICH. COMP. LAWS ANN. § 208.1413 (West Supp. 2007). These refundable credits disappear after January 1, 2012, once the Michigan Corporate Income Tax becomes effective. MICH. COMP. LAWS ANN. § 206.623 (West 2011). See *infra* Section III of this article for more on the Michigan Corporate Income Tax.

45. After months of preparation, Governor Synder announced his plans to eliminate personal property taxes on industrial property at his state of the state address on January 19, 2012. Karen Bouffard, *Lobbied on Eve of Speech*, DETROIT NEWS, Jan. 1, 2012, at A3. The proposal replaces a portion of the revenue lost by the elimination of personal property taxes by the benefit to be obtained through the expiration of tax credits which had been profusely provided by the prior Administration. *Id.*

46. Walter Toebe Constr. Co. v. Dep't of Treasury, 289 Mich. App. 659; 810 N.W.2d 128 (2010).

47. *Id.* at 660.

48. *Id.*

49. *Id.* The petitioner had failed to attach any proof that the property had been classified as industrial personal property, and did not state that industrial personal property taxes that had been levied were paid. *Id.*

50. The General Property Tax Act is contained in MICH. COMP. LAWS ANN. §§ 211.11-57. 'Industrial real property' is defined as "platted or unplatted parcels used for manufacturing and processing purposes, with or without buildings," and "Parcels used for utilities sites for generating plants, pumping stations, switches, substantions, compressing

conference.[51] At the informal conference, "[t]he hearing referee found that 'industrial personal property is defined by statute and not by'" a determination of the assessor.[52] Because the referee found that the "property fit the definition in the GPTA, the referee recommended allowing the credit despite the Department's disallowance."[53] The Department rejected the hearing referee's recommendation as it is permitted to do so by law.[54]

The Department asserted that the appropriate definition for determining whether the credit would be allowed should be the Single Business Tax Act (SBTA)[55] definition, which requires the property to be "classified industrial personal property" under the GPTA.[56] The Department alleged that "because the property in question had never been classified as industrial personal property, . . . it did not meet the definition contained within the SBTA, and [therefore,] was ineligible for the SBT credit."[57] On petition before the Tax Tribunal, the Tribunal concurred with the defendant.[58] The taxpayer then brought this appeal as of right.[59]

The single issue before the court of appeals was whether the Tax Tribunal erred in holding that the SBTA definition of 'industrial personal property' depends on the classification of the property by the assessor, or whether the SBTA imports the definition of 'industrial personal property' from the GPTA.[60] The court began its analysis by noting that "[m]any sections of the SBTA import[] definitions from other statutes," such as the Internal Revenue Code or the Insurance Code of 1956, using the phrases "as defined in" or "as defined by" when "denot[ing] an adoption of a statutory definition from another statute."[61] However, the court noted that this language is absent in the SBTA.[62] Rather, the SBTA

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stations, warehouses, rights-of-way, flowage land, and storage areas." MICH. COMP. LAWS ANN. § 211.34c(2)(d)(i)-(ii).

51. *Walter Toebe Constr. Co.*, 289 Mich. App. at 660.

52. *Id.*

53. *Id.*

54. *Id.* at 661.

55. *Id.* (citing former MICH. COMP. LAWS ANN. § 208.1-.145, repealed by 2006 Mich. Pub. Acts No. 235, effective Dec. 31, 2007).

56. MICH. COMP. LAWS ANN. § 208.

57. *Walter Toebe Const. Co.*, 289 Mich. App. at 660.

58. *Id.* at 661.

59. *Id.*

60. *Id.*

61. *Id.*

62. *Id.*

defines 'industrial personal property' as "personal property *classified* as industrial personal property *under* section 34c of the GPTA."[63]

Based on this drafting, the court of appeals found that the most reasonable inference was to allow the Department to rely on an assessor's classification of the property, rather than to require the Department to make an independent assessment of whether the petitioner's property met the definition in the GPTA.[64] Therefore, the court of appeals found that whether property qualified as 'industrial personal property' for purposes of the SBTA credit was dependent upon the assessor's classification and not on the specific definition contained in the GPTA.[65] Lacking the proper action by the assessor, the plaintiff was not entitled to the Single Business Tax Credit.[66]

While one may consider such a decision harsh, particularly given the concurrence by the assessor that the property had been erroneously classified to begin with, a quick peek behind the scene suggests that the taxpayer in this matter had likely failed to timely appeal its property classification before the March board of review, but still desired to obtain a credit for its industrial personal property taxes paid.[67] This case should highlight the need for taxpayers to adhere strictly to statutory guidelines, particularly in the area of the General Property Tax Act.

C. Klooster v. City of Charlevoix

In the interesting case of *Klooster v. City of Charlevoix*,[68] the Michigan Supreme Court resolved the complex issue of whether the termination of a joint tenancy, caused by the death of a co-tenant, fell within the joint tenancy exception under the GPTA that avoids the classification of a "transfer of ownership" for purposes of an uncapping event for tax re-assessment.[69] In this case, which is sure to be of interest to owners of vacation homes in Michigan, the Michigan Supreme Court held that the death of a co-tenant, and the conveyance from the remaining co-tenant to himself and his brothers as joint tenants, was a conveyance for purposes of the GPTA, and therefore was an uncapping event for purposes of re-assessment of real property.[70] The result was an

63. *Walter Toebe Const. Co.*, 289 Mich. App. at 662 (emphasis added).
64. *Id.* at 661-62.
65. *Id.*
66. *Id.*
67. *Id.* at 660.
68. 488 Mich. 289, 795 N.W.2d 578 (2011).
69. *Id.* at 293. The prior history of the case can be found at *Klooster v. City of Charlevoix*, 286 Mich. App. 435, 781 N.W. 2d 120 (2009).
70. *Klooster*, 488 Mich. at 293-94.

increase in the taxable value of the property, and a related increase in the real property taxes due on the property.

James and Donna Klooster had held the property as tenants by the entirety.[71] After more than forty years of ownership, Donna quitclaimed her interest in the property to her husband, James.[72] Subsequently, James quitclaimed the property to himself and his son, the petitioner, as joint tenants with right of survivorship.[73] James passed away, leaving the petitioner as the sole property owner by operation of law.[74] In 2005, the petitioner quitclaimed the property to himself and his brother as joint tenants with right of survivorship.[75] In 2006, the assessor issued a notice of assessment to the petitioner and his brother that reassessed the property and increased the property's taxable value using the true cash value of the property.[76] The assessment did not state which of the prior transactions was treated as the transfer of ownership—whether it had been "the termination of the joint tenancy caused by the death of [the petitioner's] father in January of 2005 or the September 2005 creation of the joint tenancy between petitioner and his brother . . . ."[77] Regardless, the reassessment increased the taxable value of petitioner's property.[78] Petitioner had followed the standard procedure for appealing.[79] On appeal, the court of appeals reversed and found that a "conveyance" requires a transfer of title by written instrument.[80] Therefore, the death of petitioner's father and the resulting transfer of fee title to petitioner by operation of law (rather than by written instrument) did not constitute a

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71. *Id.* at 294.

72. *Id.*

73. *Id.*

74. *Id.*

75. *Id.*

76. *Klooster*, 488 Mich. at 294. This occurs when a transfer of ownership has occurred. *Id.*

77. *Id.*

78. *Id.* The taxable value increased from $37,802 to $72,300. *Id.* While this increase is significant as a percentage, it is clear that it is not a mansion on the shores of Lake Michigan. *Id.*

79. Petitioner appealed first to the city's Board of Review and, when unsuccessful, appealed to the Michigan Tax Tribunal. *Klooster*, 488 Mich. at 294-95. "The tribunal affirmed the assessment, ruling that the transfer of ownership to petitioner by virtue of his father's death was a conveyance for purposes of the [assessment]." *Id.* at 295. As to this transaction, "the Tax Tribunal ruled that the joint tenancy exception [in] MCL 211.27a(7)(h) did not apply to the January 2005 transfer because petitioner was not an original owner or an already existing joint tenant before the . . . joint tenancy was created. The Tax Tribunal did not rule on the September 2005 conveyance" that was caused by the creation of the joint tenancy between the petitioner and his brother. *Id.* at 295 (citations omitted).

80. *Id.*

transfer of ownership under the GPTA that would result in the uncapping of the value of the property.[81] The supreme court granted leave to appeal.[82]

The supreme court had two questions before it: (1) whether a "conveyance" under the GPTA must be by means of a written instrument, and (2) whether either of the two transactions described above would cause an uncapping for purposes of property tax reassessment.[83] The court began its analysis by reviewing whether there had been a transfer of ownership[84] or whether the joint tenancy exception of MCL section 211.27a(7)(h) applied.[85] "The GPTA provides that [u]pon a transfer of ownership of property . . . , the property's taxable value for the calendar year following the year of the transfer is the property's state equalized valuation for the calendar year following the transfer."[86] "A transfer of ownership allows reassessment of the property based on [the] state's equaliz[ation] value, lifting the cap on the rate of increase provided by MCL 211.27a [Proposal A]."[87]

A transfer of ownership will not result in an uncapping if there is a permitted exclusion.[88] In reviewing a particular transaction, the court noted the importance of determining who the original owner of the

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81. *Id.*

82. *Id.*

83. *Id.* at 293.

84. *Id.* at 297. The General Property Tax Act defines a "transfer of ownership" as a "conveyance of title to or a present interest in property, including the beneficial use of the property, the value of which is substantially equal to the value of the fee interest." MICH. COMP. LAWS ANN. § 211.27a(6) (West 2009); *see Klooster*, 488 Mich. at 297.

85. *Klooster*, 488 Mich. at 297-98. The joint tenancy exception of MICH. COMP. LAWS ANN. § 211.27a(7)(h) "exclud[es] three types of conveyances from the definition of 'transfer of ownership,'" including "(A) the termination of a joint tenancy, (B) the creation of a joint tenancy where the property was not previously held in a joint tenancy, and (C) the creation of a successive joint tenancy." *Id.* at 298 (citing MICH. COMP. LAWS ANN. § 211.27a(7)(h) (West 2009)).

