April 15, 2005

Dear Tax Tribunal Practitioner,

We are issuing today a full panel decision on the treatment of discovery requests under MCL 28(1)(f): *Compuware Corporation* v *Michigan Department of Treasury*, MTT Docket Nos. 303847 and 304047. A copy of the decision is attached for your convenience. The decision will also be available for access on our website early next week.

If you have members, colleagues or acquaintances that would benefit from keeping up-to-date with Tribunal developments, simply send an e-mail message to Marijo Wakley at mewakle@michigan.gov with "SUBSCRIBE" in the subject line. To unsubscribe, simply reply to this e-mail with the word "UNSUBSCRIBE" in the subject line.

Attachment:

STATE OF MICHIGAN
DEPARTMENT OF LABOR & ECONOMIC GROWTH
MICHIGAN TAX TRIBUNAL

Compuware Corporation,

Petitioner,

v

MTT Docket Nos. 303847 and 304047

Michigan Department of Treasury,
Respondent.

Tribunal Judges Presiding
Jack Van Coevering
Sherry A. Lee
Michael A. Stimpson
Kimbal R. Smith, III
Judith R. Trepeck
Patricia A. Halm

ORDER DENYING RESPONDENT'S MOTION
FOR RECONSIDERATION OF ORDER DENYING PROTECTIVE ORDER

On October 6, 2004, Respondent filed a motion requesting the Tribunal to reconsider the Order entered on September 16, 2004, denying Respondent's Motion for Protective Order and compelling Respondent to produce certain requested document(s) for in camera review by the Tribunal at the prehearing conference scheduled for October 16, 2004.

On December 8, 2004, the Tribunal heard oral argument on the following issues:

1. Whether the Michigan Tax Tribunal has authority to order Respondent, Michigan Department of Treasury, to produce a document and to conduct in camera review to determine whether material contained in the document is protected from disclosure under MCL 205.28(1)(f).

2. What is the statutory construction of the following terms and phrases contained in MCL 205.28(1)(f): "administration," "audit selection," "processing criteria," "court" and "judicial order."

3. Whether the Tribunal has authority to impose a sanction under MCR 2.313(B)(2) for failure to comply with a discovery order.

Based on the arguments and pleadings filed in support thereof, the Tribunal finds that Respondent's motion should be denied. The Tribunal further finds Respondent's refusal to comply with the Tribunal's September 16, 2004 Order has prevented the Tribunal from conducting in camera review of potentially discoverable material that Respondent has unilaterally determined to be prohibited from disclosure under the Revenue Act. MCL 205.28(1)(f).

Although the Tribunal could place Respondent in default and prohibit Respondent from offering any evidence or argument at a default hearing under TTR 247[1], this would require Petitioner to prove its case without the benefit of the requested discovery material. The Tribunal declines to place Respondent in default and hold a default hearing.

The Tribunal has not ruled on the relevance of the requested information because Respondent has refused to produce it. However, the Tribunal finds that Petitioner has identified potentially discoverable material that appears to be relevant and admissible, or may lead to the discovery of admissible evidence, to the extent disclosure is not prohibited under MCL 205.28(1)(f). MCR 2.302(B).

At issue in this litigation is whether certain "royalties" meet the definition of "sale or sales" under MCL 208.7. It is undisputed that, in a previous audit, Respondent did not require Petitioner to include royalties in the sales factor and that Respondent changed its position during the audit period in question. However, there is a dispute as to whether Respondent consistently applied its interpretation of the law to other taxpayers. Petitioner has alleged, upon information and belief, that the requested document(s) may state a position contrary to the one taken in the audit. (Petitioner's Response in Opposition to Motion for Reconsideration of Tax Tribunal

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1 TTR 247 provides:

> For purposes of this rule, "default hearing" means a hearing at which the defaulted party is precluded from presenting any testimony or submitting any evidence not submitted to the Tribunal before the entry of the order placing the party in default and may not, unless otherwise ordered by the Tribunal, examine the other party's witnesses.

Order Denying Protective Order, Page 3.) The requested document(s) could shed light upon Respondent's reasons for changing its position on royalties in the sales factor.

Petitioner claims that the correct interpretation of "sale or sales" pursuant to MCL 208.7(1) is the one that Respondent held from the inception of the Single Business Tax ("SBT") in 1976 throughout the 1992-1996 audit period. Petitioner is entitled to statements of law or policy regarding Respondent's position. To the extent the Tribunal determines that the requested document(s) are a statement of policy or interpretation of law, they are not subject to the prohibitions of MCL 205.28(1)(f). *Newark Morning Ledger* v *Dep't of Treasury*, Court of Appeals Docket No. 244733, [*UNPUBLISHED*] (May 27, 2004).

