TAXATION

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I. INCOME AND MICHIGAN BUSINESS TAX

While the Michigan Corporate Income Tax was effective commencing in 2012, the Michigan Business Tax remains in place for taxpayers with certain certificated credits, as well as for taxpayers with open audit periods. Judicial decisions addressing technical and statutory issues with the Michigan Business Tax are relevant to these taxpayers, as well as those with open refund periods.

Total Armored Car Serv., Inc. v. Dep't of Treasury

In *Total Armored Car Service, Inc. v. Department of Treasury*, the taxpayer was audited for Michigan Business Tax resulting in a tax deficiency primarily due to: (1) the denial of the Materials and Supplies deduction taken for certain services (rather than for the acquisition of tangible personal property);[1] and (2) the denial of the Compensation

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1. Mich. Comp. Laws (MCL) section 208.1113(6) provides a deduction for "purchases from other firms" which includes:

Credit[2] for 100% of compensation to Michigan resident employees. The taxpayer had not apportioned the credit among the states based on where the employees performed their services.[3] The taxpayer appealed to the Michigan Tax Tribunal protesting the audit adjustments, as well as asserting that it should be taxed as a separate tax entity, rather than as a member of a unitary group.[4] The Tax Tribunal upheld the assessment.[5] The taxpayer appealed to the Michigan Court of Appeals as of right.[6]

The Court of Appeals affirmed the Tax Tribunal and held that the Materials and Supplies Deduction of MCL section 208.1113(6) was limited to purchases of tangible personal property, not purchases of services, which is consistent with the plain language of the statute.[7] The court recognized that while subdivisions (a) and (b) of the statute permit a deduction for services related to the acquisition of inventory or assets, subdivision (c) includes only tangible items of property not included in inventory or depreciable property.[8] The court found that the qualifying clause immediately following "materials and supplies," which is "including repair parts and fuel," indicates an intent to limit materials and supplies to tangible property.[9] When read in context with the entire section, the court applied the doctrine of statutory construction "known as *ejusdem generis*, [which holds that] where a general term follows a series

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(a) Inventory acquired during the year, including freight, shipping, delivery, or engineering charges included in the original contact price for that inventory.

(b) Assets, including the costs of fabrication and installation, acquired during the tax year of a type that are, or under the internal revenue code will become, eligible for depreciation, amortization, or accelerated capital cost recovery for federal income tax purposes.

(c) To the extent not included in inventory or depreciable property, material and supplies, including repair parts and fuel.

MICH. COMP. LAWS § 208.1113(6) (2013).

2. MCL section 208.1403(2) provides a credit "equal to 0.370% of the taxpayer's compensation in this state." The term "compensation" is defined in MCL section 208.1107(2) (2012) and includes "all wages, salaries, fees, bonuses, commissions, other payments made in the tax year on behalf of or for the benefit of employees, officers, or directors of the taxpayers, and any earnings that are net earnings from self-employment." MICH. COMP. LAWS § 208.1403(2) (2014).

3. Total Armored Car Serv., Inc. v. Dep't of Treasury, 325 Mich. App. 403, 406, 926 N.W.2d 276, 278 (2018).

4. *Id.* at 405–06, 926 N.W.2d at 277. Note, Michigan adopted unitary group filing with the enactment of the Michigan Business Tax. Prior to the enactment, consolidated filing for a related group of taxpayers was discretionary and permitted only upon application and fulfillment of certain requirements.

5. *Id.* at 406, 926 N.W.2d at 277.

6. *Id.*, 926 N.W.2d at 278.

7. *Id.* at 408, 926 N.W.2d at 279.

8. *Id.* at 409, 926 N.W.2d at 279.

9. *Id.*

of specific terms, the general term is interpreted to include only things of the same kind, class, character, or nature as those specifically enumerated."[10]

As to the computation of the Compensation Credit, the court held that the legislature recognized that "compensation" is essentially remuneration received in return for services rendered or work performed.[11] Again following the plain language of the statute, the court concluded that inserting the aforementioned definition of compensation before the phrase "in this state" provides that the credit is available for "[remuneration for services or work performed] in this state."[12] Therefore, the credit is only available to the extent that the services or work was performed in the state.[13] The Court of Appeals, while noting that the Tax Tribunal's reasoning was flawed, acknowledged that the Tax Tribunal reached the same result.[14]

Lastly, the court addressed the challenge to inclusion of the taxpayer within the unitary business group and affirmed the Tax Tribunal's denial of the taxpayer's request to be considered a solitary taxpayer rather than a member of a unitary group.[15] The court agreed with the Tax Tribunal that reasons existed for not applying *LaBelle*, specifically noting that the taxpayer had failed to previously request such treatment from the Department of Treasury (Department) and had failed to file amended returns on a separate entity basis.[16] Thus, the court found that the claim was not ripe for adjudication as the taxpayer had not been aggrieved by the Department and lacked standing to pursue such a claim.[17]

II. SALES, USE, AND EXCISE TAXES

A. Ford Motor Co. v. Dep't of Treasury

In *Ford Motor Co. v. Department of Treasury*, the taxpayer appealed a grant of summary disposition to the Department by the Michigan Court

10. *Id.* (citing Neal v. Wilkes, 470 Mich. 661, 669, 685 N.W.2d 648, 652 (2004)).
11. *Id.* at 410, 926 N.W.2d at 280.
12. *Id.* at 411, 926 N.W.2d at 280.
13. *Id.* The Court noted that the statute "makes no reference to the residency of the subject employees." *Id.*
14. *Id.* at 411–12, 926 N.W.2d at 280.
15. *Id.* at 413, 926 N.W.2d at 281; *see also* LaBelle Mgmt. Inc. v. Dep't of Treasury, 500 Mich. 931, 889 N.W.2d 250 (2017) (considering the definition of the phrase "owns or controls . . . indirectly" as used within MCL section 208.1117(6) (2019)).
16. *Total Armored Car Serv.*, 325 Mich. App. at 415, 926 N.W.2d at 282.
17. *Id.*

of Claims.[18] The taxpayer had filed refund claims for motor fuel tax paid on gasoline that had been placed in vehicles manufactured by the taxpayer, which had been shipped to non-Michigan locations after assembly.[19] Each newly manufactured vehicle was filled with sufficient gasoline to allow the taxpayer to test the vehicle once it had been built, to move the vehicle from the assembly area to the shipping area, and to move the vehicle off the carrier after shipping.[20] The parties agreed that none of the gasoline had been used to drive the vehicles on Michigan roads or highways.[21] The Motor Fuel Tax Act (MFTA) imposes a tax on motor fuel "imported into or sold, delivered, or used" in this state.[22] The purpose of the tax is to "require persons who operate a motor vehicle on the public roads or highways of this state to pay for the privilege of using those roads or highways."[23] As the taxpayer did not use the fuel on Michigan roads, it qualified for a refund of taxes paid.[24]

The taxpayer submitted refund claims indicating that for the periods covered by the claim, seven gallons of fuel had been placed in each vehicle manufactured.[25] The Department denied the claims, and the taxpayer requested an informal conference.[26] At the informal conference, the Department asserted "it would not approve a refund of tax paid for more than 3.2 gallons per vehicle unless the [taxpayer] could substantiate its

18. Ford Motor Co. v. Dep't of Treasury, No. 338784, 2018 Mich. App. LEXIS 2559, at *1 (Mich. Ct. App. May 29, 2018).

19. *Id.* at *2.