86. *Id.* at 299 (citing MICH. COMP. LAWS ANN. § 211.27a(2) (West 2009)).

87. Proposal A, passed in 1994, amended MICH. CONST. art. IX, § 3 "to limit the annual increase in property tax assessments." *Id.* at 296. "The purpose of Proposal A was to limit tax increases on property as long as it remain[ed] owned by the same party, even though the actual market value of the property may have risen at a greater rate." *Id.* at 296 (citing Toll Northville Ltd. v. Northville Twp., 480 Mich. 6, 12, 743 N.W.2d 902 (2008)). "The 1995 amendments of the GPTA fixed the cap on assessment increases at the lesser amount of either 5 percent of the assessed value of the property for the previous year or the increase in the rate of inflation from the previous year." *Id.* (citing MICH. COMP. LAWS ANN. § 211.27a(2)). However, as provided for in MICH. COMP. LAWS ANN. § 211.27a(3), "after certain transfers of ownership, the property becomes 'uncapped' and . . . subject to reassessment based on the actual property value." *Id.*

88. *See* MICH. COMP. LAWS ANN. § 211.27a(7)(h) (West 2009); *Klooster*, 488 Mich. at 298.

property was prior to the transaction, and who the owner is after a transfer of ownership transaction.[89] "The joint-tenancy exception [to uncapping] provides that 'a joint owner at the time of the last transfer of ownership . . . is an original owner' and that a person '. . . is an original owner of property owned by that person's spouse.'"[90]

The court then focused on the "conveyance at issue" that is "either the creation or termination of a joint tenancy, that may or may not uncap the property for reassessment purposes."[91] "If the conveyance at issue is the creation of a joint tenancy, it is important to determine whether the property is being conveyed from a previous joint tenancy or some other type of ownership . . . ."[92] "If the conveyance at issue is the termination of joint tenancy . . . the identity of ownership before the creation of the joint tenancy is only relevant under the original-ownership requirement to ensure that the continuity of original ownership remains uninterrupted."[93] The court then focused on the two conveyances at issue: the January 2005 conveyance caused by the death of the petitioner's father, and the September 2005 conveyance that was the creation of a joint tenancy between the petitioner and his brother.[94]

The court analyzed the continuous-tenancy requirement of MCL section 211.27a(7)(h).[95] The court noted that the creation of the joint tenancy between the father and the son was not an uncapping event "because [the statute] excludes such conveyances from the definition of 'transfer of ownership'" under the original ownership requirement, because the father had been an "original owner of the property before the joint tenancy was initially created."[96] When the "father died in January

89. *Klooster*, 488 Mich. at 298.

90. *Id.* (citing MICH. COMP. LAWS ANN. § 211.27a(7)(h)). The court noted, "[t]here are three possibilities for who may constitute an 'original owner' under the joint-tenancy exception: (1) a sole owner at the time of the last uncapping event, (2) a joint owner at the time of the last uncapping event, and (3) the spouse of either a sole or joint owner of the property at the time of the conveyance at issue (i.e., the conveyance that may uncap the property)." *Id.* at 299-300.

91. *Id.* at 300.

92. *Id.*

93. *Id.*

94. *Id.*

95. *Klooster*, 488 Mich. at 300. "The continuous-tenancy requirement provides that 'if the property is held as a joint tenancy at the time of conveyance, at least 1 of the persons was a joint tenant when the joint tenancy was initially created and that person has remained a joint tenant since the joint tenancy was initially created.'" *Id.* (citing MICH. COMP. LAWS ANN. § 211.27a(7)(h) (West 2009)).

96. *Id.* at 302.

2005, the joint tenancy terminated by operation of law, vesting [the son] with sole ownership."[97] As a result, the petitioner became the owner.[98]

The court's next inquiry was whether this second event, i.e., the "change in the nature of the ownership of the property occasioned by the death of the only other joint tenant (James, the father) is even a conveyance, as that term is used in the GPTA."[99] The court found that "the termination of a joint tenancy occasioned by the death of the only other joint tenant is a conveyance under the GPTA."[100] It was immaterial to the court that there was a written instrument to memorialize this conveyance, as there was only one remaining joint tenant.[101] The contingent remainder vests in the survivor as a fee simple in the property.[102] The court noted that the statute defines a "transfer of ownership," but does not define the word "conveyance."[103] Thus, the court turned to the relevant dictionary definitions of conveyance and found that "[t]he conveyance occasioned by the death of the only other cotenant fits [within the dictionary definition of 'conveyance'] because the vesting of a fee simple at the moment of death in the last surviving cotenant is a 'transfer of property that does not pass by a delivery of a thing.'"[104]

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97. *Id.*

98. *Id.* at 303.

99. *Id.* at 302-03.

100. *Id.* at 303.

101. *Klooster*, 488 Mich. at 303. Requiring readers to hearken back to their 1L days, the court "described a joint tenancy with rights of survivorship as a joint life estate with a duel contingent remainder that vests the fee simple in whichever cotenant outlives the other." *Id.* at 303 (citing Albro v. Allen, 434 Mich. 271, 274-75, 454 N.W.2d 85 (1990)). "A contingent remainder is '[a] remainder that is either given to an unascertained person or made subject to a condition precedent.'" *Id.* (citing BLACK'S LAW DICTIONARY 1405 (9th ed.)). "The contingent remainder is thus created simultaneously with the creation of the joint tenancy with rights of survivorship and 'waits patiently' for possession." *Id.* (quoting THOMAS F. BERGIN & PAUL G. HASKELL, PREFACE TO ESTATES IN LAND AND FUTURE INTERESTS 73 (2d ed. 1984)). The court continued, "[i]n the case of a joint tenancy with rights of survivorship, the contingency is surviving the cotenants, and at the moment of death, the decedent's interest in the property passes to the survivor or survivors." *Id.* (citing *Albro*, 434 Mich. at 274-75). "When there is only one remaining joint tenant, the contingent remainder vests in the survivor a fee simple in the property." *Id.* at 304.

102. *Id.* at 303.

103. *Id.* at 304.

104. *Id.* at 304-05. "The relevant definitions of 'conveyance' include (1) '[a] voluntary transfer of a right or of property,' and (2) '[t]he transfer of a property right that does not pass by delivery of a thing or merely by agreement.'" *Id.* at 304 (alteration in original) (quoting BLACK'S LAW DICTIONARY (8th ed. 2004)).

The court then determined whether this "conveyance [was] a transfer of ownership that uncap[ped] the property for reassessment purposes."[105] The court found that there had been a conveyance, and noted that "[u]nless an applicable exception exists, the interest that vests in the last survival in a joint tenancy with right to survivorship *would* constitute a transfer of ownership because the fee simple that vests in the survivor is a 'conveyance of title . . . , the value of which is subsequently equal to the value of the fee interest.'"[106] The court held that the joint tenancy exception applied to the January 2005 conveyance.[107] "James initially created the joint tenancy in August 2004 and 'remained a joint tenant since the joint tenancy was initially created' until the joint tenancy terminated" upon his death.[108] As the exception applied, the January 2005 conveyance was not a transfer of ownership under the GPTA for purposes of reassessment.[109]

Turning to the September 2005 conveyance, the court reviewed the creation of a nonsuccessive joint tenancy, and whether this conveyance qualified for the joint tenancy exemption.[110] The court found that in 2005, the petitioner, "who held the property in sole ownership" from January 2005 until September 2005, "conveyed the property to himself and his brother as joint tenants" with rights of survivorship.[111] In applying the original ownership requirement of the statute, the court found that this "2005 conveyance was not excluded from the definition of 'transfer of ownership' . . . because under the original ownership requirement, petitioner was not an 'original owner of the property before the joint tenancy was initially created.'"[112] "Because the [previous] August 2004 and January 2005 transactions were excluded by MCL 211.27a(7)(h) from the definition of 'transfer of ownership,' neither conveyance constituted an uncapping event . . . ."[113] As neither of these conveyances constituted an uncapping event, the petitioner "did not acquire the status of an original owner to the property."[114] "Because the petitioner was not an original owner of the property before he created the

105. *Id.* at 306.

106. *Id.* (citing MICH. COMP. LAWS ANN. § 211.27a(6) (West 2009)).

107. *Klooster*, 488 Mich. at 308.

108. *Id.* at 309.

109. *Id.*

110. *Id.* at 309-10. "The tax tribunal and the court of appeals chose to focus only on the January 2005 conveyance occasioned by the death of the father did not remove" the September 2005 conveyance from the record. *Id.* at 310.

111. *Id.* at 311.

112. *Id.* (citing MICH. COMP. LAWS ANN. § 211.27a(7)(h) (West 2009)).

113. *Klooster*, 488 Mich. at 311.

114. *Id.*

joint tenancy with his brother, the September 2005 conveyance did not satisfy the joint tenancy exception of MCL 211.27a(7)(h)."[115] The court held that the "September 2005 conveyance was therefore a transfer of ownership that uncapped the subject property" and required the property to be reassessed under the GPTA.[116]

While this decision may not give a great deal of comfort to many of those currently holding vacation property, the court went beyond deciding the case, and also applied it to the creation of successive joint tenancies. The court noted that "[i]f the property had been held in a joint tenancy before the conveyance *creating* a successive joint tenancy," then "[t]he continuous-tenancy requirement pertains to the immediately preceding joint tenancy . . . ."[117] Thus, had a joint tenancy between the petitioner and his brother been created when the father was still alive, and had the father relinquished his interest, this would have permitted the property to pass to the sons without an uncapping event.[118]

The court has provided clear direction for practitioners to heed if they wish to avoid the results of *Klooster v. City of Charlevoix*.[119] However, one wonders how long such a technique will last, given the state's propensity to retroactively legislate away judicial victories. It may likely only be a matter of time before the legislature proposes legislation to do away with the benefits of creating a successive joint tenancy prior to the relinquishment of an interest by a cotenant. Until that occurs, however, practitioners should listen wisely to the words of the Michigan Supreme Court.