Petitioner argues that the requested document(s) are relevant to its claim that a statutory amendment to the "sales definition" (2000 PA 477[2]) evidences a legislative intent to return to Respondent's previous position. Petitioner argues that the new definition of sales should be given retroactive application because 2000 PA 477 responded to inconsistent application of Respondent's interpretation of "sales." These issues have been briefed only in the context of the discovery motions and without the benefit of the requested documents. Petitioner is entitled to discovery before the Tribunal decides this issue.

The Tribunal has ruled that Petitioner is entitled to relevant statements of law or policy, subject to in camera review and redaction of material protected by MCL 205.28(1)(f). Respondent has refused to comply. The Tribunal concludes that the appropriate sanction is to deem admitted Petitioner's claim contained in Paragraph 46 of its Petition, as indicated in the Judgment section of this Order. TTR 264[3]; TTR 111; MCL 205.732; MCR 2.313(B)(2)(a), (b) and/or (c).

Procedural History

On May 7, 2004, Petitioner filed a Motion to Compel Production of Documents claiming that Respondent failed to produce documents containing statements of departmental policy and procedure requested in Petitioner's March 2, 2004 discovery requests, described as follows:

a. Please produce a copy of any and all Department of Treasury policy statements, bulletins, letter rulings, audit procedures, or audit standards issued between 1995-2001 that set forth or discuss "maintenance fees are service fees rather than royalties."

b. Please produce a copy of Department of Treasury employee, Michael Martin's, memorandum(s) written between 1995-2001 which relate to audit policy or audit standards and discuss "royalties," "apportionment," "maintenance fees," and/or "service

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2 In addition to amending the definition of sales, 2000 PA 477 amended the definition of "gross receipts" and included provisions specific to certain industries (such as advertising agencies, property management companies, and foreign airlines). Enacting section 1, states, "This amendatory act takes effect for the tax years that begin after December 31, 2000."

3 TTR 264(2) provides:

> If a party refuses to obey an order made under R 205.1255(3) or an order made under R 205.1260, then the tribunal may issue orders in regard to the refusal as justice requires or as provided in R 205.1247.

fees."

Petitioner has requested document(s) authored by Respondent's employee Michael Martin that describe Respondent's position on the inclusion of royalties in the sales factor. (Page Four of Petitioner's Brief in Support of Petitioner's Motion to Compel Production of Documents.) At the prehearing conference held October 12, 2004, Petitioner's counsel claimed that Petitioner became aware of the document during the audit, based on discussions with Respondent's auditor.

Respondent does not deny that the document exists.

On May 18, 2004, Respondent filed a response in opposition to Petitioner's Motion to Compel Discovery and a Motion for Protective Order, asserting that the documents in question are subject to MCL 205.28(1)(f), which, in relevant part, prohibits the disclosure of "information or parameters that would enable a person to ascertain the audit selection or processing criteria of the department."

On September 8, 2004, the Tribunal ordered Respondent to produce the documents for in camera review at the prehearing conference scheduled for September 14, 2004 for the purpose of determining whether the document contained "audit selection or processing criteria." Respondent has not complied with the September 8, 2004 Order.

Had Respondent complied with the September 8, 2004 Order, the Tribunal could have ordered Respondent to produce the entire document or to produce it with protected portions redacted. On the other hand, if the document was found to contain only "audit selection or processing criteria" the Tribunal would have entered a protective order to prevent the document's disclosure.

On September 13, 2004, the Tribunal granted a Joint Motion to Adjourn Prehearing Conference.

On September 16, 2004, the Tribunal denied Respondent's Motion for a Protective Order and again required Respondent to produce the requested documents for in camera review at the prehearing conference rescheduled for October 12, 2004. The Tribunal did not order Respondent to divulge any document to Petitioner but only to produce the identified document(s) for in camera review by the Tribunal.

On October 6, 2004, Respondent filed the Motion for Reconsideration that is the subject of this Order. Petitioner hand delivered a written response to the motion on October 11, 2004.

On October 12, 2004, while Respondent's Motion was still pending, Respondent appeared at the prehearing conference without the requested documents in hand. Respondent refused to produce the documents for in camera review, as required by the September 16, 2004 Order, based in part on its view that the Tribunal lacks authority to conduct such a review or to enter a "judicial order" for production of material under MCL 205.28(1)(f).

On October 18, 2004, Respondent filed a "Motion for Briefing and Argument before the Entire Tribunal (All the Members) of Petitioner's Motion to Compel Discovery and Respondent's Motion for a Protective Order." The Tribunal granted Respondent's motion and oral argument

was held December 8, 2004. Respondent filed a "Brief Before the Entire Tax Tribunal Opposing Petitioner's Motion to Compel Discovery." Petitioner filed a "Response to the Department of Treasury's Motion for Briefing and Argument before the Entire Tribunal."