20. *Id.* (citing AutoAlliance Int'l, Inc. v. Dep't of Treasury, 282 Mich. App. 492, 499, 766 N.W.2d 1, 5 (2009)); MICH. COMP. LAWS § 207.1008(5)(a) (2017); MICH. COMP. LAWS § 207.1108(5)(c) (2007). The purpose of the tax is to "require persons who operate a motor vehicle on the public roads or highways of this state to pay for the privilege of using those roads or highways." MICH. COMP. LAWS § 207.1008(5)(a); *AutoAlliance*, 282 Mich. App. at 499, 766 N.W.2d at 5. The Act permits a person to seek a refund of the tax paid when the fuel was used for a nontaxable purpose. MICH. COMP. LAWS § 207.1108(5)(c); *AutoAlliance*, 282 Mich. App. at 499, 766 N.W.2d at 5.

21. *Ford Motor Co.*, 2018 Mich. App. LEXIS 2559, at *1.

22. *Id.* at *2 (citing MICH. COMP. LAWS § 207.1008(1)(a); *AutoAlliance*, 282 Mich. App. at 499, 766 N.W.2d at 5).

23. *Id.* (citing MICH. COMP. LAWS § 207.1008(5)(a); *AutoAlliance*, 282 Mich. App. at 499, 766 N.W.2d at 5).

24. *Id.* at *2–3.

25. *Id.* The periods covered by the refund claims were September 2, 2008 to December 22, 2009 and January 1, 2010 to December 21, 2010. Note: automotive manufacturers generally shutdown for the period between Christmas and New Year's Eve for maintenance and staffing purposes.

26. *Id.* at *3. Pursuant to MCL section 205.22, a taxpayer aggrieved by a "decision" of the Treasury Department may seek an informal conference before a Hearing Referee. *See* MICH. COMP. LAWS § 205.22 (2016).

claim for a greater amount."[27] The hearing referee provided the taxpayer additional time to submit additional information and indicated that "affidavits from engineering at the assembly plants would suffice."[28] Subsequently, the taxpayer provided a letter indicating it was relying on the information previously submitted to the Department in lieu of additional affidavits.[29] The hearing referee denied the claims, and the taxpayer filed a complaint at the Court of Claims.[30]

Joint motions for summary disposition were filed.[31] The taxpayer's motion was supported by the affidavits from the taxpayer's Government Regulations Coordinator at the Dearborn Truck Plant, the Government Regulations Coordinator at the Michigan Assembly Plant, and its Manager of Indirect Taxes.[32] A copy of computer screenshots of fuel specification forms from 2015 that directed employees to place seven gallons of fuel into each F-150 was provided as an exemplar of proof along with the affidavits.[33] The taxpayer explained "it no longer retained fuel specification forms" for the refund period.[34] The Department claimed it was entitled to summary disposition as no fuel specification sheets were provided for the specific vehicles, nor was other information submitted that would permit the Department to verify the amount of fuel placed in the vehicles during the relevant refund periods.[35] The Court of Claims found in favor of the Department, holding that the taxpayer was obligated under the MFTA to substantiate how much fuel was placed in each vehicle and had failed to do so.[36] The taxpayer appealed to the Court of Appeals, arguing that it had met its burden of substantiating the amount of refund claimed.[37]

The Court of Appeals upheld the motion in favor of the Department, finding that the statute governing motor fuel tax refund claims specifically

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27. *Ford Motor Co.*, 2018 Mich. App. LEXIS 2559, at *3. The basis for the Department's assertion that it would only pay on 3.2 gallons is not contained in the opinion. Presumably, this was a de facto standard set by the Department and agreed to by similarly situated vehicle manufacturers in previously approved refund claims.

28. *Id.*

29. *Id.*

30. *Id.*; MCL section 205.22 gives a taxpayer aggrieved by a "decision" of the Treasury Department the right to "appeal" the decision either to the Court of Claims or to the Michigan Tax Tribunal. While the term "appeal" is used, the Court of Claims conducts its review de novo, in the manner of an original action before that court, rather than as an appeal. MICH. COMP. LAWS § 205.22.

31. *Ford Motor Co.*, 2018 Mich. App. LEXIS 2559, at *4.

32. *Id.* at *4, n.3.

33. *Id.* at *4.

34. *Id.* at *5.

35. *Id.* at *4.

36. *Id.* at *5.

37. *Id.*

granted the Department the authority "to investigate a refund claim to the extent it considered necessary."[38] Additionally, the Court of Appeals noted the statute specifically requires a taxpayer seeking a refund to provide to the Department "the information required by the department."[39] The court began its analysis by reviewing the requirements under the MFTA, which requires taxpayers to comply with the provisions of MCL section 207.1048 when seeking a refund.[40]

Pursuant to MCL section 207.1048(3), "The department may make any investigation it considers necessary before refunding tax paid under this act to a person but in any case may investigate a refund after the refund has been issued and within 4 years from the date of issuance of refund."[41] In regards to the proffered affidavits, the Court of Appeals found that the Court of Claims was not obligated to accept the affidavits as dispositive on the issue of substantiation.[42] The Court of Appeals also dismissed an allegation of a violation of the separation of powers, finding the Department's authority to require the refund claim to be reasonably supported was not a delegation of greater power to the Department than the Legislature had intended, as "[t]he Legislature is permitted to enact a law that delegates authority sufficient to effect the efficient administration of legislative policy."[43]

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38. *Id.* at *10.

39. *Id.* at *7 (citing MICH. COMP. LAWS § 207.1048(b) (2001)).

40. *Id.* MCL section 207.1048 provides, in relevant part:

> (1) In order to make a refund claim under this act, a person shall do all of the following:
>
> (a) File the claim on a form or in a format prescribed by the department.
>
> (b) Provide the information required by the department including, but not limited to, all of the following:
>
> (i) The total amount of motor fuel purchased based on the original invoice unless the department waives this requirement.
>
> (ii) The total amount of tax paid.
>
> (iii) A statement that the fuel was used for an exempt purpose or by an exempt user.
>
> (iv) A statement that the fuel was paid for in full.
>
> (v) A statement printed on the form that the claim is made under penalty of perjury.
>
> (c) Comply with any specific requirement described in sections 32 to 47.
>
> (d) Sign the claim.
>
> (e) File the claim not more than 18 months after the date the motor fuel was purchased.