II. SINGLE BUSINESS TAX CASE

A. Preston v. Department of Treasury

Preston v. Department of Treasury[120] involved a question regarding the correct apportionment method that should be used by a general partner for purposes of the Single Business Tax Act.[121] The plaintiff was a general partner that owned a lower level partnership, which in turn

115. *Id.* at 311-12.
116. *Id.* at 312.
117. *Id.*
118. *Id.* at 313.
119. *See generally Klooster*, 488 Mich. at 313.
120. 292 Mich. App. 728, -- N.W.2d -- (2011). It should be noted that members of the author's firm represented the plaintiff in this matter.
121. *Id.*; MICH. COMP. LAWS ANN. § 208.1-.145, *repealed by* 2006 Mich. Pub. Act 325, (effective Dec. 31, 2007).

owned two nursing homes operating in Michigan.[122] The general partner also held interests in other partnerships, which also held similar nursing home operations in other states.[123] The income from the lower-tiered partnership in Michigan was offset by losses from the other partnerships that operated nursing homes outside of Michigan.[124] The general partner had filed its Single Business Tax return as a unitary group, and had apportioned the income and losses pursuant to MCL 206.103.[125]

"One of the lower [tier] partnerships was Riverview Medical Investors LP (RMI)."[126] RMI owned two nursing homes in Michigan.[127] The Department of Treasury ("Treasury") audited the taxpayer's individual income tax returns and assessed income tax deficiencies on the basis that the taxpayer was required to "apportion *all* of his income derived from RMI to [the State of] Michigan and [was] not permitted to apportion income and losses from [the] other partnerships, because the other partnerships did not operate in Michigan."[128]

The court of claims heard the plaintiff's motion for summary disposition and granted it from the bench.[129] "[T]he court of claims concluded that it was clear that the businesses were all related and were intended to operate as one [unitary] unit."[130] "[The] defendant filed a motion for reconsideration, which the court of claims denied," and an appeal was taken to the court of appeals.[131]

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122. *Preston*, 292 Mich. App. at 730-31.

123. *Id.* at 731.

124. *Id.* at 731-32.

125. *Id.* at 732. The plaintiff in this case owned ninety-nine percent of Life Care Affiliates II ("LCAII"), of which ninety-eight percent was owned as a general partner and one percent was owned as a limited partner. *Id.* at 730. LCAII itself was a general partner in twenty-two lower level partnerships. *Id.* The partnerships owned twenty-seven nursing homes operating in eleven different states. *Id.* LCAII owned ninety-nine percent interest as a general partner and plaintiff owned a one percent interest as a limited partner. *Id.* Ninety-nine percent of the profits and losses from the nursing homes were distributed to LCAII as the general partner. *Id.* LCAII then combined the profits and losses distributed from the lower tier partnerships and distributed them to plaintiff on his ninety-nine percent interest in LCAII. *Id.* LCAII had no other business activity and all of its income and other items in its tax base were pass through items from its twenty-two lower level partnerships. *Id.* at 730-32.

126. *Id.* at 730.

127. *Id.*

128. *Preston*, 292 Mich. App. at 731-32 (emphasis added). "Plaintiff requested an informal conference with [the Treasury] and argued that the income from RMI should be apportioned with the income and losses of all the nursing homes because RMI was part of plaintiff's unitary nursing home business." *Id.* at 732. The Hearing Referee had rejected this argument. *Id.* at *3. The plaintiff then filed a complaint in the court of claims. *Id.*

129. *Id.* at 730.

130. *Id.* at 732.

131. *Id.*

On appeal, the Treasury argued that the income from RMI must be apportioned solely to Michigan "because RMI operates exclusively in Michigan," and could not be combined with the income and losses from the other partnerships because the other partnerships did not operate in Michigan.[132] Further, the Treasury reasoned "that plaintiff's income was not derived from a 'unitary business,' but rather arose from several separate business entities, therefore precluding apportionment."[133] The court of appeals disagreed and found that plaintiff's business did indeed operate as a unitary business group.[134]

The opinion is noteworthy as it provides a short, but very precise, analysis of why apportionment is the lynch pin of the unitary business theory.[135] With the codification of the unitary theory with the Michigan Business Tax Act and the Corporate Income Tax Act, and audits under these Acts just beginning or to begin over the next several years, it is important for practitioners not familiar with the unitary theory to get up to speed in order to assist their clients. This case makes for easy learning of this concept.

The court discussed the factors that lead to the adoption of apportionment methodology.[136] "[A]pportionment is often implemented because of the difficulties in trying to allocate taxable income based on geographic boundaries."[137] Under the unitary business principle, "states are permitted to tax multistate businesses on an apportionable share of the multi state business carried on in part in the taxing state."[138] Under the Michigan Individual Income Tax Act (IITA), Michigan has also adopted an apportionment based tax regime.[139] "If a taxpayer's income-producing activities are confined solely to Michigan, then its entire income [from such activities] must be allocated to Michigan."[140] If a taxpayer has income from business activities from both inside and outside of Michigan, the income is apportioned according to MCL 206.103.[141] "In order to apply Michigan's formula apportionment there

132. *Id.* at 732-33.

133. *Id.*

134. *Preston*, 292 Mich. App. at 737.

135. *See generally id.*

136. *See id.* at 733-36.

137. *Id.* at 733 (citing Allied-Signal, Inc. v. Dir., Div. of Taxation, 504 U.S. 768, 778 (1992); Container Corp. of Am. v. Franchise Tax Bd., 463 U.S. 159, 164 (1983)).

138. *Id.* (quoting *Allied-Signal*, 504 U.S. at 778).

139. *Id.* at 733.

140. *Preston,* 292 Mich. App. At 733. (pursuant to MICH. COMP. LAWS ANN. § 206.102 (West 2011)).

141. *Id.* at 734. MICH. COMP. LAWS ANN. § 206.103 provides that "income is apportioned to Michigan 'by multiplying the income by a fraction, the numerator of which is the property factor plus the payroll factor plus the sales factor, and denominator

must 'be some sharing or exchange of value not capable of precise identification or measurement—beyond the mere flow of funds arising out of a passive investment or a distinct business operation—which renders formula apportionment a reasonable method of taxation.'"[142] "In the absence of some underlying unitary business, multistate apportionment is precluded."[143]

In determining whether or not there is a unitary business group, the court cited *Container Corporation of America v. Franchise Tax Board*,[144] which held that the determination of whether a unitary business group exists is based upon whether there exists: "(1) economic realities, (2) functional integration, (3) centralized management, (4) economies of scale, and (5) substantial mutual interdependence."[145] The Treasury provided several arguments in support of its position that the court should ignore the existence of the other partnerships and preclude the taxpayer from apportioning its income.[146] The court dismissed all of the arguments the Treasury put forth, and found its interpretation "ignored the existence of the plaintiff" and "[was] a strained reading of the administrative rule," and the court disagreed that "the unitary business principle does not apply."[147] The court accepted the affidavit of the Chief Financial Officer submitted by plaintiff, which had gone unrebutted at the motion hearing for plaintiff's motion for summary disposition.[148] According to the court, it was clear "that there is some sharing or exchange of value not capable of precise identification or measurement that occurs from the centralized management," and "there [was] no general issue of material fact regarding whether LCAII is a unitary business."[149]

The arguments put forth by the defendant were ill conceived, poorly supported, and not adopted by any known state and/or local tax authority.[150] One wonders why the Treasury decided to take this appeal

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which is 3." *Id.* (quoting MICH. COMP. LAWS ANN. § 206.115 (West 2012)); *see also* Grunewald v. Dep't of Treasury, 104 Mich. App. 601, 606, 305 N.W.2d 269 (1981).

142. *Preston*, 292 Mich. App. at 734 (citing Holloway Sand & Gravel Co. Inc. v. Dep't of Treasury, 152 Mich. App. 823, 834-35, 393 N.W.2d 921 (1986))).

143. *Id.* (citing *Holloway Sand & Gravel*, 152 Mich. App. at 830).

144. 463 U.S. 159, 164 (1983).

145. *Id.*

146. *See Preston*, 292 Mich. App. at 734-36.

147. *Id.* at 735.

148. *Id.* at 737. In the affidavit, the Chief Financial Officer explained the "common operation and management techniques among the nursing homes and the resulting economies of scale." *Id.* The affidavit provided further details regarding the centralized management, reduction in costs through shared planning and centralized purchased. *Id.*

149. *Id.* (quoting *Container Corp. of Am.*, 463 U.S. at 166).