Law and Analysis

Issue I – *In Camera Review*

Respondent has determined that it is prohibited from disclosing certain requested documents to the Tribunal or Petitioner under section 28(1)(f) of the Revenue Act, MCL 205.28(1)(f). The Tribunal does, however, have the authority to affirm, reverse, modify, or remand a final decision, finding, ruling, determination, or order of an agency. MCL 205.732(a). As such, Respondent's determination is subject to review by the Tribunal.

The Tribunal also has authority to issue writs and orders which it deems appropriate for the disposition of a matter of which it may acquire jurisdiction. MCL 205.732(c). The Tribunal's order to produce the document(s) for review is authorized by law and is necessary to conduct a meaningful de novo hearing. MCL 205.735(1).

The Tribunal is organized as a specialized, administrative "tax court" and its final orders are subject to direct review by the Michigan Court of Appeals. MCL 205.753. The Tribunal has original and exclusive jurisdiction over proceedings involving property tax laws. MCL 205.731; MCL 205.721. The Tribunal has concurrent jurisdiction with the Court of Claims over proceedings involving state tax laws in "nonproperty tax" matters. MCL 205.22. Section 28(1)(f) of the Revenue Act is a tax law within the Tribunal's subject matter jurisdiction. As a "quasi-judicial agency," the Tribunal has authority to enter a "judicial order" within the meaning of Section 28(1)(f) to determine whether information is "audit selection or processing criteria." *Bechtel Power Corp* v *Department of Treasury*, 128 Mich App 324 (1983).

Petitioner is entitled to documents to the extent that they describe or explain the Department's policy, legal interpretation, or position with regard to the issues in this case, but is not entitled to any document or part of a document that contains "information or parameters that would enable a person to ascertain audit selection or processing criteria" within the meaning of MCL 205.28(1)(f).

The Tribunal, the finder of fact in this case, was created by the Legislature as a "court" of special expertise.[4] More specifically, the Tribunal is both familiar with and experienced in resolving substantive property and nonproperty tax law issues and, as such, is competent to determine

4 By statute, the Tribunal is a "multi-disciplinary" court, meaning that composition of the Tribunal is required to include an accountant, an assessor, an appraiser, and other relevant tax professionals in addition to attorneys. MCL 205.722; MSA 7.650(22). As intended by the Legislature, this panel of the Tribunal has long and wide-ranging collective experience with this tax matter that includes: many years as an accountant, as an attorney representing taxpayers at all levels of local, state and federal tax practice, as a County Treasurer, as a City Assessor, as a City Attorney, as a Tax Counsel to the Michigan Department of Treasury, as an Assistant Attorney General, as a Deputy Treasurer, as an Administrator of the Treasury's Legal and Hearings Division, and as an assistant legal counsel to the Michigan Senate.

whether the information contained in the requested document(s) is discoverable under section 28(1)(f), which provides:

> (f) Except as otherwise provided in this subdivision, an employee, authorized representative, or former employee or authorized representative of the department or anyone connected with the department shall not divulge any facts or information obtained in connection with the administration of a tax or ***information or parameters that would enable a person to ascertain the audit selection or processing criteria of the department for a tax administered by the department***. An employee or authorized representative shall not willfully inspect any return or information contained in a return unless it is appropriate for the proper administration of a tax law administered under this act. A person may disclose information described in this subdivision if the disclosure is required for the proper administration of a tax law administered under this act or the general property tax act, 1893 PA 206, MCL 211.1 to 211.157, pursuant to a judicial order sought by an agency charged with the duty of enforcing or investigating support obligations pursuant to an order of a court in a domestic relations matter as that term is defined in section 2 of the friend of the court act, 1982 PA 294, MCL 552.502, or pursuant to a judicial order sought by an agency of the federal, state, or local government charged with the responsibility for the administration or enforcement of criminal law for purposes of investigating or prosecuting criminal matters or for federal or state grand jury proceedings or ***a judicial order if the taxpayer's liability for a tax administered under this act is to be adjudicated by the court that issued the judicial order***. A person may disclose the adjusted gross receipts and the wagering tax paid by a casino licensee licensed under the Michigan gaming control and revenue act, the Initiated Law of 1996, MCL 432.201 to 432.226, pursuant to section 18, sections 341, 342, and 386 of the management and budget act, 1984 PA 431, MCL 18.1341, 18.1342, and 18.1386, or authorization by the executive director of the gaming control board. However, the state treasurer or a person designated by the state treasurer may divulge information set forth or disclosed in a return or report or by an investigation or audit to any department, institution, or agency of state government upon receipt of a written request from a head of the department, institution, or agency of state government if it is required for the effective administration or enforcement of the laws of this state, to a proper officer of the United States department of treasury, and to a proper officer of another state reciprocating in this privilege. The state treasurer may enter into reciprocal agreements with other departments of state government, the United States department of treasury, local governmental units within this state, or taxing officials of other states for the enforcement, collection, and exchange of data after ascertaining that any information provided will be subject to confidentiality restrictions substantially the same as the provisions of this act.