MICH. COMP. LAWS § 207.1048.

41. MICH. COMP. LAWS § 207.1048(3).

42. *Ford Motor Co.*, 2018 Mich. App. LEXIS 2559, at *11. The Court of Appeals noted that this was so "particularly given the shifting nature of the claimed refund amount." *Id.*

43. *Id.* at *12 (citing Mich. Elec. Coop. Ass'n v. Mich. Pub. Serv. Comm'n, 267 Mich. App. 608, 622, 705 N.W.2d 709, 719 (2005)).

The Court of Appeals found that language of the MFTA conferred administrative, not legislative, authority to the Department and "provide[d] constitutionally sufficient standards to guide [the Department] in the exercise of the discretion conferred upon it to determine the evidentiary proof necessary to carry out its task of determining refund requests under the act."[44]

The Court of Appeals also dismissed the taxpayer's allegation that the Court of Claims' decision deprived it of the fair notice requirements contained in the statute as well as any meaningful review of the Department's refund claim denial.[45] The Court of Appeals noted that while the taxpayer has a property interest in its requested refund, the procedures employed were constitutionally sufficient to avoid any due process violations, given the opportunity for an informal conference, which the Court of Claims reviewed.[46] The Court of Appeals also found that the statutory language put the taxpayer on notice of its obligation to substantiate its claim in order to obtain the requested refund.[47] Additionally, the taxpayer had two opportunities (first at the informal conference and second at the Court of Claims) to submit substantiating documentation from the relevant tax periods.[48] The record confirmed that the taxpayer was unable to do so "solely because it had failed to retain such documents."[49]

In *Ford*, the Court of Appeals noted that the plain statutory language made it clear that "the Legislature gave the Department the authority to establish what documentation is required before a taxpayer can be issued a refund under the MFTA . . . [and] [t]hat the Legislature intended to give the Department wide latitude in determining whether a taxpayer has met its burden of substantiation[,]" and thus, "the Department has the authority to make any investigation it considers necessary before refunding tax paid under this act . . . ."[50]

The takeaway from this decision is that taxpayers are on notice that the Department's ability to approve or deny a refund claim based upon its determination of the correctness of the documentation provided to support such a claim is at the Department's discretion, and taxpayers are well advised to discuss with the Department in advance their willingness to accept proposed documentation. Judicial activity to dispute the correctness

44. *Id.* at *12–13.
45. *Id.* at *13.
46. *Id.* at *14.
47. *Id.*
48. *Id.* at *14–15.
49. *Id.* at *15.
50. *Id.* at *9–10 (internal quotation marks omitted).

of the Department's determination is not likely to yield positive results, given the discretion afforded to the Department by the Court of Appeals.

B. Ally Financial Inc. v. State Treasurer and Santander Consumer USA, Inc. v. State Treasurer

In a consolidated appeal of two financing entities, the Michigan Court of Appeals addressed refunds sought under Michigan's bad-debt statute for sales tax paid and remitted on vehicles financed through installment contracts.[51] In *Ally Financial Inc. v. State Treasurer* and *Santander Consumer USA, Inc. v. State Treasurer*, purchasers of vehicles had paid dealerships the purchase price and sales tax due for vehicles that the dealerships had financed through their respective companies and then remitted the sales tax to the state.[52] The dealers assigned the installment contracts to the financing entities, giving them the right to collect the installment contract payments and the right to repossess the vehicles if there was a default on the contracts.[53] The financing entities subsequently determined that certain contracts were uncollectible after the vehicle purchasers defaulted on their installment contracts.[54] The financing entities repossessed and resold many of the vehicles for less than what was owed under the individual installment contracts.[55]

The financing entities wrote off the balances owed as bad debt under the Internal Revenue Code and filed refund claims pursuant to Michigan's bad-debt statute for the prorated amount of previously paid Michigan sales tax attributable to the bad debt remaining on the delinquent accounts.[56] The Department denied the refunds for two reasons: (1) the belief that MCL section 205.54i excludes "repossessed property" from the definition of "bad debt," and (2) the failure of the taxpayers to support their claims with the required RD-108 forms (under the presumption that the form

51. Ally Fin., Inc. v. State Treasurer, 317 Mich. App. 316, 320, 894 N.W.2d 673, 676 (2016), *aff'd in part, rev'd in part*, 502 Mich. 484, 918 N.W.2d 662 (2018). Generally, the Michigan Supreme Court grants or denies an application for leave to appeal, and the matter would then be fully briefed. As Michigan Court Rule 7.305 provides, the Michigan Supreme Court may also direct argument on the application and subsequently issue a decision based on the application argument, rather than accepting the application and continuing with briefing. MICH. CT. R 7.305. This option is less frequently used, albeit more so in the past few years.

52. *Ally Fin., Inc*, 317 Mich. App. at 320, 894 N.W.2d at 676.

53. *Id.*

54. *Id.* at 321, 894 N.W.2d at 676.

55. *Id.* at 320, 894 N.W.2d at 676.

56. *Id.* at 321, 894 N.W.2d at 676; *see also* 26 U.S.C. § 166 (2019).

provides the best evidence that the sales tax was paid).[57] The Court of Claims determined that the alternative documentation provided by the plaintiffs to support the amount of taxes to be refunded, in lieu of the required form, was insufficient and denied the refund claims.[58] The financing entities appealed as of right to the Michigan Court of Appeals.

The Court of Appeals affirmed the refund denial in a published decision.[59] Applications for leave to appeal were filed with the Michigan Supreme Court, and the Court heard oral argument on whether to grant them.[60] In ordering oral argument on the applications, the Michigan Supreme Court directed the parties to address four questions, with the pertinent inquiry being: "(3) how this Court should review the Department's decision to require RD-108 forms pursuant to MCL 205.54i(4), and under that standard, whether the decision was appropriate?"[61]

The Court unanimously agreed with the Court of Claims that the Department properly exercised its discretion by requiring the financing entities to provide validated RD-108 forms in order to evidence the taxes paid.[62] Focusing on the issue of substantiation of the amount of the refund claim, the Court upheld the discretion afforded by the bad-debt statute to the Department.[63] Specifically, the statute provides: "Any claim for a bad debt deduction under this section shall be supported *by that evidence required by the department*."[64] The financing entities had been unable to provide the RD-108 forms for many of the vehicles as it had been the vehicle dealerships, not the plaintiffs, who had been the original parties to submit the RD-108 forms.[65] And, in certain instances, the dealerships no

57. *Id.*; *see also* MICH. COMP. LAWS § 205.54i(4) (2007) (providing that any claim for a bad-debt deduction under MCL section 205.54i must be supported by evidence required by the Department. Specifically, the Department requires taxpayers to provide a validated Form RD-108 (issued by the Michigan Secretary of State for vehicle registration and titling) supporting their claims for tax refunds, reasoning that the Secretary of State will only issue an RD-108 form once sales tax has been paid).