150. *See generally id.*

to the court of appeals when it could have kept its dignity intact and allowed the plaintiff to accept its victory by motion for summary disposition at the lower level, leaving it an unpublished decision. It is apparent that we may expect an increase in litigation due to the reluctance on the part of the Treasury to admit when it does not have a strong basis for an assessment. One must feel compassion for the Assistant Attorneys General assigned to the Revenue Division who, under the rules of professional responsibility, must zealously defend their client's position, even when such position is contrary to well-established United States Supreme Court precedent.[151]

III. SALES AND USE TAX CASES

A. General Motors Corporation v Department of Treasury

In a case of significant interest throughout the nation, the Michigan Court of Appeals overturned the court of claims in the matter of *General Motors Corporation v. Department of Treasury*.[152] This case was of interest due to the issue of retroactivity.[153] There were two main issues before the court.[154] First, whether legislation which amended the Use Tax Act retroactively for eleven years was impermissible under the holding of *United States v. Carlton*,[155] and second, whether the legislation

151. MICH. R. PROF. CONDUCT 1.0, comment.

152. 290 Mich. App. 355, 803 N.W.2d 698 (2010). The lower court case in this matter was covered in a prior WAYNE LAW REVIEW *Survey* Edition. *See* Lynn A. Gandhi, *Taxation*, 56 WAYNE L. REV. 1447, 1466-70 (2010) (citing Gen. Motors Corp. v. Dep't of Treasury, No. 07-151-MT (Mich. Ct. App. Apr. 17, 2009) The case was brought by General Motors (GM) to obtain a use tax refund on tax paid for demonstrator vehicles which were later sold. *Gen. Motors Corp.*, 290 Mich. App. at 385. GM's refund had been based on the decision in *Betten Auto Center Inc. v. Dep't of Treasury*, 272 Mich. App. 14, 723 N.W.2d 914 (2006), *aff'd in part and vacated in part*, 478 Mich. 864 (2007). *Gen. Motors Corp.*, 290 Mich. App. at 388. In response to GM's significant refund claims, the legislature passed 2007 Mich. Pub. Act 103, which amended the Use Tax Act, to obviate the holding of *Betten*. *Id.* at 389. In the lower court decision, the court of claims had found that the eleven year period of retroactivity of the use tax amendment violated GM's constitutional right to due process, contrary to the holding in *United States v. Carlton*, 512 U.S. 26 (1994) (permitting only a "modest" period of retroactivity for economic legislation). The court of claims had also found that 2007 Mich. Pub. Act 103 violated Michigan's Constitution regarding special legislation, MICH. CONST. art. IV, § 29, because it was enacted for the sole purpose of preventing GM from receiving use tax refunds. *Gen. Motors Corp.*, 290 Mich. App. at 359.

153. *Gen. Motors Corp.*, 290 Mich. App. at 359.

154. *Id.* at 358-59.

155. *See id.* at 371 (quoting United States v. Carlton, 512 U.S. 26 (1994)).

violated the state constitutional provisions against "special legislation."[156]

After a thorough review of the facts, the court began with an analysis of the due process considerations under the Fourteenth Amendment.[157] The court noted, "the Due Process Clause protects individual liberty and property interests from arbitrary government actions."[158] In order "to be protected under the Due Process Clause, a property interest must be a vested right."[159] "A vested right is 'an interest that the government is compelled to recognize and protect of which the holder could not be deprived without injustice.'"[160] The court noted that "[General Motor]'s claim for refund of use taxes paid was not a vested right, but rather a mere expectation that its claim might succeed in light of the *Betten* decision."[161] The court found that "GM, as a taxpayer, [did] not have a vested right in a tax statute or in the continuance of any tax law."[162] The court also found that the legislation satisfied the "first *Carlton* due process criterion for permissible retroactive legislation; specifically that the Legislature's purpose in enacting the amendment was neither illegitimate nor arbitrary."[163]

The court clarified that the inquiry as to whether or not "[r]etroactive economic legislation must satisfy [the] rational basis tests for both prospective as well as retrospective application."[164] The court noted that the "[l]egislature may not reverse a judicial decision or repeal a final judgment,"[165] and that neither occurred with the enactment of 2007 Mich. Pub. Act 103.[166]

This case began when "GM filed its first claim for a refund of the use taxes paid on its employees' use of program vehicles over [a

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156. *See id.* at 378 (citing MICH. CONST. art. IV, § 29).

157. *See id.* at 370.

158. *Id.* (citing People v. Sierb, 456 Mich. 519, 522-23, 581 N.W.2d 219 (1998); Cummins v. Robinson Twp., 283 Mich. App. 677, 700-01, 770 N.W.2d 421 (2009)).

159. *Gen. Motors Corp.*, 290 Mich. App. at 370 (citing Detroit v. Walker, 445 Mich. 682, 698-99, 520 N.W.2d 135 (1994); Sherwin v. State Hwy Comm'r, 364 Mich. 188, 200, 111 N.W.2d 56 (1961)).

160. *Id.* (quoting *Walker*, 445 Mich. at 699)).

161. *Id.* at 371. GM had asserted that the use of program vehicles was exempt from taxation because the vehicles were purchased for resale and demonstration purposes under MICH. COMP. LAWS ANN. § 205.94(1)(c), as interpreted by *Betten Auto Center, Inc. v. Dep't of Treasury*, 272 Mich. App. 14 (2006), *aff'd in part and vacated in part*, 478 Mich. 864 (2007).

162. *Gen. Motors Corp.*, 290 Mich. App. at 371.

163. *Id.* at 372 (quoting *Carlton*, 512 U.S. at 32).

164. *Id.* at 372.

165. *Id.* at 372-73.

166. *Id.* at 373.

specified period and] Treasury held GM's claim in abeyance pending appeal of *Betten*."[167] On May 25, 2007, the Michigan Supreme Court issued its order in *Betten*.[168] Subsequent to that order, on June 7, 2007, House Bill 4882, which later became 2007 Mich. Pub. Act 103, was introduced in the Michigan House of Representatives.[169] It is clear from the legislative analysis that the Department and the Legislature "were concerned regarding the impact of the *Betten* decision on state revenue."[170] The supreme court "denied reconsideration in *Betten* on July 9, 2007" and "[o]n September 14, 2007, GM filed its second claim for a refund."[171] "Meanwhile, the Michigan House approved [House Bill] 4882" with "Senate approv[al] on September 30, 2007," and "the Governor signed the Bill into law on October 1, 2007."[172] "The Legislature gave the Act retroactive effect by providing . . . [in the] enacting section [that the Act was] curative and intended to prevent any misinterpretation of the ability of a taxpayer to claim an exemption from . . . use tax," based on the decision of the Michigan Court of Appeals in *Betten*.[173] In addition, the Legislature provided that "[t]his amendatory act is retroactive and is effective beginning September 30, 2002 and for all tax years that are open under the statute of limitations . . . ."[174]

While the Michigan Court of Appeals agreed that the "Due Process Clause imposes some limit on the retroactive reach of tax legislation,"[175] the court determined that the "totality of the circumstances establishes that the retroactive application of 2007 PA 103 did not exceed a modest" period of retroactivity.[176] The court based its decision on several reasons. First, the court noted that the legislation sought "to confirm a tax that had been assessed by Treasury and paid by the taxpayer for many years."[177] Second, the court noted, "GM did not act in reliance on an expectation its

167. *Id.* at 365.

168. *Gen. Motors Corp.*, 290 Mich. App. at 365; *Betten Auto Ctr.*, 478 Mich. at 864.

169. *Gen. Motors Corp.*, 290 Mich. App. at 365.

170. *Id.* at 365-66. "The Department of Treasury estimates that the *Betten Auto Center* decision has a potential one-time cost of $250.2 million based on refund claims received from automobile manufacturers and dealerships, and projected on-going cost of $29.2 million. To the extent the bill reduces refund claims and subjects converted property and services to taxation, the state would realize cost savings on the order of the above cited figures." *Id.* at 366 (citation omitted).

171. *Id.* at 366.

172. *Id.*

173. *Id.* at 366-67 (citing 2007 Mich. Pub. Acts 103).

174. *Id.*

175. *Gen. Motors Corp.*, 290 Mich. App. at 375.

176. *Id.* at 375-76.

177. *Id.*

activity would not be taxed."[178] "In short, GM did not rely on the preamendment version of the Use Tax Act to its detriment."[179] Third, the court found that "the Legislature acted promptly in response to the *Betten* decision to correct what might have resulted in a significant loss of previously collected revenue," and that there was no delay in acting.[180] Fourth, the court found that "the nominal period to which the amendment retrospectively applies—five years—could be said to extend beyond the taxpayer's interest in finality and repose because the period of retroactivity is consistent with the applicable statute of limitations."[181]

This modest period of retroactivity seemed extreme in light of GM's argument that it applied for eleven years, but the court found that the additional period of retroactivity was due to GM's having waived its interest in the applicable statute of limitations, and therefore GM could not now argue that it had an interest in finality and repose under the Due Process Clause.[182] "In summary, [the court of appeals found that] GM [did not] overcome the presumption that 2007 PA 103 [was] constitutional."[183] As "GM [did] not have a vested right to the continuation of a tax statute, and [as] the period of retroactivity [did] not exceed the limits of the Due Process Clause," the court found that it must overturn the court of claims' decision.[184]

In turning to GM's second argument "that 2007 PA 103 violat[ed] the Michigan constitutional provision [against] special legislation,"[185] the court concurred with the lower court and found that the legislation did not constitute special legislation.[186] The court noted that "[if] a law is general and uniform in its operation upon all persons and like circumstances, it is general in the constitutional sense."[187] The fact that

178. *Id.*
179. *Id.*
180. *Id.*
181. *Gen. Motors Corp.*, 290 Mich. App. at 376.
182. *Id.* at 376-77.
183. *Id.* at 377.
184. *Id.* at 378.
185. *See id.* (citing MICH. CONST. art. IV, § 29, providing that "the legislature shall pass no local or special act in any case where a general act can be made applicable, and whether a general act can be made applicable, shall be a judicial question. No local or special act shall take effect until approved by two-thirds of the members elected to and serving in each house and by a majority of the electors voting thereon in the district effected. Any act repealing local or special acts shall require only a majority of the members elected to and serving in each house and shall not require submission to the electors of each district.").
186. *Id.* at 378.
187. *Gen. Motors Corp.*, 290 Mich. App. at 379 (citing Rohan v. Detroit Racing Ass'n, 314 Mich. 326, 350, 22 N.W.2d 433 (1946)).

the law only applies to a limited number of persons does not necessarily make it a special law, rather than a general law.[188] There was no specific language in 2007 Mich. Pub. Act 103 that limited its application to GM.[189] "However, the fact that other vehicle manufacturers decided not to seek a use tax refund does not mean that the act did not apply [to them]."[190] The court of appeals noted that the court of claims' reliance regarding the lack of legislative committee hearings did not support it's ruling that the law was a special law.[191] There is no legal authority holding that the lack of committee hearings is a basis for finding that legislation is "special" legislation.[192] The court of appeals also highlighted that "[n]othing [in the record] rebut[ed] the presumption of propriety regarding the enactment of 2007 PA 103[,]" and that "[t]he Court of Claims must be reversed on the issue."[193]

Both the Michigan Supreme Court and the U.S. Supreme Court denied an appeal.[194] There is a motion pending before the Michigan Supreme Court for reconsideration but one cannot hold out hope in vain. What is clear in Michigan is that a period of retroactivity will be deemed to be modest if on its legislative face, such period is limited to the statute of limitations for the tax involved.[195] The case of *General Motors* follows the cases *GMAC L.L.C. v. Department of Treasury*, which permitted a seven-year retroactive application[196] and *Enterprise Leasing Company of Phoenix v. Arizona Department of Revenue.*[197] Retroactive legislation is difficult enough, but retroactive tax legislation is even more so, due to taxpayers' reliance on tax law. It is strange that the courts have adopted a definition of a "modest" period of retroactivity for tax legislation that prohibits refunds, while legislation in the other areas of tax, such as rate increases, would produce a loud outcry if enacted

188. *Id.* at 378-79 (quoting *Rohan*, 314 Mich. at 349)).