> History: Add. 1980, Act 162, Eff. Sept. 17, 1980 ;--Am. 1982, Act 514, Eff. Mar. 30, 1983 ;--Am. 1986, Act 58, Eff. May 1, 1986 ;--Am. 1993, Act 13, Imd. Eff. Apr. 1, 1993 ;--Am. 1998, Act 221, Imd. Eff. July 1, 1998 ;--Am. 2000, Act 308, Imd. Eff. Oct. 16, 2000 ;--

> Am. 2002, Act 657, Imd. Eff. Dec. 23, 2002 ;--Am. 2003, Act 114, Imd. Eff. July 24, 2003. [Emphasis Added]

An in camera review by the Tribunal would allow for the creation of a record for review by the Court of Appeals on appeal or by the circuit court in an action to enforce the Tribunal's September 16, 2004 Order.[5] To hold otherwise would not only deprive Petitioner of potentially discoverable material for use in the prosecution of its case, but also undermine the Legislature's intent in creating the Tribunal to provide a specialized legal forum for the efficient resolution of nonproperty tax disputes.

This case does not involve confidential tax information pertaining to nonparty taxpayers or "audit selection criteria." Rather, Respondent asserts that written communications between employees of Respondent's audit division are "audit processing" criteria within the meaning of MCL 205.28(1)(f). Respondent claims it may unilaterally withhold any information it determines is covered by section 28(1)(f) and that its determination is not reviewable by the Tribunal.

In *Bechtel*, *supra*, the Court of Appeals recognized the Tribunal's authority to make independent determinations regarding the disclosure of material potentially protected by section 28(1)(f). More specifically, the Court required the Tribunal to enter a stipulated consent order to keep the taxpayer's SBT return and other tax and financial information under seal. Initially the Tribunal refused to enter the consent order, believing that the documents were subject to the Freedom of Information Act ("FOIA").

The Court of Appeals held that in the event of a FOIA request "the Tribunal should then examine in camera the materials requested and delete such identifying details as are necessary to prevent unwarranted invasion of petitioners' privacy." *Id*., 331. The Court cited *International Business Machines, Inc* v *Dep't of Treasury*, 71 Mich App 526; 248 NW2d 605 (1976), which held that the Court of Claims must "separate the kernel of agency statements of law and policy from what would otherwise be confidential or identifying details." *Id*., 540. In *Bechtel*, which was an appeal from the Tribunal, the Court of Appeals cited the *IBM* case, which originated in the Court of Claims. The Court applied the same standard to both the Tribunal and the Court of Claims.

Furthermore, the Court of Appeals noted that under an exception to the FOIA, a document that is otherwise available to the public may not be disclosed if another statute, such as the Revenue Act, prevents the disclosure. Therefore, any matter covered under 28(1)(f) is exempt from production under FOIA. The Tribunal's determination in response to a FOIA request necessarily involves a determination under the Revenue Act, MCL 205.28(1)(f), which must be interpreted in the context of other statutes and case law regarding the disclosure of administrative documents, including the Michigan Administrative Procedures Act ("MAPA") and FOIA.

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5 TTR 264(1) provides:

> If a party or other person refuses to answer a question after being ordered to do so by the tribunal, then the proponent of the question may file a petition with the circuit court for Ingham county or the county in which discovery is being taken to compel the party or person who is ordered to make discovery to comply with the order of the tribunal.

In *Bechtel*, the Court of Appeals ordered the Tribunal to review the materials for the purpose of redacting any confidential taxpayer information that would be prohibited from disclosure under both FOIA and MCL 205.28(1)(f). *Bechtel* involved a former version of section 28(1)(f) that included a "judicial order" exception and held that the Tribunal had authority to conduct in camera review of material potentially within the scope of 28(1)(f). *Id*., 331. The Court remanded the case for entry of the consent order and charged the Tribunal as follows:

> It is clear that the Tax Tribunal is subject to the Freedom of Information Act. MCL 205.746; M.S.A. § 7.650(46). Section 13(1)(d) of the act, however, exempts from disclosure "[r]ecords or information specifically described and exempted from disclosure by statute". MCL 15.243 subd. (1)(d); M.S.A. § 4.1801(13) subd. (1)(d). Section 28(1)(f), of the Department of Revenue act, MCL 205.28 subd. (1)(f), M.S.A. § 7.657(20) subd. (1)(f), prohibits anyone connected with the Department of Revenue from divulging "any facts or information obtained in connection with the administration of a tax". Section 13(1)(a) of the Freedom of Information Act, MCL 15.243 subd. (1)(a); M.S.A. § 4.1801(13) subd. (1)(a), permits a public body to exempt from disclosure information "of a personal nature where the public disclosure of the information would constitute a clearly unwarranted invasion of an individual's privacy".
>
> Much of the information in the ***court*** file is arguably exempt under either or both of those provisions. See *International Business Machines* v *Dep't of Treasury*, 71 Mich App 526; 248 NW2d 605 (1976). [Emphasis added.]