58. *Ally Fin., Inc.*, 317 Mich. App. at 322, 894 N.W.2d at 677.

59. *Id.* at 338, 894 N.W.2d at 685.

60. Ally Fin., Inc. v. State Treasurer, 500 Mich. 1010, 896 N.W.2d 10 (2017) (mem.).

61. *Id.* at 1010–11, 896 N.W.2d at 11.

62. Ally Fin., Inc. v. State Treasurer, 502 Mich. 484, 508, 918 N.W.2d 662, 675 (2018). As to the determination of whether unpaid amounts under an installment contract qualified as bad debt, the Michigan Supreme Court held that the definition of "repossessed property" only includes what the taxpayer has collected under an installment contract at the time of the default, and thus, the amounts remaining under the installment contracts as bad debt. *Id.*

63. *Id.* at 505, 918 N.W.2d at 674.

64. *Id.* at 503, 918 N.W.2d at 673 (emphasis in original) (quoting MICH. COMP. LAWS § 205.54i(4) (2007).

65. *Id.* at 504, 918 N.W.2d at 673.

longer had the forms.[66] While copies could have been obtained from the Secretary of State, the cost to do so was $11 per form.[67] The financing entities argued that under these circumstances the Department acted arbitrarily and capriciously by not accepting the proffered alternative documentation in lieu of the RD-108 forms.[68]

The Court noted the specific discretion the statute gives to the Department, which will be upheld "if supported by a rational basis."[69] The Court found the evidence consisting of the financing entities' own internal accounting records and summaries did not prove that the taxes claimed as paid had actually been remitted to the Department.[70] While the financing entities argued that the issuance of the vehicle titles was sufficient proof that tax had been remitted (or else the titles would not have issued), the Court did not agree that the issuance of the titles was conclusive evidence that the taxes were paid, nor did they establish the amount of tax which was paid.[71] Thus, the Court found that the Department property exercised its discretion under the statute in rejecting the alternative documentation.[72] The Court noted "plaintiffs are not left without any method of obtaining the refunds because they can obtain these forms from the Secretary of State for a reasonable cost."[73]

Given the Michigan Supreme Court's direction, taxpayers are well advised to follow some simple guidelines in preparing their refund claims.[74] First, consider if there is a statutory requirement for a particular form or documentation to be provided along with the refund claim.[75] If available, and assuming reasonable in time and effort to acquire, taxpayers would be well-advised to obtain the documentation.[76] If the costs and effort are unreasonable, document such efforts to share with the

66. *Id.*

67. *Id.*

68. *Id.* (describing plaintiffs' own spreadsheets tracking the amount of tax paid on each vehicle).

69. *Id.* (citing Guardian Indus. Corp. v. Dep't of Treasury, 198 Mich. App. 363, 381–82, 499 N.W.2d 349, 358 (1993)).

70. *Id.*

71. *Id.* at 504–05, 918 N.W.2d at 673–74. The Court noted that it was possible that some of the vehicles purchased may have qualified for an exemption. *Id.* at 505 n.40, 918 N.W.2d at 673. Under this scenario, a title would have issued even though no tax had been paid. *Id.*

72. *Id.* at 505, 918 N.W.2d at 674.

73. *Id.* at 505 n.41, 918 N.W.2d at 674. Presumably, once obtained, refunds could be pursued. However, it is not clear whether the applicable statute of limitations would still be open.

74. *See id.*

75. *See id.* at 507, 918 N.W.2d at 675.

76. *See id.*

Department during the refund process, or at an informal conference.[77] It is more efficient and effective to have such discussions while review is pending, rather than during litigation.[78]

Second, realize that proof of remittance differs from proving that the amount of tax claimed is correct.[79] Proving payment was remitted to the Department can be trickier, particularly in the context of excise taxes when amounts remitted can be large and are sent via Automated Clearing House (ACH) with minimal online reporting detail.[80] Gone are the days of paper invoices, cancelled checks, sales receipts, and bills of lading.[81]

Third, consideration of evidence to be submitted goes to the issue of admissibility, i.e., whether the person is qualified to be a witness or whether the evidence is admissible.[82] Interestingly, while rules of evidence guide practitioners, the Michigan Rules of Evidence do not bind the courts; the courts may make their own determination as the triers of fact.[83] For jury trials, the standard for screening evidence is "quite low,"[84] and tax matters before the Court of Claims are rarely afforded a hearing, let alone a trial. The current practice at the Court of Claims is a decision based on motions for summary disposition following the completion of discovery, and for which the Court of Claims, by local rule, has all but dispensed with

77. *See, e.g.*, Ford Motor Co. v. Treasury Dep't, 496 Mich. 382, 394, 852 N.W.2d 786, 792–93 (2014).

78. *See Ally Fin., Inc.*, 502 Mich. at 507, 918 N.W.2d at 675.

79. *Id.* at 504, 918 N.W.2d at 673.

80. *See, e.g.*, Van Senus Auto Parts, Inc. v. Mich. Nat'l. Bank-Wyoming, 116 Mich. App. 342, 350, 323 N.W.2d 391, 395 (1982).

81. Counsel for the Department still insist upon receiving such documents. While the Department's auditors are generally well-versed in electronic records, the assistant attorneys general who represent the Department do not have commensurate experience in either the current electronic state in which financial records are kept or the Financial Accounting Standards Board (FASB) chart of accounts. Discovery requests are received on a regular basis requesting vast amounts of both paper and electronic records. Most disconcerting is the perceived lack of understanding of what the reports and records demonstrate.

82. *See* MICH. R. EVID. 104(b).

83. Except in respect to privileges. *See* MICH. R. EVID. 104(a).

84. Howard v. Kowalski, 296 Mich. App. 664, 682, 823 N.W.2d 302, 311 (2012), *rev'd in part sub nom.* Estate of Johnson v. Kowalski, 495 Mich. 982, 843 N.W.2d 922 (2014) (mem.) ("[A]s long as some rational jury could resolve the issue in favor of admissibility, the court must let the jury weigh the disputed facts. Specifically, the court must allow the jurors to assess the credibility of the evidence presented by the parties."); *see also* MICH. R. EVID. 104(b); THE HONORABLE J. RICHARDSON JOHNSON, EVIDENCE BENCHBOOK, PART OF THE ORIGINAL CIRCUIT COURT BENCHBOOK 1–7 (Mich. Judicial Inst. 2020), https://mjieducation.mi.gov/documents/benchbooks/22-evidbb/file [http://web.archive.org/web/20200301143415/https://mjieducation.mi.gov/documents/benchbooks/22-evidbb/file].

oral argument.[85] To best present facts to support a tax refund, a thorough record must be established by exhibits to the briefing, and all such exhibits must have the appropriate foundation to support the facts contained therein.[86]