189. *Id.* at 379.

190. *Id.*

191. *Id.* at 379-80.

192. *Id.* at 380.

193. *Gen. Motors Corp.*, 290 Mich. App. at 380. The court continued to deal with the other issues raised regarding the filing of an amended complaint and the Takings Clause as well as the Title-Object Clause that had been raised by GM. *Id.* None of these arguments passed muster with the court of the appeals and the case was reversed with no jurisdiction retained. *See id.* at 388-89.

194. Gen. Motors Corp. v. Mich. Dep't of Treasury, 132 S. Ct. 1143 (2012); Gen. Motors Corp. v. Mich. Dep't of Treasury, 489 Mich. 991, 800 N.W.2d 85 (2011).

195. *Gen. Motors Corp.*, 290 Mich. App. at 374-75.

196. GMAC L.L.C. v. Dep't of Treasury, 206 Mich. App. 365, 781 N.W.2d 310 (2009).

197. 211 P.3d 1 (Ariz. 2008).

retroactively.[198] Consider, for example, a five-year retroactive amendment to the personal income tax rate. What is clear is that state legislatures, motivated by fear of the loss of revenues, are emboldened and empowered and have been blessed by their judicial brethren to treat corporate taxpayers as unlimited sources of revenue.

IV. THE MICHIGAN CORPORATE INCOME TAX[199]

In 2011, the Administration held true to its campaign promise to eliminate the Michigan Business Tax.[200] Within six months of election, Governor Snyder proposed and passed the Michigan Corporate Income Tax (CIT).[201] The CIT continues many of the attributes of the Michigan Business Tax, while providing several new key provisions that require review and implementation measures prior to the January 1, 2012 effective date of the tax.[202]

A. Entities Subject to Tax

Every taxpayer with nexus conducting business activity within Michigan is subject to the tax.[203] In addition, under the CIT, any person with an "ownership interest or beneficial interest in a flow-through entity that has business activity in the state" will also be subject to tax.[204] The tax is levied at a rate of six percent.[205] The tax is only applicable to C-corporations and unitary business groups.[206] 'Corporation' is defined as

198. As Justice O'Connor noted in her concurring opinion in *Carlton*, "the Court has never intimated that Congress possesses 'unlimited power to 'readjust rights and burdens . . . and upset otherwise settled expectations.'" *Carlton*, 512 U.S. at 37-38 (O'Connor, J., concurring) (quoting Connley v. Pension Benefit Guaranty Corp., 475 U.S. 211, 229 (1986)). In Justice O'Connor's view, "[t]he governmental interest in revising the tax laws must at some point give way to the taxpayer's interest in finality and repose." *Id.* at 37-38 (O'Connor, J., concurring).

199. This section has been co-authored by June Summers Haas, a partner in the Lansing office of Honigman Miller Schwartz and Cohn LLP. Ms. Haas also specializes in state and local tax.

200. Chris Christoff & Kathleen Gray, *Gubernatorial Candidates Bernero, Snyder Clash Over Michigan's Future*, DETROIT FREE PRESS (Oct. 11, 2010), *available at* http://www.freep.com/article/2010101/NEWS15/10110488/Gubernatorial-candidates-Bernero-Snyder-clash-over-Michigan-s-future.

201. 2011 Mich. Pub. Acts 37, codified in various sections of MICH. COMP. LAWS ANN. § 206 (West 2011).

202. *Id.*

203. MICH. COMP. LAWS ANN. § 206.623(1).

204. *Id.*

205. *Id.*

206. MICH. COMP. LAWS ANN. § 206.605 (West 2011).

"a person that is required or has elected to file as a C corporation as defined under section 1361(a)(2) and section 7701(A)(3) of the internal revenue code [(IRC)]."[207] For the first time since 1976, flow-through entities (partnerships, limited liability companies, and S-corporations) will not be subject to an entity level business tax in Michigan.[208] Instead, the income of flow-through entities is only subject to a single level of tax at the partner or shareholder level.[209] Insurance companies continue to be subject to the gross premiums tax similar to that previously imposed under the MBT,[210] and financial institutions continue to be subject to a net capital tax, also similar to that previously imposed under the MBT.[211]

Interestingly, while the income of flow-through entities may still be included in the tax base of corporate members, the statute does not provide for the flow-through entity's factors to be included in the apportionment factor of the corporate member, unless the flow-through entity meets the statutory tests to be included in the corporate member's unitary business group.[212] Recalling the basic tenents of state taxation that relate to unitary taxation and apportionment, it is a well-accepted doctrine that a state cannot tax income that does not arise from unitary business conducted in the state,[213] and that the income from a unitary business group must be fairly apportioned.[214] An open question under the CIT is whether all distributions from flow-through entities are properly includible in the tax base of a corporate member, particularly distributions that are related to passive investments or for which there is no flow of value between the flow-through entity and its member.

B. Unitary Business Group and Mandatory Combined Filing Requirement

The CIT continues the imposition of tax on a unitary business group with the mandatory combined filing methodology implemented with the passage of the MBT.[215] The state's purpose in adopting mandatory

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207. MICH. COMP. LAWS ANN. § 206.605(1) (West 2011).

208. MICH. COMP. LAWS ANN. § 206.609 (West 2011); 2011 Mich. Pub. Acts 176. A flow-through entity may be included in a taxpayer's unitary business group if it meets the required statutory tests. *Id.*

209. *See* MICH. COMP. LAWS ANN. §206.623(1).

210. *See* MICH. COMP. LAWS ANN. § 206.635.

211. *See* MICH. COMP. LAWS ANN. § 206.653(1). There were minor changes to the net worth tax for treasury balances.

212. *See supra* note 208.

213. *See* Allied Signal, Inc. v. Dir., Div. of Taxation, 504 U.S. 768 (1992).

214. *See* Complete Auto. Transit, Inc. v. Brady, 430 U.S. 976 (1977).

215. *See* MICH. COMP. LAWS ANN. §§ 206.611(5)-.691 (West 2011).

unitary business group filing was to prevent the perceived tax planning among members of an affiliated group. Under the CIT, a unitary business group may include corporations (including partnerships and limited liability companies taxed as corporations) as well as insurance companies and financial institutions.[216] While insurance companies and financial institutions are not subject to the CIT, inclusion of these entities in the unitary business group ensures that calculation of the unitary business group tax base excludes intercompany transactions.[217] Whether a business group is considered unitary under the CIT is determined on a waters-edge basis, and excludes foreign companies from the unitary group.[218] A unitary business group must be comprised of United States persons.[219] A United States person is defined as having the same meaning "as defined in section 7701(a)(30) of the internal revenue code."[220] Foreign operating entities, as specifically defined in the CIT, are not eligible for inclusion in the unitary business group.[221]

The CIT defines a unitary business group as "a group of United States persons, . . . other than a foreign operating entity, 1 of which owns or controls . . . more than 50% ownership interest with voting rights [or the equivalent of voting rights]."[222] In addition, there must be "business activities or operations which result in a flow of value" or contribution and dependency between or among the corporations in the unitary group.[223] Thus, a unitary business group must meet the control test and one of two alternative relationship tests: (1) the flow of value test, or (2) the integration, dependency, or contribution test.[224] Previously, the

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216. MICH. COMP. LAWS ANN. § 206.611(6).

217. *Id.*

218. *Id.*

219. *Id.*

220. MICH. COMP. LAWS ANN. § 206.611(7).

221. MICH. COMP. LAWS ANN. § 206.607 defines a foreign operating entity as a United States corporation that "[h]as substantial operations outside the United States, the District of Columbia, any territory or possession of the United States except for the commonwealth of Puerto Rico" and "[a]t least 80% of its income is active foreign business income as defined in section 861(C)(1)(b) of the [IRC]." *Id.* § 206.607(3). Under the IRC, businesses operating and generating income in a U.S. possession or territory generate foreign source income. So it seems illogical, and also contrary to other states' definitions of 80/20 companies, that the Michigan foreign operating entity definition requires substantial operations outside U.S. possessions and Puerto Rico, along with 80% of its income as active foreign business income, which could include income from Puerto Rico and the U.S. possessions and territories. MICH. COMP. LAWS ANN. § 206.607.

222. MICH. COMP. LAWS. ANN. § 206.611(6).

223. *Id.*

224. *Id.*

Treasury issued nonbinding Revenue Administrative Bulletins[225] and frequently asked questions and answers (FAQ) to provide guidance on the application of these tests and the composition of the unitary business group under the MBT.[226] Similar guidance is expected to be issued in regard to the unitary business group determinations under the CIT, given the similar statutory definition of a unitary business group.