Respondent attempts to distinguish *Bechtel* on the grounds that the Department provided the materials to the Tribunal "in the course of litigation" and not pursuant to an order of the Tribunal. However, *Bechtel* does not describe the circumstances under which the Department provided the information to the Tribunal. It is true that *Bechtel* does not specifically hold that the Tribunal may order Respondent to produce documents -- that issue was not before the Court of Appeals. However, the remand order plainly anticipates that some of the information in the Tribunal's "court file" might have been protected by 28(1)(f) and commanded the Tribunal to make a determination before disclosing the information pursuant to a FOIA request. The former version of 28(1)(f) at issue in *Bechtel* contained a "judicial order" exception similar to the present version in this case.[6]

Respondent further argues that the Tribunal is not a "court" within the meaning of section 28(1)(f) and therefore cannot conduct in camera review or order disclosure. It is undisputed that the Tribunal is not a court within the judicial branch, but is a "quasi-judicial" agency within the executive branch. However, the Tribunal rejects Respondent's overly strict interpretation of the Revenue Act. The Court of Appeals has not recognized a stark distinction between a "court" and the Tribunal when dealing with section 28(1)(f). More specifically, the Court, in *Bechtel*,

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6 *Bechtel* involved a dispute over the 1976 tax year. The Tribunal issued its order of summary disposition in that case on April 1, 1982 and the court remanded the case to the Tribunal in 1983. However, the amendments to section 28(1)(f) since that time do not diminish the applicability of the Court's analysis to the present case.

referred to the Tribunal as a "court" when it stated that the tax information was part of the "Tribunal's ***court*** file." *Id*., 330. [Emphasis Added]. This contradicts Respondent's view that only a "court" in the judicial branch may enter a "judicial order" for the disclosure of information that is potentially within the scope of section 28(1)(f). Reading the relevant statutory language as a whole, it becomes clear that the Legislature intended to give the forum adjudicating the taxpayer's claim the authority to order disclosure of allegedly protected documents. The adjudicative forum in this case is the Tribunal.

The Revenue Act does not contain a general definition of "court." As such, it is appropriate to examine the Revenue Act as a whole to help interpret the meaning of section 28(1)(f).[7] In that regard, the Legislature has carefully and specifically selected legal terms of art as necessary to refer to particular adjudicative forums.

Section 3 of the Revenue Act provides that the "circuit court" may enforce subpoenas issued by Respondent. MCL 205.3(a). Here, the Legislature used the specific term "circuit court" where it intended to exclude the Tribunal and the Court of Claims. The term "circuit court" also appears in MCL 205.14(8). The Legislature used the term "court of claims" in MCL 205.22(1), (2) and (3). The use of that term obviously excludes the Tribunal and the circuit court. Similarly, the term "court of appeals" appears in subsection 22(3) and excludes the Tribunal, the Court of Claims, and the circuit court.

In subsection 22(4), the Legislature used the general term "court" in a manner clearly intended to include the Tribunal. "The assessment, decision, or order of the department, if not appealed in accordance with this section, is final and is not reviewable in any ***court*** by mandamus, appeal, or other method of direct or collateral attack." [Emphasis added.] Here, the term "court" -- without modification -- applies to any adjudicative forum with jurisdiction over a tax assessment. Likewise, the term "court" in section 28(1)(f) is also used in a generic sense and is not limited to any particular adjudicative forum.[8]

In subsection 30a(2)(c)(ii) of the Revenue Act, the Legislature used the term "court of competent jurisdiction" to refer to a court within the judicial branch of government with authority to issue a writ of garnishment, which naturally does not include the Tribunal. Therefore, the Legislature is quite precise in its use of legal terms to refer to specific adjudicative forums. In section 28(1)(f) the Legislature chose the general term "court" in the context of describing an adjudicative forum with jurisdiction over a tax dispute, which includes the Tribunal and the Court of Claims. If the Legislature intended to exclude the Tribunal from section 28(1)(f), it could have used a more specific term, as it did elsewhere in the Revenue Act.

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7 "The language [of a statute] does not stand alone, and …cannot be read in a vacuum. Instead, it exists and must be read in context with the entire act, and the words and phrases used there must be assigned such meanings as are in harmony with the whole." *Sweatt* v *Dep't of Corrections*, 468 Mich 172, 179 (2003). "[W]here the legislature has carefully employed a term in one place and excluded it in another, it should not be implied where excluded." *Sutherland* 2A Sec. 46.05.

8 The word 'court' is often employed in statutes otherwise than in its strict technical sense, and is applied to various tribunals not judicial in their character, *State* v *Howat*, 107 Kan 423; 191 P 585, 589." *Blacks Law Dictionary*, Revised Fourth Edition, page 425.