The amount of weight or reliability to be given to the evidence is solely reserved to the fact-finder, which is the judge at the Court of Claims.[87] If proper foundation is established, any deficiency in the weight afforded to the evidence is an issue of authenticity, rather than admissibility.[88] As the Michigan Court of Appeals noted in *Ford*, the lack of a dispositive finding based on the affidavits and supporting schedules was due to "the shifting nature of the claimed refund amount."[89] Thus, the affidavits were not found to be inadmissible, but rather, little weight was afforded to their reliability.[90]

Another notable takeaway is the affirmation by the Michigan Supreme Court that the Department will be afforded discretion in determining whether a taxpayer has substantiated its refund claims, and the failure to provide sufficient evidence to document the tax claimed for the refund periods will act as a bar to the approval of the refund.[91] Once litigation has commenced on the Department's denial of a refund, whether at the Court of Claims or the Michigan Tax Tribunal, there is only one opportunity to create the record on which future appeals are based.[92] On appeal to the Court of Appeals, no further evidence may be entered into the record to either authenticate records for admissibility or to substantiate the weight to be given to the evidence.[93]

C. Jim's Body Shop, Inc. v. Dep't of Treasury

The taxpayer in *Jim's Body Shop, Inc. v. Department of Treasury* was an auto repair shop that performed both collision work as well as routine

85. MICH. CT. CL. LOCAL COURT RULE 2.119(A)(6).

86. *See* MICH. CT. CL. LOCAL COURT RULE 2.119(A)(3).

87. *See* Mitchell v. Kalamazoo Anesthesiology, PC, 321 Mich. App. 144, 156, 908 N.W.2d 319, 326 (2017). With the retirement of Chief Judge Michael Talbot, the current Court of Claims judge designated for tax cases is Colleen O'Brien.

88. JOHNSON, *supra* note 84, at 1–7 (citing People v. Jambor, 271 Mich. App. 1, 7 n.2, 717 N.W.2d 889, 893, *rev'd*, 477 Mich. 853, 720 N.W.2d 746 (2006)).

89. Ford Motor Co. v. Dep't of Treasury, No. 338784, 2018 Mich. App. LEXIS 2559, at *11 (Mich. Ct. App. May 29, 2018).

90. *Id.*

91. *See* Ally Fin. Inc. v. State Treasurer, 502 Mich. 484, 504, 918 N.W.2d 662, 673 (2018).

92. *See, e.g.*, *id.* at 488, 918 N.W.2d at 664.

93. *See id.*

maintenance services during the audit period.[94] The Department commenced a sales and use tax audit for the period August 1, 2011–December 31, 2014 and found the taxpayer's records to be inadequate as the taxpayer had not remitted any use tax for the audit period.[95] While the taxpayer reported some sales tax, it failed to report sales tax on its annual returns.[96] Additionally, the taxpayer's accounting records were incomplete, and the Department was unable to determine if sales or use tax had been remitted.[97] The Department, therefore, employed an indirect audit method and a one-year block methodology, which resulted in an assessment of $111,024, inclusive of interest and a negligence penalty.[98]

The taxpayer appealed the final assessment to the Court of Claims arguing that the Department's assessment was not entitled to a presumption of correctness because the Department had not complied with all the elements of the statute regarding the "indirect method" of auditing and provided documentation that had not been provided during the audit.[99] The Department adjusted the assessment, and the Court of Claims upheld the revised assessment on cross-motions for summary disposition.[100]

On appeal, the Michigan Court of Appeals affirmed the Court of Claims decision[101] and addressed the challenge that an assessment calculated using an indirect method is not entitled to the statutory presumption of correctness contained in MCL section 205.104a(4).[102] The

94. Jim's Body Shop, Inc. v. Dep't of Treasury, 328 Mich. App. 187, 191–92, 937 N.W.2d 123, 126 (2019).

95. *Id.* at 192, 937 N.W.2d at 126–27.

96. *Id.*

97. *Id.*, 937 N.W.2d at 127.

98. *Id* at 193, 937 N.W.2d at 127. An indirect audit method looks to other information to estimate purchases made during the year for which tax would be due. For example, to determine a reasonable estimate for capital purchases, the Department reviewed the taxpayer's federal depreciation schedules. *Id.* For expense purchases, the Department subtracted the total amount of retail sales made by the taxpayer in a one-year block from the taxpayer's total purchases for the one-year block, adjusted to the cost of goods before markup. *Id.* at 193–94, 937 N.W.2d at 127. The use of indirect audit methods is permitted by statute and occurs on a regular basis, particularly for smaller, cash-based businesses. *See* MICH. COMP. LAWS § 205.104a(4) (2014).

99. *Jim's Body Shop*, 328 Mich. App. at 197, 937 N.W.2d at 129.

100. *Id.* at 195, 937 N.W.2d at 128.

101. *Id.* at 208, 937 N.W.2d at 135.

102. *Id. at* 196–202, 937 N.W.2d at 128–132. MCL section 205.104a(4) provides:

> If a taxpayer fails to file a return or to maintain or preserve sufficient records as prescribed in this section, or the department has reason to believe that any records maintained or returns filed are inaccurate or incomplete and that additional taxes are due, the department may assess the amount of the tax due from the taxpayer based on an indirect audit procedure or any other information that is available or that may become available to the department. That assessment is considered prima facie correct for the purpose of this act and the burden of proof of refuting

court noted that while the statutory provisions relied upon by the taxpayer in its challenge contain procedural requirements to perform an indirect audit, an assessment does not lose its presumption of correctness for failure to follow these procedures.[103] Rather, those subparagraphs are "relevant to a taxpayer's burden if the taxpayer can show that as a result of the Department's failure to abide by those procedural requirements, the assessment was not correct . . . ."[104] The court held that the taxpayer has the burden to prove that the use of an indirect audit method is incorrect, which the taxpayer failed to do in the instant case, and thus affirmed the Department's assessment, noting the Department "has wide discretion in the selection of the method, and the taxpayer has no right to choose the method ultimately applied."[105]

The court also rejected the taxpayer's argument that the industrial processing exemption should apply to some of its purchases, finding that the taxpayer was not an industrial processor, as its business did not constitute making sales of tangible personal property at retail but, rather, were sales of the services of repairing automobiles.[106] Analyzing the facts of the case under the "incidental-to-service test," the court concluded that under the totality of the transaction, the paint and other supplies the taxpayer used were not available without the service provided by the taxpayer, and thus, the sale of paints were incidental to the sale of the auto-

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the assessment is upon the taxpayer. An indirect audit of a taxpayer under this subsection shall be conducted in accordance with 1941 PA 122, MCL 205.1 to 205.31, and the standards published by the department under section 21 of 1941 PA 122, MCL 205.21, and shall include all of the following elements:

(a) A review of the taxpayer's books and records. The department may use an indirect method to test the accuracy of the taxpayer's books and records.