1. Control Test

Under the control test, one member of the unitary business group must own or control more than a 50% ownership interest with voting rights or the equivalent of voting rights.[227] In Revenue Administrative Bulletin 2010-1, *Michigan Business Tax Unitary Business Group Control Test*, the Department expressed the position that

> [a] person owns or controls more than 50% of the ownership interests with voting rights . . . if that person owns or controls, directly or indirectly, (1) more than 50% of the total combined voting power of all ownership interests with voting (or comparable) rights *or* (2) more than 50% of the total value of all ownership interests with voting (or comparable) rights.[228]

The Treasury indicated that an ownership interest with comparable rights to voting rights is one that confers the power "to vote in the selection of the management of the entity."[229] In Revenue Administrative Bulletin 2010-1, the Treasury stated that parent-subsidiary and brother-sister controlled group of entities will meet the control test where there is

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225. *See, e.g.*, DEP'T OF TREASURY, REV. ADMIN. BULL. NO. 2010-1, MICHIGAN BUSINESS TAX UNITARY BUSINESS CONTROL GROUP TEST (2010); DEP'T OF TREASURY, REV. ADMIN. BULL. NO. 2010-2, MICHIGAN BUSINESS TAX UNITARY CONTROL GROUP RELATIONSHIP TESTS (2010). Revenue Administrative Bulletins (RABs) are not issued in accordance with the Michigan Administrative Procedures Act, 1969 Mich. Pub. Acts 306, and thus do not have the force and effect of law, and are not legally binding authority in the state. An RAB is not binding on taxpayers or the Department, although the Department has issued an RAB claiming to be bound by the positions in its Revenue Administrative Bulletins. *See* DEP'T OF TREASURY, REV. ADMIN. BULL. NO. 1989-39, INTERPRETATIONS OF TERMS AND DISCLOSURE (1989).

226. *See* MICHIGAN TAXES, *Frequently Asked Questions*, http://www.michigan.gov/taxes/ 0,1607,7-238-47449---F,00.html.

227. MICH. COMP. LAWS ANN. § 206.611(6).

228. DEP'T OF TREASURY, REV. ADMIN. BULL. NO. 2010-1, MICHIGAN BUSINESS TAX UNITARY BUSINESS CONTROL TEST (2010).

229. *Id.*

more than 50% ownership.[230] The Treasury has also stated that brother-sister entities may constitute a unitary business group, even if the owners are not included in the group.[231] The Treasury applied IRC section 1563(c), but for IRC section 1563(c)(2)(B), to exclude certain ownership interests from the determination of the control test.[232]

The Treasury has indicated its intent to apply rules similar to the federal attribution rules to ownership interests among immediate family members and between corporations and their shareholders to determine control of a unitary business group.[233] Under the Treasury's interpretation, an individual is deemed to constructively own the ownership interests of his spouse, children, grandchildren and parents.[234] In addition, a shareholder that owns more than 50% in value of the stock of a corporation is considered to own all stock "owned, directly or indirectly, by or for [the] corporation in that proportion to which the value of the stock which . . . bears to the value of all the stock of the corporation."[235] Conversely, the corporation is deemed to own all the ownership interests owned, directly or indirectly, by or for that shareholder.[236] The Treasury has acknowledged that, under the attribution rules, a controlled group of entities may meet the control test but not be under the control of any one member of the group (such as attributed ownership between feuding family members). In such case, if the group fails to satisfy the control standards as described by the United States Supreme Court, then that group is not a unitary business group.[237]

The Treasury has also taken the position that a foreign (non-U.S.) entity treated as a single member limited liability company disregarded for federal tax purposes under a U.S. parent company is not includible in a unitary business group.[238] Accordingly, a foreign SMLLC must file a separate CIT return if the entity has nexus and sufficient business activity in Michigan.[239] The Treasury has stated that U.S. subsidiaries of a foreign entity may constitute a unitary business group, even though the

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230. *See id.*

231. *See* MICHIGAN TAXES, *supra* note 226.

232. *See* 26 U.S.C. § 1563(c) (2006).

233. *See* DEP'T OF TREASURY, REV. ADMIN. BULL. NO. 2010-1, MICHIGAN BUSINESS TAX UNITARY BUSINESS CONTROL TEST (2010).

234. *Id.*

235. *Id.*

236. *Id.*

237. *Id.*

238. *See* MICHIGAN TAXES, *Frequently Asked Questions No.* U31, http://www.michigan.gov /taxes/0,1607,7-238-47449---F,00.html.

239. *See* MICHIGAN TAXES, *Frequently Asked Questions No.* U36, http://www.michigan.gov /taxes/0,1607,7-238-47449---F,00.html.

foreign entity is a separate filer, when both the control and relationship tests are met.[240]

2. Relationship Test

Under the first of the two alternative relationship tests, members are unitary if there is a flow of value between the members.[241] Flow of value has been defined by the Department as created by functional integration, centralized management, and economies of scale.[242] Functional integration is generally demonstrated through common programs or systems and shared information or property.[243] Centralized management comes from common management or directors, shared staff functions, and business decisions made for the group, rather than separately by each member.[244] Economies of scale include centralized business functions and pooled benefits or insurance.[245] Vertically or horizontally integrated businesses, conglomerates, parent companies with their wholly owned subsidiaries, and entities in the same general line of business commonly exhibit a flow of value.[246] However, flow of value must be more than "the mere flow of funds arising out of passive investment."[247]

Under the second alternative relationship test, businesses must be "integrated with, dependent upon, or contribute to each other" (the "integration, dependency or contribution test").[248] This test is "commonly satisfied when one entity contributes to the financing of operations of another or when intercompany transactions exist, including operational financing."[249]

Foreign entities with nexus will have to file on a stand-alone basis.[250] Of course, a foreign entity without a permanent establishment in the U.S. will not have federal taxable income, and the expectation would be that a state corporate income tax would also not apply. However, without a physical presence in the U.S., there may be limited federal tax treaty protection. This may allow the Department to assert that the entity must

240. *Id.*

241. DEP'T OF TREASURY, REV. ADMIN. BULL. NO. 2010-2, MICHIGAN BUSINESS TAX UNITARY BUSINESS GROUP RELATIONSHIP TESTS (2010).

242. *Id.*

243. *Id.*

244. *Id.*

245. *Id.*

246. *Id.*

247. DEP'T OF TREASURY, REV. ADMIN. BULL. NO. 2010-2, MICHIGAN BUSINESS TAX UNITARY BUSINESS GROUP RELATIONSHIP TESTS (2010).

248. *Id.*

249. *Id.*

250. *Id.*

file on a stand-alone basis for CIT filing under the nexus standard contained in the Act.

3. Nexus

Michigan asserts a broad jurisdiction to impose tax under the CIT nexus standard.[251] There are three primary nexus standards under the CIT. First, any taxpayer with physical presence within Michigan for more than one day is included.[252] Second, any taxpayer that actively solicits business in the state and has Michigan sourced gross receipts greater than $350,000 is also included.[253] Third, a new nexus standard incorporated into the statute is the assertion of nexus over any taxpayer that "has an ownership interest or a beneficial interest in a flow-through entity, directly or indirectly through 1 or more flow-though entities."[254]

As a net income tax, the CIT is subject to the limitations of Federal Pub. Law 86-272.[255] Under Pub. Law 86-272, a state cannot impose a net income tax if the taxpayer's only contact with the state is solicitation of orders for sales of tangible personal property when orders are sent outside of Michigan for acceptance and filled by shipment or delivery from outside Michigan.[256] Pub. Law 86-272 protection does not apply to sales of services and intangibles, if there are any activities other than protected solicitation activities, or to activities ancillary to solicitation.[257]

This physical presence standard is in place under both the SBT and the MBT, and similar standards for CIT purposes are expected to be the same as those contained in RAB 2008-4, *Michigan Business Tax Nexus Standards*. Nexus-creating activities do not include the activities of professionals providing services when those services are not associated with establishing or maintaining the marketplace in Michigan.[258]

One controversial area of this nexus standard is the imposition of tax on persons whose only activity in the state is "active solicitation" with more than $350,000 in gross receipts apportioned to Michigan.[259] 'Active solicitation' is to be defined in written guidance to be applied

251. *See* MICH. COMP. LAWS ANN. § 206.621 (West 2011).
252. *See id.* § 206.621(1).
253. *Id.*
254. *Id.*
255. *See* 15 U.S.C. §§ 381-84 (2006).
256. 15. U.S.C. § 381(a)(1).
257. *See* list of unprotected activities in subsection (II)(C) of RAB 2008-4, *Michigan Business Tax Nexus Standards*.
258. MICH. COMP. LAWS ANN. § 206.621(2)(b).
259. MICH. COMP. LAWS ANN. § 206.621(1).

prospectively.[260] The same standard was enacted under the MBT and defined in RAB 2007-6, *Actively Solicits Defined.*[261] Similar standards are expected to be issued for the CIT prior to the effective date of the tax. Under the MBT, active solicitation is defined as purposeful solicitation that "is directed at or intended to reach persons within Michigan or the Michigan market."[262] Purposeful solicitation includes "speech or conduct that explicitly or implicitly invites an order" or activities that are "entirely ancillary to a request for an order."[263] The Department has defined the active solicitation standard to include advertising through print, radio, internet, television, and other media.[264] Under the active solicitation standard any Michigan businesses is eligible to apportion sales if the business "actively solicits" customers in other states.[265] There are ten other states that assert a statutory economic presence nexus standard. To date, there have been no court decisions on any of these standards.