Furthermore, the enacting section to P.A. 1980, No. 162 uses the term "court of record" to describe a court within the judicial branch of government. (See compilers notes to the Michigan Compiled Laws, P.A. 1980, No. 162, available at www.michiganlegislature.org.) Also see, MCL 205.25, "[e]xcept as provided in subsection (6), the officer or agent serving the warrant shall proceed upon the warrant in all respects and in the same manner as prescribed by law in respect to executions issued against property upon judgments by a court of record." Clearly, the term "court of record" is used in that context to exclude the Tribunal.

This usage holds true for other tax laws, such as the Single Business Tax Act, MCL 208.9(4)(g)(iv) which refers to a "court of competent jurisdiction" and in MCL 208.25 – "final appellate court decision." The Motor Fuel Tax Act also refers specifically to the "circuit court." MCL 207.1130(9) and (10). The Legislature is adept at identifying particular courts when it intends to limit jurisdiction to a particular adjudicative forum. It has not done so in this case.

The Tribunal is a quasi-judicial agency that has acquired jurisdiction over the assessment in this case, and as such has authority to issue a "judicial order" within the meaning of MCL 205.28(1)(f).

Respondent correctly points out that the Tribunal lacks power to issue orders for contempt, an injunction, or to declare a statute unconstitutional, but this is irrelevant to the matter at hand. The power to order discovery of tax information is not the type of "judicial" power that cannot be transferred to an administrative agency under the constitutional separation of powers doctrine.

Additionally, the *IBM* case held that under the MAPA, a statement of policy must be disclosed. The MAPA parallels the federal FOIA provisions that forbid the promulgation of secret administrative law by internal interpretive statements.

> The scheme of section 21 reveals that section 21(1)(c) was intended to sweep within the disclosure requirements any written statements upon which the agency relies as indicative of law or policy, whether or not those statements might also fall within parts (a) or (b) as decisions in contested cases or promulgate rules. We agree with the Federal courts that the fundamental principle is that secret law is an abomination. *Davis, Administrative Law Treatise*, s 3A.12 (1970 Supp.) *International Business Machines, Inc* v *Dep't of Treasury*, 71 Mich App 526; 248 NW2d 605 (1976)

The Revenue Act should not be interpreted to allow the Department to maintain a body of secret administrative law. More importantly, Respondent's view of the law not only undermines the Tribunal's statutory authority to review Respondent's interpretation and application of section 28(1)(f), but would also hinder the Tribunal's ability to conduct an original, independent, and de novo nonproperty tax matter proceeding. MCL 205.735(1); MCL 205.732(a). In a practical sense, Respondent's view renders the Tribunal's statutory authority to conduct nonproperty tax matter proceedings meaningless as taxpayers are more likely to file such cases in the Court of Claims where they could more effectively seek discovery of departmental policy statements.

Issue II – *Defining Statutory Terms*

The statute does not define "audit selection or processing criteria." However, a document that contains only a statement of law or policy is not "audit processing criteria." See *Newark, supra*. A document is not "audit section or processing criteria" merely because it was written by or transmitted to an auditor. To the extent that Petitioner requested "audit procedures" or "audit standards" the Tribunal's Order was protective in nature and was limited to statements of law or policy. Respondent has failed in its burden to prove that the document contains only audit selection or processing criteria.

The Tribunal agrees with Respondent that disclosure of audit selection criteria would undermine the evenhanded enforcement of tax laws and could lead to tax avoidance or evasion. While it may never be appropriate to disclose criteria by which the department chooses taxpayers for audit ("audit selection criteria"), Respondent's own administrative rules state that a taxpayer has a right to know audit processes that resulted in an assessment.

The 2004 Taxpayer Rights Handbook, published by Respondent pursuant to MCL 205.4(3), states that the taxpayer is entitled to know "audit methodologies and procedures."

> Section 4 - Audit Guidelines
>
> The auditor presents the results of the audit to the taxpayer when the audit work is complete and the determination is final.
>
> The auditor prepares a written report at the close of the audit. The report includes information about:
>
> 1. ***Audit methodologies and procedures***
> 2. Results of audit(s). [Emphasis added.]

Also, see "*Taxpayers Rights During Audit*" Form 2315 (Tax Guide p. 267):

> "you have a right to…[r]eceive copies of the audit workpapers that ***show how the auditor determined any changes to your taxes***." [Emphasis added.]

Under the Revenue Act, the taxpayer has the right to know the actual reasoning that resulted in the assessment, including "audit methodologies and procedures." The above language is mandated by the "Taxpayer Rights" amendments to the Revenue Act. MCL 205.4(3).

> Not later than 1 year after the effective date of this section, the department shall publish a handbook for taxpayers and tax preparers. The handbook shall be made available…and shall contain all of the following:
>
> (a) ***Audit*** and collection ***procedures*** used by the department.
> (b) The procedures governing departmental communications with taxpayers in the audit and collection process. MCL 205.4(3). [Emphasis added.]