(b) Both the credibility of the evidence and the reasonableness of the conclusion shall be evaluated before any determination of tax liability is made.

(c) The department may use any method to reconstruct income, deductions, or expenses that is reasonable under the circumstances. The department may use third-party records in the reconstruction.

(d) The department shall investigate all reasonable evidence presented by the taxpayer refuting the computation.

MICH. COMP. LAWS § 205.104a(4).

103. *Jim's Body Shop*, 328 Mich. App. at 199, 937 N.W.2d at 130.

104. *Id.* at 199, 937 N.W.2d at 130.

105. *Id.* at 201, 937 N.W.2d at 131 (citing By Lo Oil Co. v. Dep't of Treasury, 267 Mich. App. 19, 42, 703 N.W.2d 822, 838 (2005)).

106. *Id.* at 203, 937 N.W.2d at 132.

body repair.[107] As the taxpayer made no sales at retail, it would not be eligible for the industrial processing exemption.[108]

Lastly, the court upheld the negligence penalty, finding that the taxpayer had failed to exercise "ordinary care and prudence in preparing and filing [its tax returns] and paying the applicable tax in accordance with the statute."[109] The Department determines whether a taxpayer was negligent on a case-by-case basis and will waive the penalty only if "the taxpayer 'demonstrates to the satisfaction of the department that the deficiency . . . was due to reasonable cause.'"[110] The court noted that the taxpayer's claim that it was entitled to the industrial processing exemption was "belied by the fact that it did not raise this exemption until litigation and, in any case, ordinary care would have compelled plaintiff to file returns despite such a belief."[111] "These circumstances show that plaintiff failed to exercise ordinary care."[112]

D. Emery Electronics, Inc. v. Dep't of Treasury

In *Emery Electronics, In. v. Department of Treasury*, the taxpayer sold cellphone service contracts, cellphones, and related equipment.[113] The taxpayer purchased its inventory from Verizon (which was produced by a variety of different manufacturers).[114] The cellphone service contracts were solely with Verizon.[115] Under its contract with Verizon, the taxpayer was permitted to set the sales price of phones and accessories, and the taxpayer would receive a commission for each service contract that it sold for the service provider.[116] Exercising its right to set the price of cell phones, the taxpayer set the price of the phones at $0 when the customer

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107. *Id.* at 205–06, 937 N.W.2d at 133–34.

108. *Id.* Note, MCL section 205.94o and 2.05.54o, permits the industrial processing exemption to apply to a servicer who performs industrial processing activities on behalf of another. It is not required that the servicer make retail sales; only that the item processed is eventually sold at a retail.

109. *Id.* at 207–08, 937 N.W.2d at 134–35. MICH. ADMIN. CODE R. 205.1012 defines "negligence," for purposes of the penalty, as "the lack of due care in failing to do what a reasonable and ordinarily prudent person would have done under the particular circumstances." Determining whether a taxpayer was negligent is done on a case-by-case basis.

110. *Jim's Body Shop*, 328 Mich. App. at 207–08, 937 N.W.2d at 135.

111. *Id.* at 208, 937 N.W.2d at 135.

112. *Id.*

113. Emery Elecs., Inc. v. Dep't of Treasury, No. 342250, 2019 WL 573423, at *1 (Mich. Ct. App. Feb. 12, 2019).

114. *Id.*

115. *Id.*

116. *Id.*

simultaneously entered into a Verizon service contract.[117] For the audit period of November 1, 2009 through October 31, 2013, the taxpayer claimed the resale exemption from sales and use tax for its inventory purchases of cellphones and did not remit any use tax.[118] The Department conducted a use tax audit and assessed tax on the phones the taxpayer gave away to customers based on the purchase price the taxpayer paid for the phones.[119]

The taxpayer appealed the assessment to the Court of Claims and argued that the Use Tax Act's definition of "purchase price" allows for a taxpayer to reduce the purchase price of property for purposes of use tax liability for reimbursements it receives for the sale of the property from a third party.[120] The Department asserted that the taxpayer had purchased the phones exempt from tax and subsequently converted the phones to a taxable use when it gave the phone away for free when a Verizon service contract was purchased.[121] The Department also argued that the Use Tax Act does not provide a reduction in the taxable purchase price of property based on payment of third-party commissions.[122] The Court of Claims granted summary disposition to the Department, finding the taxpayer had made a taxable use of the phones when it used them for promotional purposes by giving them away for no charge when a service contract was purchased.[123] The Court of Claims also found that the commissions Verizon paid did not represent a reimbursement for the cell phones purchased, but that they were based solely on the sale of the service contract.[124] The taxpayer appealed as of right to the Michigan Court of Appeals.[125]

The Court of Appeals upheld the Court of Claims decision, concluding that the payments from Verizon to the taxpayer were commissions for the sale of service contracts that were not related to the amount the taxpayer charged for the phones.[126] The court found, viewing the record evidence in the light most favorable to the plaintiff, there was no genuine issue of material fact that the taxpayer had paid Verizon for each cell phone, and

117. *Id.* at *2.
118. *Id.*
119. *Id.*
120. *Id.*
121. *Id.*
122. *Id.* There is a factual distinction between a commission paid, and a rebate based on the commercial terms that govern such payments.
123. *Id.* at *3.
124. *Id.*
125. *Id.*
126. *Id.* at *5.

that "[s]ales commissions are not, by definition, reimbursements."[127] "Plaintiff's attempt to characterize its commissions otherwise would require this Court to deviate from well-established rules of contract interpretation and look beyond the four corners of the parties' contacts."[128] The Court of Appeals found that the assessment was proper on the cost basis of the phones the taxpayer gave away.[129]

E. Priority Health v. Dep't of Treasury

In consolidated appeals, the Michigan Court of Appeals reversed the Tax Tribunal's grant of summary disposition for the Department in *Priority Health v. Department of Treasury*, finding that the taxpayers presented evidence demonstrating there was a genuine issue of material fact sufficient for trial.[130] While noting that such evidence was not overwhelming, the court determined that there was sufficient credible evidence to remand the cases for further proceedings.[131] This case is a reminder to counsel of the importance of establishing the record at the lower court level, whether that be the Court of Claims or the Tax Tribunal.[132]

The taxpayers were a nonprofit Michigan health maintenance organization and its wholly owned subsidiary.[133] The taxpayers provided insurance coverage for medical, hospital, prescription drug, and other healthcare services.[134] The case pertained to the prescription drug coverage.[135] Consistent with industry practice, the taxpayers entered into a contract with a third-party pharmacy benefit manager (PBM) to administer prescription drug benefit programs.[136] When an insured member filled a prescription at a pharmacy, the pharmacy billed the PBM, and the PBM would pay the pharmacy's claim and submit the claim to the taxpayers.[137] Other PBMs were used to administer rebates on select