The newest nexus standard is based upon ownership of an interest in a flow-through entity.[266] Under this standard, an ownership interest in an S-corporation, partnership or trust will create nexus if the flow through entity is conducting business activity in Michigan.[267] There is no minimum amount of ownership interest needed to create nexus. And while the interest must be a "beneficial" interest, the term is not statutorily defined,[268] other than the acknowledgement that such ownership interest can be direct or indirect.[269] Again, the statute lacks clarity and does not define the parameters of what would constitute an indirect interest. We anticipate further guidance on this standard to be issued by the Department, but surmise that the premise adopted by the Department is that of attributional nexus, created due to the attribution of the business activity of the flow-through entity to its corporate owner(s). The Treasury has stated that if one member of the unitary group has nexus with Michigan, the entire unitary business group has nexus.[270]

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260. MICH. COMP. LAWS ANN. § 206.621(2)(a).

261. *See* DEP'T OF TREASURY, REV. ADMIN. BULL. NO. 2007-6, ACTIVELY SOLICITS DEFINED (2007).

262. *Id.*

263. *Id.*

264. *Id.*

265. MICH. COMP. LAWS ANN. § 206.661(2).

266. *See* MICH. COMP. LAWS ANN. § 206.621(1).

267. *Id.*

268. *Id.*

269. *Id.*

270. *See* DEP'T OF TREASURY, REV. ADMIN. BULL. NO. 2008-4, MICHIGAN BUSINESS TAX NEXUS STANDARD (2008).

Thus, a flow-through entity can create nexus for a member's entire unitary group, even though the flow-through entity itself, by definition, cannot be included within the owner's unitary business group (albeit the inclusion of its factors and income).

C. Calculating the Tax Base Under the CIT

The CIT base begins with federal taxable income.[271] The CIT adds back all state, local and net income taxes deducted in the calculation of federal taxable income, as well as interest and divided income from other state obligations or securities, less related expenses.[272] In addition, federal net operating loss (NOL) addbacks and carryforwards are eliminated from federal taxable income.[273] The CIT decouples from IRC sections 168(k) and 199, and thus amounts deducted under these provisions are also added back to the CIT base.[274] All dividends and royalties from foreign entities and foreign operating entities must also be added back to the extent they are deducted from federal taxable income.[275]

The CIT continues the MBT related party royalty and interest add-back.[276] Any deduction for a "payment of royalty, interest, or other expense paid to a person related . . . [and] not included in the taxpayer's unitary business group" must be added back unless

> [t]he taxpayer can demonstrate that the transaction has a nontax business purpose, is conducted with arm's-length pricing and rates and terms as applied in accordance with sections 482 and 1274(d) of the internal revenue code, and 1 of the following is true: (i) The transaction is a pass through of another transaction between a third party and the related person . . . . (ii) An addition would result in double taxation . . . . (iii) An addition would be unreasonable as determined by the state treasurer. (iv) The related person recipient of the transaction is organized under the laws of a foreign nation which has in force a comprehensive income tax treaty with the United States.[277]

271. MICH. COMP. LAWS ANN. § 206.623(2).
272. *Id.*
273. MICH. COMP. LAWS ANN. § 206.623(2)(c).
274. MICH. COMP. LAWS ANN. § 206.623(2)(d).
275. MICH. COMP. LAWS ANN. § 206.623(2)(d)-(e).
276. *See* MICH. COMP. LAWS ANN. § 206.623(2)(e).
277. *Id.*

Income and expenses from oil and gas are eliminated from the tax base.[278]

The tax base of a unitary business group is calculated in the same manner, except that any income and expenses are eliminated from the tax base.[279] This includes intercompany transactions from flow-through entities that are included in the unitary business group.[280]

D. Apportionment Under the CIT

The CIT continues the single one hundred percent sales factor adopted under the MBT.[281] The state's move to a solely sales factor was based on the decision to neutralize a business's decision on whether to locate or expand a facility in Michigan. With a single sales factor, a business' increase in property or payroll in the state will have no effect on its CIT tax burden, as there will be no increase in its apportionment factor.[282] Rather, the tax burden is distributed based on the amount of sales made to customers in Michigan.[283] Many of the legislators and others who designed the CIT were straightforward in stating that they retained the MBT single sales factor in order to make the new tax as appealing as possible for businesses to locate to, or expand in, Michigan. Thus, all taxpayers who are subject to the CIT will apportion their income based on one hundred percent sales factor.[284] The statute specifically provides that a taxpayer may not use the three-factor apportionment provided under the Multistate Tax Compact.[285]

The CIT adopts the *Finnigan*[286] standard of apportionment by statutorily incorporating the rule that the sales of any member of a unitary group is included in the numerator of the sales factor, even if that member does not otherwise have nexus in Michigan.[287] The general apportionment rules are destination-based, or where the customer

278. MICH. COMP. LAWS ANN. § 206.623(2)(g).
279. MICH. COMP. LAWS ANN. § 206.623(3).
280. *Id.*
281. *Id.*
282. *Id.*
283. MICH. COMP. LAWS ANN. § 206.663(1).
284. *Id.* § 206.663(3).
285. *Id.* Note, the statutory prohibition against using the MTC 3-factor formula only became effective on January 1, 2011. This implies a permissive use of the factor for those periods prior to January 1, 2011. Taxpayers should consider possible claims for periods still open.
286. *See* Appeal of Finnigan Corp., No. 88-SBE-022, SBE 8-25-88 (Cal. Aug. 25, 1988).
287. MICH. COMP. LAWS ANN. § 206.663(2).

receives the benefit.[288] For income from real and personal property, the rules are essentially the same as under the MBT.[289] Income from sales of tangible personal property is sourced to the ultimate destination.[290] Income "from the sale, lease, rental, or licensing of real property" is sourced to the location of the real property.[291] Rental tangible property receipts are sources based on the days in state to days everywhere, and rental mobile transportation property receipts are a source based on in-state use.[292]

In general, financial receipts are sourced in accordance with financial apportionment sourcing rules that were previously contained in the MBT and in RAB 2002-14. Royalties and income are sourced to the state where the intangible property was used.[293] Interest from loans secured by real property is sourced based on the location of the real property.[294] Interest from loans not secured by real property is sourced to the location of the borrower.[295] Income from sales of services is sourced to where the customer receives the benefit of the services.[296] If the benefit is received in more than one state then the receipts are included in proportion to the in-state benefit.[297] The MBT alternative apportionment rule that allows taxpayers to petition for use of one or more factors continues.[298] The statute provides that the apportionment provisions are presumed to fairly attribute, and in order to obtain permission to utilize an alternative apportionment methodology, a taxpayer must demonstrate "that the business activity attributed to the taxpayer in state is out of all appropriate proportion . . . and leads to a grossly distorted result."[299]

E. Small Business Credit

The CIT continues the small business credit from the MBT.[300] This "credit" is actually a compliance mechanism that has the effect of

288. MICH. COMP. LAWS ANN. § 206.665.
289. *Id.* at § 206.665(1)(b).
290. *Id.* at § 206.665(1)(a).
291. *Id.* at § 206.665(1)(b).
292. *Id.* at § 206.665(1)(c)-(d).
293. *Id.* at § 206.665(1)(e).
294. MICH. COMP. LAWS ANN. § 206.665(4).
295. *Id.* at § 206.665(5).
296. *Id.* at § 206.665(2)(c).
297. *Id.* Guidance is also expected to provide further clarification of when an in-state benefit is received.
298. *See* MICH. COMP. LAWS ANN. § 206.667.
299. *Id.* at § 206.667(3).
300. *See* MICH. COMP. LAWS ANN. § 206.671.

phasing in the CIT for up to $20,000,000 in gross receipts.[301] The small business credit reduces the effective tax rate for qualified small businesses to 1.8% on modified federal taxable income.[302] Businesses with gross receipts of up to $20 million will qualify.[303] There are several qualifications in order to take advantage of the small business credit: adjusted business income may not exceed $1.3 million,[304] and owner/operators cannot receive compensation or distributable shares of income in excess of $180,000.[305]

F. Certified Credits

Although the Snyder Administration vowed to get rid of inducement credits going forward, there were concerns within the Administration regarding the elimination of those credits that the state had contractually obligated itself to provide, dependent upon the credit recipient's satisfaction of its obligations. These credits were termed "certificated credits" because a certificate evidencing the credit would be issued by the Michigan Economic Development Corporation upon completion of the project to which the credit related.[306] Certificated credits include: all Michigan Economic Growth Authority (MEGA) Credits (standard, high-tech, rural, and retention), which provides a credit based on a percentage of personal income tax withholding over a set period of time; Brownfield Credits; Renaissance Zone Credits, for which a development agreement was executed with the Michigan Strategic Fund or part of a collaborative agreement (limiting the Renaissance Zone credit to tool and die renaissance zones or Next Energy renaissance zones, not the geographically assigned renaissance zones); Historic Preservation Credits; Michigan Film Credits (both infrastructure and production company credits); Michigan Early Stage Venture Investment Credits; Photovoltaic MBT Credits; Anchor Jobs Credits; Defense Contracting MBT Credits; Anchor District Credits; Polycrystalline Energy Credits; Battery Projection Credits; and Hybrid R&D Technology Credits.[307] Certificated credits also include tax vouchers issued by the Michigan

301. *Id.* at § 206.671(1).
302. *Id.* at § 206.671(4).
303. *Id.* at § 206.671(1).
304. *Id.*
305. *Id.* § 206.671(1)(a)(i).
306. *See* MICH. COMP. LAWS ANN. § 206.680. The certificate is technically issued by the Department of Treasury upon the submission of a Request for Certificate of Completion, which is submitted by the taxpayer upon the completion of the project, or a particular project phase, depending on if the project is a phased project.
307. *See* MICH. COMP. LAWS ANN. § 208.1107.