The Revenue Act contains no absolute prohibition against disclosure of "audit procedures." To the contrary, some audit procedures must be disclosed to the taxpayer in appropriate cases. The Tribunal has authority to determine whether purportedly protected "audit processing criteria" are the type of "audit procedures" that the taxpayer has a right to know under MCL 205.4(3). The taxpayer has a right to know Respondent's legal interpretation and "audit procedures" that were actually in place at the time the assessment was issued.[9] The finder of fact must, however, prohibit disclosure of information that would undermine the administration of Michigan's tax laws.

During oral argument, the Assistant Attorney General stated the harm that the statute seeks to avoid:

> Well, the problem could be if audit processing were divulged, it would allow taxpayers – now, this is going to be a worse case scenario – if all the audit processing criteria were divulged, would allow taxpayers to know where the Department would be auditing, what areas that would be looked at, and so maybe a little more aggressive in the tax planning in certain ways, feeling free that certain things weren't going to be looked at. Tr., 53.

These generalized concerns are legitimate, however, Respondent has not identified a specific "audit processing criteria" that should not be "ascertained" by the public in this case. Respondent has not established how Respondent's statutorily mandated administrative functions would be thwarted by disclosure of the requested document(s).

In an unpublished, per curiam opinion, the Court of Appeals recently provided informative rules on what is not protected by section 28(1)(f). The court held that a taxpayer was entitled to know

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9 Indeed, disclosure of audit procedures encourages better compliance to the extent taxpayers understand what records they should be keeping. Reference to the confidentiality interpretations by other taxing entities that have entered into agreements to exchange information with Respondent and that also seek to improve taxpayer compliance are instructive.

Respondent has entered into these agreements pursuant to explicit language in section 28 (1)(f) that provides:

> The state treasurer may enter into reciprocal agreements with...the United States Department of Treasury…or taxing officials of other states for the enforcement, collection, and exchange of data after ascertaining that any information provided will be subject to confidentiality restrictions substantially the same as the provisions of this act.

We take notice that Respondent has long worked under a confidentiality agreement with the Internal Revenue Service and note that the IRS provides its "Audit Techniques Guides," to the public on its website, www.irs.gov. Audit Techniques Guides, the website explains, "contain examination techniques, common and unique industry issues, business practices, industry terminology and other information to assist examiners in performing examinations." Presumably, the IRS discloses its audit techniques under "substantially the same" confidentiality protections as Respondent.

how Respondent applied the law to other taxpayers during an audit. *Newark, supra*. (Respondent's application for leave to appeal is pending before the Michigan Supreme Court.) The information pertained directly to how Respondent treated non-party taxpayers during an audit. The Court held Respondent's practices and policies were not "information obtained in connection with the administration of a tax" and therefore were outside the scope of MCL 205.28(1)(f). The taxpayer was entitled to information "concerning defendant's practices." *Id*. The practices in question related directly to audits and treatment of other taxpayers.[10]

Hearings in the Tax Tribunal are generally consistent with the contested case procedures of the MAPA. "If an applicable Tax Tribunal rule does not exist…the provisions of chapter 4 of Act No. 306 of the Public Acts of 1969, as amended, being 24.271 to 24.287 of the Michigan Compiled Laws [i.e., MAPA], shall govern." TTR 111.

The MAPA provides in relevant part:

> On a request for identifiable agency records, with respect to disputed material facts involved in a contested case, except records related solely to the internal procedures of the agency or which are exempt from disclosure by law, an agency shall make such records promptly available to a party. MCL 24.274(2).

The MAPA requires disclosure of "identifiable agency records," with the exception of records "related solely" to internal agency procedures or which are exempt by law. The statute implicitly authorizes an administrative agency to review requested documents to determine whether they "relate solely to" internal agency procedures or are exempt by law, such as under section 28(1)(f).
Petitioner accurately points out that the statute allows Respondent to disclose otherwise protected information for the "proper administration of a tax" with or without a judicial order. Therefore, if Respondent produced the material in compliance with the Tribunal's Order, it would not be subject to the statute's criminal penalties because the disclosure would be necessary for the proper administration of a tax. "Proper administration" includes compliance with Tribunal orders. The obvious fact that the Revenue Act charges Respondent with the "administration" of tax laws does insulate Respondent from review by the Tribunal, as the Tribunal is also charged with the administration of the state's tax laws.