127. *Id.* at *4.
128. *Id.* ("When a contract is plain and unambiguous, courts are to apply the terms as written." (citing Twp. of Chestonia v. Twp. of Star, 266 Mich. App. 423, 432, 702 N.W.2d 631, 637 (2005))).
129. *Id.* at *5.
130. Priority Health v. Dep't of Treasury, No. 341120, 2018 WL 5629745, at *5–6 (Mich. Ct. App. Oct. 30, 2018).
131. *Id.*
132. *See id.*
133. *Id.* at *1.
134. *Id.*
135. *Id.*
136. *Id.*
137. *Id.*

prescription drugs.[138] If a claim qualified for a rebate, the PBM would receive the rebate from the drug manufacturer and would subsequently pay the rebate to the taxpayers.[139]

The Health Insurance Claims Assessment Act (HICAA) imposes a 1% tax on "paid claims," defined as "actual payments, net of recoveries."[140] The taxpayers filed tax returns, which included the paid claims to pharmacies, but reduced the gross amount of the paid claims by an estimated amount of pharmacy rebates.[141] On audit, the Department determined that the rebates were not recoveries and assessed an additional HICAA tax for the amount of the estimated rebates.[142] The Department's position was that in order for a rebate to be used as a "recovery," it must be linked to a specific claim and could not merely be set off in total.[143]

The Tax Tribunal denied the Department's motions for summary disposition, finding the taxpayers presented sufficient evidence that the rebates could be traced back to specific claims, that the asserted claim may be supported by evidence at trial, and therefore, there were genuine issues of material fact remaining.[144] On a motion for reconsideration before a different judge, the Tax Tribunal granted the motion for reconsideration and granted partial summary disposition for the Department, concluding that the first judge had erred when it allowed the taxpayers to "merely promise to offer factual support for their claims at trial, rather than producing documentary evidence to affirmatively show a genuine issue of fact for trial."[145]

On appeal, the Michigan Court of Appeals reversed, finding summary disposition for the Department was improper, as the taxpayers had presented evidence demonstrating a genuine issue of material fact for trial, albeit "not overwhelming."[146] The court also noted that "the amount of tax that petitioner has to pay under HICAA is a type of damages that involves mathematical computation. This is best done by the fact-finder at a trial where the methodology on both sides can be vetted and specific calculations analyzed."[147]

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138. *Id.*
139. *Id.*
140. *Id.*; MICH. COMP. LAWS §§ 550.1731–550.1741 (2011); MICH. COMP. LAWS § 550.1732(s) (2011).
141. *Priority Health*, 2018 WL 5629745, at *2. The HICCA tax applied only to Michigan claims and not to claims paid on behalf of non-Michigan residents. *Id.* at *2 n.4.
142. *Id.* at *2.
143. *Id.*
144. *Id.* at *3.
145. *Id.*
146. *Id.* at *5.
147. *Id.*

III. STATUTE OF LIMITATIONS

Federated Financial Corp. of America v. Dep't of Treasury

An interesting issue regarding the application of the statute of limitations on return filings was addressed in *Federated Financial Corporation of America v. Department of Treasury,* specifically whether the taxpayer's 2009 Michigan Business Tax (MBT) return had been filed within the applicable statute of limitations.[148] The date of filing would determine if the taxpayer was entitled to certain credits.[149] The taxpayer claimed that it filed the return on November 15, 2010, when it placed the return in the mail.[150] The Department claimed it did not received the return until December 15, 2014, when it notified the taxpayer that a return had not been filed.[151] The Department determined that the taxpayer was not entitled to certain credits claimed on its 2009 return, as the return was untimely (filed after April 30, 2014 to account for the four year statute to claim credits or a refund) and assessed the taxpayer the amount it had taken as a credit on the return.[152] The taxpayer argued that the return had been timely filed and that the Department's July 2016 assessment was time barred by the statute of limitations under MCL section 205.27a(2).[153]

At the Court of Claims, the taxpayer submitted two affidavits.[154] The first was from its accountant, stating that the 2009 return was prepared on November 3, 2010 and, in accordance with the accountant's usual practice, the return would have been mailed to the taxpayer within one or two days of completion.[155] The second affidavit was from the taxpayer's corporate controller, stating that in accordance with his usual practice, the return would have been signed and mailed shortly after being received from the accountant.[156] Nonetheless, the Court of Claims granted summary disposition to the Department, finding the taxpayer's evidence to be too

148. Federated Fin. Corp. of America v. Dep't of Treasury, No. 344181, 2019 WL 5280845, at *1 (Mich. Ct. App. Oct. 17, 2019).

149. *Id.*

150. *Id.*

151. *Id.*

152. *Id.*

153. *Id.*; MCL section 205.27a(2) provides: "[a] deficiency, interest, or penalty shall not be assessed after the expiration of 4 years after the date set for the filing of the required return or after the date the return was filed, whichever is later." MICH. COMP. LAWS § 205.27a(2) (2014).

154. *Federated Fin.*, 2019 WL 5280845, at *1.

155. *Id.*

156. *Id.* at *2.

speculative with regard to the issue of the date on which the return was filed.[157]

On appeal as of right to the Michigan Court of Appeals, the court affirmed the Court of Claims' determination that the 4-year statute of limitations applies to credit carryforwards and not just to "refunds."[158] However, the Court of Appeals reversed the Court of Claims determination to grant summary disposition on the issue of when the taxpayer's return was filed, finding that the taxpayer had established by the affidavits that there was a material question of fact remaining.[159] Citing *Good v. Detroit Automobile Inter-Insurance Exchange*, which stands for the proposition that "upon proper evidence of business custom and habit of a commercial house as to addressing and mailing, the mere execution of [a] letter in the usual course of business rebuttably presumes subsequent receipt by the addressee," the Court of Appeals reversed and remanded for further proceedings.[160]

Based on the affidavits proffered, it is expected that the remand will find, as a matter of fact, that the taxpayer has substantiated the presumption that the returns were filed in the normal course. The burden will then shift to the Department to prove that the returns were not timely received. While the current electronic filing requirements may mitigate this issue going forward, the case is helpful to other aspects of tax compliance, particularly the current practice of the Department in denying the application of carryforwards due to the lack of the term "carryforward" in the refund statute.

IV. PROPERTY TAXES

The Headlee Amendment continues to be a topic for the assertion of challenges, as these two cases highlight.

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157. *Id.*

158. *Id.* at *3. The Court of Claims concluded:

> Although [MCL 205.27a(2)] only mentions refunds, this provision applies to claiming credits as well as refunds. See MCL 205.30(2) (treating a claim for a credit in excess of taxes due as 'a claim for refund' and applying the four-year limitations period set forth in MCL 205.27a(2) to such a claim).

Id.

159. *Id.* at *4.