Early State Venture Act, and specific credits issued for NASCAR activities.[308]

The solution developed by the Administration was to honor the existing certificated credits, but only if a taxpayer elects to remain under the MBT regime.[309] Alternatively, taxpayers can choose to follow the new CIT regime, but this requires them to forgo their certificated credits.[310] The election must be made on the first tax return filed after January 1, 2012, and remains in place for the duration of the certificated credits, including any carryforwards.[311] Once made, the election cannot be changed or amended.[312] If a taxpayer making such election is a member of a unitary business group, the entire group, not just the entity receiving the credit, is required to make the election.[313]

Thus, taxpayers will need to be careful in calculating their forecasted tax estimates to make the correct decision of which alternative is more advantageous. This first year election is not required for Brownfield Credits or Historic Preservation Credits. For these credits, the taxpayer may choose to elect to file under the MBT in the specific year in which the certificate is received.[314] This exception was permitted only after intense lobbying by developers who rely on the ability to sell the credits to provide funding for the projects, particularly those projects in urban areas. In order to simplify the monetization of these two credits, the statute provides for a refund of these credits at ninety percent of the credit value, which can be requested prior to the actual filing of the MBT return for the year the credit is claimed.[315] For certain Historic Tax Credits, the refund may be limited to eighty-six percent.[316]

The election is also available to flow-through entities and individuals that are no longer subject to an entity level tax under the CIT. Flow-through entities may elect to pay the MBT with offset by a certificated credit in lieu of paying the tax due under the IITA.[317]

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308. *Id.*

309. MICH. COMP. LAWS ANN. § 206.608(1). Technically, this is why the MBT has not actually been repealed. Such repeal will not occur until the Secretary of State receives a written notice from the Department of Treasury that the last certificated credit or any carryforward from that credit has been claimed. *See* 2011 Mich. Pub. Acts 39.

310. MICH. COMP. LAWS ANN. § 208.1500(3).

311. MICH. COMP. LAWS ANN. § 206.608(2).

312. *Id.*

313. MICH. COMP. LAWS ANN. § 208.1500(1). Certain recipients of electric battery credits are not required to file for their certificated credit on a unitary group basis.

314. MICH. COMP. LAWS ANN. §206.680(1).

315. MICH. COMP. LAWS ANN. § 206.510.

316. *Id.* at § 206.510(2).

317. MICH. COMP. LAWS ANN. § 206.500(2).

The decision of whether or not to make the election is not as straightforward as it first appears. In making the determination of whether the election provides a greater benefit, i.e., staying on the MBT and offsetting the tax with credits, or transitioning to the CIT and foregoing the benefit of any awarded credits, the certificated credits are actually applied to the higher of either the MBT liability (including non-certificated credits), or the CIT liability.[318] Thus, there can be a haircut against the value of the certificated credit.

To illustrate:

Step 1: Determine MBT liability utilizing both non-certified and certified credits and compare to CIT liability with no credits. If the MBT scenario is better, the company would elect to file under the MBT and use their certified credits.

Step 2: Once the decision has been made to file under the MBT, the actual certified credit is applied against the higher liability of the MBT liability before the certified credit or the CIT liability.

Example:

	Company A		**Company B**	
Step 1	**MBT Calculation:**		**MBT Calculation:**	
	CIT Calculation:		**CIT Calculation:**	
	Gross Receipts Liability:	$ 6 mil	Gross Receipts Liability:	$ 8 mil
	+ Business Income Liability:	$ 3 mil	+ Business Income Liability:	$ 2 mil
	Liability before credits:	$ 9 mil	**Liability before credits:**	$10 mil
	- Non-Certified credits	$ 2 mil	- Non-Certified credits	$ 8 mil
	- Certified credits	$ 5 mil	- Certified credits	$ 3 mil

318. MICH. COMP. LAWS ANN. § 208.1500(4).

	Total Liability	**$ 2 mil**	**$3 mil**	**Total Liability**	**($ 1 mil)**	**$3 mil**
Step 2	**MBT Calculation:**			**MBT Calculation:**		
Liability	**CIT Calculation:**			**CIT Calculation:**		
Before	Gross Receipts Liability:	$ 6 mil		Gross Receipts Liability:	$ 8 mil	
Credits	+ Business Income Liability:	$ 3 mil		+ Business Income Liability:	$ 2 mil	
Use the	**Liability Before Credits:**	**$ 9 mil**		**Liability before credits:**	**$10 mil**	
Greater	- Non-Certified credits	$ 2 mil		- Non-Certified credits	$ 8 mil	
Liability	**Liability Before Cert Credits**	**$ 7 mil**	**$3 mil**	**Liability Before Cert Credits**	**$ 2 mil**	**$3 mil**
	- Certificated Credits	$ 5 mil		- Certified Credits		$3 mil
	MBT Liability	**$ 2 mil**		**MBT Liability**		**$0**
	N/A					
Summary	Company A Liability = $2 Mil			Company B Liability = $0		

G. Withholding

As part of the CIT, the withholding provisions for non-resident individuals were maintained, and new withholding requirements were

passed to require flow-through entities to collect withholdings applicable to the CIT on the distributive shares of their members' business income.[319] In order for an entity to be required to withhold, the entity must have more than $200,000 of business income apportioned to Michigan.[320] This new withholding regime is in addition to that required under the IITA, which requires withholding under the 4.35 percent personal income tax rate on the distributive share of taxable income of each nonresident member of an entity who is an individual.[321] A deduction from distributive income is allowed for the proportion of personal and dependency exemptions of the individual allowed under the IITA.[322]

Withholding for corporate members of flow-through entities is at the full statutory rate of six percent on the members' distributive share of business income.[323] Flow-through entity members that are themselves flow-through entities are also subject to the withholding provisions.[324] However, the statute contains a mechanism to prevent multiple withholdings on the same income for tiered partnerships.[325] Under the statute, the Department will "apply the tax withheld by a flow-through entity on the distributive share of business income of a member flow-through entity to the withholding required of that member flow-through entity."[326] Additional withholding provisions apply to casinos, racetracks and eligible film production companies.[327]

This ambiguity in the meaning of "distributive shares" to which the CIT withholding applies raises the potential for the effective withholding rate to far exceed the member's actual Michigan liability. In looking to the federal treatment of flow-through entities, a member's distributive share may be impacted by offsets (such as suspended losses or other deferred tax attributes) or other provisions of the flow-through entity's operating agreements.[328] In addition, there is the issue of how the apportionment factor of the lower-tiered entity is applied in determining

319. MICH. COMP. LAWS ANN. § 206.703.

320. *Id.* at § 206.703(4).

321. *Id.* at § 206.703(3). The rules for withholding by pass-through entities for income tax of individual nonresident owners were enacted effective October 1, 2003, and have not changed; withholding of personal income tax is still required. *Id.*

322. *Id.*

323. *Id.* at § 206.703(4). 'Business income' has the same definition as contained in MICH. COMP. LAWS ANN. § 206.603(2).

324. MICH. COMP. LAWS ANN. § 206.703(2).

325. *See id.*

326. *Id.* at § 206.703(5).

327. *See id.* at § 206.703(6)-(9).

328. The most common items include guaranteed payments, redemption of partnership interests, cash distributed in excess of partnership basis, and crediting of distributions.

the overall Michigan apportionment of the upper-tiered entity. But for unitary flow-through entities, the statute embraces the use of separate accounting methods, which does not align with the adoption of the unitary business group under the CIT.[329] These issues create a likely potential for over-withholding, which should be taken into account in preparing CIT quarterly estimates.

Taxes that are withheld will "accrue to the state on the last day of the month in which the taxes are withheld," and are required by statute to be remitted to the Department "within 15 days after the end of [the] month."[330] Withholding will be no more than quarterly for ease of administration. The Department has the authority to require remittance at other times than monthly if it has reasonable grounds to believe that a flow-through entity will not pay taxes withheld to the state.[331]

Further guidance is anticipated in this area, particularly as to whether Michigan will be developing a MI K-1 form for use in reporting. While the state does permit composite returns for partnerships, it is not clear if the state will consider a form of a composite return for flow-through entities for their corporate members.

H. Transition to the CIT

Similar to the transition from the SBT to the MBT, fiscal year taxpayers will have a short year for both 2011 and 2012. The Department is expected to provide transition procedures similar to the MBT. Forms are currently underway, but are not likely to be released until well into 2012. A fiscal year taxpayer will be allowed to file its first return on April 30, 2013, the same as a calendar year taxpayer, and can elect to calculate income under the annual or actual accounting methods.[332] Under the annual method, the CIT is calculated for the entire fiscal year and then calculated based on the number of months in the 2012 short year.[333] Under the actual method, taxpayers calculate their tax based upon the actual income and expenses for the month in the 2012 short year.[334]

Estimated tax returns are due on the 15th of April, July, October and January of each year for calendar year taxpayers.[335] Fiscal year taxpayers

329. MICH. COMP. LAWS ANN. § 206.703.
330. *Id.* at § 206.703(11).
331. MICH. COMP. LAWS ANN. § 206.705.
332. *See* MICH. COMP. LAWS ANN. § 206.683.
333. *Id.* at § 206.683(1)(a).
334. *Id.*
335. MICH. COMP. LAWS ANN. § 206.681(2).

must make quarterly estimated tax payments as well.[336] There is a transition rule for interest and penalties.[337] If a taxpayer pays estimated taxes equal to at least eighty-five percent of the tax that is otherwise due, then there is no interest or penalty.[338] The statute appropriates $1 million for the implementation of a new accounting system and a new computer system to be able to accept electronic returns.[339] The million-dollar appropriation ensures that this tax bill cannot be repealed by a referendum, as under Michigan law, bills that appropriate money are not subject to referendum or petition drives.

V. CONCLUSION

With the enactment of the CIT, Michigan's overall business tax burden has significantly lessened, and the hope is that Michigan is now better positioned to take advantage of the recovering economy. Taxpayers are well advised to give thoughtful consideration of the change to the CIT, as well as consideration to the filing of their final MBT return. One thing is certain; the tax landscape continues to change in Michigan and taxpayers must stay alert for proposed guidance, rules and case law, which will further define the new Michigan corporate income tax.

336. *Id.*
337. MICH. COMP. LAWS ANN. § 206.681(3).
338. *Id.* at § 206.681(3)(a).
339. MICH. COMP. LAWS ANN. § 206.697.