Issue III – *Sanction for Noncompliance*

If Respondent's interpretation prevails, a taxpayer who commences an action in the Tribunal would be faced with a statutory conundrum that would prevent effective discovery. A petitioner may obtain a Tribunal order to compel production of documents under TTR 260(1) and seek to enforce that order by commencing an action in the circuit court. TTR 264(1). The circuit court would, however, be precluded from reviewing the documents to determine whether materials should be protected or not protected under section 28(1)(f) because the original action was not "commenced" in that circuit court. As indicated above, Respondent may disclose information if authorized by a "judicial order," but only if the "judicial order" is entered by the court that is

10 The instant case does not involve the disclosure of third-party taxpayer information. We see acutely different privacy and confidentiality concerns in those cases.

adjudicating the taxpayer's tax liability. MCL 205.28(1)(f); also see, R 205.1004(d). Although circuit courts have jurisdiction to entertain constitutional issues concerning the validity of tax laws, circuit courts have no jurisdiction to review determinations made by the Department of Treasury. *Kostyu* v *Dep't of Treasury*, 170 Mich App 123; 427 NW2d 566 (1988). As such, circuit courts cannot enter a "judicial order" authorizing disclosure under section 28(1)(f).

This conundrum would, as previously discussed, require taxpayers to prosecute their cases without potentially discoverable materials and provide for no substantive pre-appellate review of discovery materials and Tribunal cases would be brought before the Court of Appeals without adequate findings of fact or conclusions of law.

If a party refuses to obey an order to compel discovery, the Tribunal does, however, have the authority to "issue orders in regard to the refusal as justice requires or as provided in R 207.1247" [pertaining to default hearings].

In this case, the Tribunal may order a default hearing, however, Petitioner would be required to carry its burden of persuasion without full discovery. The Tribunal's rules ("TTR's") provide for the issuance of orders to address noncompliance with a discovery order. The Tribunal's rules incorporate the Michigan Court Rules ("MCR's") where no specific TTR exists. The incorporation of the MCR's does not unlawfully expand the authority of the Tribunal beyond that provided in the Tribunal's enabling act (MCL 205.701 *et seq*). More specifically, the TTR's do not confer additional powers, such as contempt powers, on the Tribunal. Rather, the TTR's incorporate specific discovery sanctions under MCR 2.313(B)(2) that are completely within the Tribunal's statutory authority. In appropriate cases, the Tribunal can dismiss a petition or order a default hearing for a failure to comply with its orders. Certainly then, the Tribunal can issue less drastic sanctions prescribed under the MCR's.

Under the circumstances of this case, the Tribunal concludes that Respondent shall be prohibited from opposing Petitioner's allegation in Paragraph 46 of its Petition. This amounts to a deemed admission that Respondent erred in its interpretation of the law. This is admittedly a strict sanction that may have the effect of a default judgment in favor of Petitioner. However, it is entirely within Respondent's power to remove the sanction by agreeing to comply with the Tribunal's properly limited September 16, 2004 Order, in which case this matter could proceed on its merits.

Respondent suggests that the appropriate sanction would be to deem admitted the fact that Respondent changed its legal interpretation with regard to royalties in the sales factor. However, this is only one of the reasons that Petitioner claims the requested document(s) is relevant. The document(s) may contain information that gives rise to other claims or theories. In any event, proper discovery practice dictates that the document(s) must be produced for in camera review.

Under Respondent's view, the only way for Petitioner to pursue full discovery is to commence the case in the Court of Claims, which presumably, Respondent would agree has authority to make determinations regarding protected or non-protected material under section 28(1)(f). However, the time for commencing an action in the Court of Claims expired 90 days after the

issuance of the final assessment notice. Neither party has suggested that the law provides for a transfer of this case to the Court of Claims at this time.

Conclusion and Judgment

The Tribunal concludes:

1. Respondent has failed to demonstrate any palpable error that misled the Tribunal and the parties and that would have resulted in a different disposition if the error was corrected.

2. The appropriate sanction for Respondent's refusal to comply with the September 16, 2004 Order is, as fully discussed above, to prohibit Respondent from opposing Petitioner's claim contained in Paragraph 46 of its Petition. TTR 264; TTR 111; MCL 205.732; MCR 2.313(B)(2)(a), (b) and/or (c). See also *Occidental Development LLC* v *Van Buren Twp*, MTT Docket No. 292745.

3. If this Order is appealed, the Tribunal will place this case in abeyance pending the final resolution of all appeals relative to this Order as the legal issues presented here are recurring and involve important matters of public policy. Therefore,

IT IS ORDERED that Respondent's Motion for Reconsideration of Order Denying Motion for Protective Order is DENIED.

IT IS FURTHER ORDERED that the allegations stated in Paragraph 46 of Count III of the Petition -- that Respondent erred by including royalty income in the numerator and the denominator of the sales factor for the reason the income does not fall within the definition of "sale" or "sales" under MCL 208.7(1) -- are established, for the purposes of this case, as a matter of law.

MICHIGAN TAX TRIBUNAL

Entered: April 15, 2005

By: Jack Van Coevering
Sherry A. Lee
Michael A. Stimpson
Kimbal R. Smith, III
Judith R. Trepeck
Patricia A. Halm

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