160. *Id.*; Good v. Detroit Auto. Inter-Ins. Exch., 67 Mich. App. 270, 276, 241 N.W.2d 71, 76 (1976). As *Good* was decided before November 1, 1990, it would not be precedential pursuant to Mich. Ct. R. 7.215(J). However, the Michigan Court of Appeals noted that the Michigan Supreme Court articulated the *Good* standard in *Morales v. Auto-Owners Ins. Co.*, 458 Mich. 288, 304 n.8, 582 N.W.2d 776, 783 (1998), and therefore the *Good* standard constitutes binding precedent. *Federated Fin.*, 2019 WL 5280845, at *4 n.1.

A. Michigan Ass'n of Home Builders v. City of Troy

In 2010, the City of Troy signed a contract with a private company to provide building department services to the City.[161] The contract provided for the City to receive a "kickback" of 20%–25% of the fees collected for building permits, inspections, and similar activities the company performed.[162] From 2010 through 2016, the City collected $2,323,061 pursuant to the contract which was deposited into the City's general fund.[163] The City claimed that it was using these amounts to make up for prior year deficits in the building department's operating costs.[164]

The Michigan Association of Home Builders (Association) brought suit against the City on behalf of its members, alleging that the City's actions violated the Headlee Amendment, as the kickback payment constituted a tax that had not been approved by voters, rather than a regulatory user fee.[165] The Association also claimed a violation of the Construction Code Act, which requires that fees be reasonable, "be intended to bear a reasonable relation to the cost" of services provided, and only be used for the operation of the building department or construction board of appeals.[166] The Michigan Court of Appeals found in favor of the City, and the Association filed an application for leave to appeal to the Michigan Supreme Court.[167]

In lieu of granting the application, the Michigan Supreme Court unanimously held:

> [T]he use of the revenue generated by defendant's building inspection fees to pay the building department's budgetary shortfalls in previous years violated the [Construction Code Act] (MCL 125.1522(1)) because it was not reasonably related to the cost of acts and services provided by the building department. However, because [defendant] presented evidence to justify the retention of a portion of these fees, the case was remanded for further proceedings.[168]

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161. Michigan Ass'n of Home Builders v. City of Troy, 504 Mich. 204, 208, 934 N.W.2d 713, 716 (2019).
162. *Id.* at 208–09, 934 N.W.2d at 716.
163. *Id.* at 209, 934 N.W.2d at 716.
164. *Id.* at 209–11, 934 N.W.2d at 716–17.
165. *Id.* at 209, 934 N.W.2d at 716–17.
166. *Id.*; *see* MICH. COMP. LAWS §§ 125.1501–125.1531.
167. *Home Builders*, 504 Mich. at 210–11, 934 N.W.2d at 717.
168. *Id.* at 229, 934 N.W.2d at 727.

Furthermore, the Court found that while the Construction Code Act does not explicitly provide a private cause of action for monetary damages,[169] the Association may seek injunctive or declaratory relief.[170]

With regard to the Headlee claim, the Court noted that the Headlee Amendment provides taxpayers with standing to sue;[171] however, it could not be determined whether the Association had actual standing as there was no record evidence that the Association or any of its members paid the disputed fees.[172] The case was remanded for the Association to establish representational standing so as to maintain a claim under the Headlee Amendment.[173]

B. Binns v. City of Detroit

This matter brought a Headlee Amendment action for drainage charges imposed by the Detroit Water and Sewage Department (DWSD) on owners of property with impervious surfaces.[174] The taxpayers argued that the drainage charges were taxes, not fees, and therefore were subject to the Headlee Amendment prohibition against any new taxes "without the approval of the voters."[175]

The City of Detroit has a combined sewer system, where storm water runoff flows into the same pipes as unsanitary wastewater, i.e., sewage.[176] Every year, billions of gallons of storm water come from rain and snow on impervious surfaces, such as roofs, driveways, parking lots, and compacted gravel and soil.[177] These hard surfaces limit the ability of the storm water to soak into the ground.[178] The storm water becomes contaminated with dirt and debris and is treated at Detroit's wastewater

169. *Id.* at 225, 934 N.W.2d at 725.
170. *Id.*
171. *Id.* at 226–27, 934 N.W.2d at 726.
172. *Id.* at 227–28, 934 N.W.2d at 726–27.
173. *Id.* at 229, 934 N.W.2d at 727.
174. Binns v. City of Detroit, Nos. 337609 and 339176, 2018 WL 6363126, at *1 (Mich. Ct. App. Nov. 6, 2018).
175. *Id.* at *5. Under the Headlee Amendment, "Any taxpayer of the state shall have standing to bring suit in the Michigan State Court of Appeals to enforce the provisions of Sections 25 through 31 . . . ." MICH. CONST. art. IX, § 32; *see also* MICH. COMP. LAWS § 600.308a(1) (1980) ("An action under section 32 of article 9 of the state constitution of 1963 may be commenced in the court of appeals, or in the circuit court in the county in which venue is proper, at the option of the party commencing the action.").
176. *Binns*, 2018 WL 6363126, at *2.
177. *Id.*
178. *Id.*

treatment plan and combined sewer overflow facilities before being released back into the environment.[179]

DWSD customers have been paying a drainage charge on their water and sewer bills since 1975.[180] In October of 2016, DWSD revised its method of calculating the drainage charge for property owners in the City.[181] DWSD had identified 22,000 parcels that had not previously been charged for drainage, including parcels that did not have a water account and, therefore, had not been in the DWSD billing system.[182] The fee was set at $750 per impervious acre, to be phased in by type of property beginning January 2017 through January 2018, in order to allow customers to prepare for the increased cost.[183]

A challenge to the charge was brought at the Michigan Court of Appeals by Detroit Alliance Against the Rain Tax (DAART), asserting that the drainage charge, without the approval of the voters, constituted a Headlee Amendment violation and requesting class action certification.[184] The defendants contended that the drainage charge was a valid user fee and not subject to the Headlee Amendment.[185]

The Court of Appeals upheld the drainage charges.[186] The court applied the Michigan Supreme Court's *Bolt* test, which consists of three criteria used to distinguish fees from taxes.[187] Those criteria include: (1) whether the charge serves a regulatory purpose or a revenue-raising purpose; (2) whether the charge is proportional to the cost of the service provided; and (3) whether the charge is voluntary or compulsory.[188]

Under the first factor, the court concluded that the charges were sufficiently regulatory in nature, as they corresponded to a service rendered and there was no evidence to suggest that the charge was assessed for any revenue-raising purpose.[189] Under the second factor, the court concluded that the charges were reasonably proportionate to the costs of the services rendered.[190] Under the third factor, the court concluded that the fee was compulsory because it was impossible for property owners to escape the drainage charge or related penalties.[191] The court concluded,

179. *Id.*
180. *Id.* at *3.
181. *Id.*
182. *Id.*
183. *Id.*
184. *Id.* at *5–6.
185. *Id.* at *5.
186. *Id.* at *15.
187. *Id.* at *7.
188. *Id.*
189. *Id.* at *11.
190. *Id.* at *14.
191. *Id.* at *15.