STATE OF MICHIGAN
DEPARTMENT OF TREASURY
LANSING

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REVENUE ADMINISTRATIVE BULLETIN 2015-26

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REVENUE ACT – AUDITS AND THE STATUTE OF LIMITATIONS

(Replaces Revenue Administrative Bulletin 2008-8)

Pursuant to MCL 205.6a, a taxpayer may rely on a Revenue Administrative Bulletin issued by the Department of Treasury after September 30, 2006, and shall not be penalized for that reliance until the bulletin is revoked in writing. However, reliance by the taxpayer is limited to issues addressed in the bulletin for tax periods up to the effective date of an amendment to the law upon which the bulletin is based or for tax periods up to the date of a final order of a court of competent jurisdiction for which all rights of appeal have been exhausted or have expired that overrules or modifies the law upon which the bulletin is based.

RAB 2015-26. Public Act 3 of 2014 amended the Revenue Act to change the manner in and the circumstances under which the statute of limitations for audits and assessments is extended. This Revenue Administrative Bulletin explains the effect of this change on Department procedures related to Department audits.

ISSUES

I. What is a statute of limitations?

II. What is the statute of limitations for assessment of tax liability and for claims for refund?

III. Prior to Public Act 3 of 2014 (PA 3), effective February 6, 2014, what circumstances could toll the statute of limitations and how is the limitations period calculated in those circumstances?

IV. What changes did PA 3 make with respect to the statute of limitations for refund claims and assessments?

V. Does the new statute of limitations extension provision apply to Department audits commenced before the enactment of PA 3?

VI. What statute of limitations extension provision applies to Department audits commenced in the period from February 6, 2014, to September 30, 2014?

VII. For Department audits that cannot be completed within one year of the expiration of the limitations period, will the Department enter into written agreements to extend the statute of limitations?

VIII. What are the benefits of entering into an agreement to extend the statute of limitations period?

CONCLUSIONS

I. A statute of limitations is a law that sets a timeframe (limitations period) within which affected parties must take action to enforce their rights or to seek redress after suffering an injury or damage. This period varies depending on the jurisdiction and the nature of the claim. Its purpose is to encourage the diligent prosecution of claims while evidence is available and fresh, ensuring finality and predictability in litigation. For tax purposes, the statute of limitations is the timeframe within which the Department must assess a tax or the taxpayer must claim a refund for a particular period.

II. The statute of limitations for assessing a tax deficiency, interest, or penalty is 4 years from either the date set for the filing of the required return or the date the return was filed, whichever is later. The statute of limitations for claiming a refund of an amount paid to the Department is 4 years from the date set for the filing of the original return.

III. Prior to the enactment of PA 3, the 4-year statute of limitations under MCL 205.27a(2) was suspended for the period agreed to in writing by the taxpayer and the Department and also for the period pending a final determination of tax at either the federal or state level and for one year after that period. Most notably, this applies to the time period during which an audit is pending.[1]

Where a final determination of the tax is pending, the expiration of the statute of limitations is calculated from the date of the final determination of the tax as announced by the IRS for federal audits and as announced by the Department in cases of state audits. In state audits, this announcement may be made in a final audit determination or other similarly-purposed correspondence. One year is then added to the date of the final determination as well as the balance of time remaining from the general 4-year statute of limitations at the point the suspension commenced.

IV. PA 3 amended the sections of the Revenue Act which permit a tolling of the statute of limitations. Where previously the limitations period was tolled through suspension of the limitations period for federal and state audits, hearings, and litigation, under PA 3 the limitations period is tolled through extensions, which are calculated differently from suspensions. Additionally, the PA 3 extension that applies differs depending on whether the necessary extension resulted from a federal or a state determination of the tax.

V. PA 3 applies prospectively as to statute of limitations extensions and does not apply to audits commenced before its enactment date.

[1] MCL 205.27a(3)(a).

VI. Unless the taxpayer and Department agree in writing, there is no statute of limitations extension for audits commenced on or after February 6, 2014, through September 30, 2014. Final assessments resulting from audits commenced during this period must be issued within the four-year limitations period.

VII. The Department will enter into written agreements to extend the statute of limitations period.

VIII. Agreements to extend the statute of limitations period can provide a mutual benefit to the taxpayer and the Department by easing the time pressure of an audit or managing the schedule of audits by other states. Extensions can also afford taxpayers the time to produce the documentation necessary to support a particular tax position and lead to a more accurate determination of the tax by the Department.

LAW & ANALYSIS

Statute of Limitations Periods. A statute of limitations sets forth the period of time within which a party must assert a claim and after which a party's claim is barred. The limitations period that a statute sets forth represents a policy decision concerning the appropriate balance among those asserting claims, those defending them, and society as a whole.[2] In the context of tax law, the limitations period represents the time period within which the taxpayer can file a claim for refund or within which the government can assess tax liability against the taxpayer. In enacting federal law, Congress has ensured consistency in enacting the same period of limitation for filing claims for refund as for assessment of tax.[3] Michigan follows this approach as well.

The Revenue Act provides the Department with a 4-year general statute of limitations period in which to assess a taxpayer. Further, a taxpayer has four years from the filing date of an original return to request a refund. The act provides in part:

> 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. The taxpayer shall not claim a refund of any amount paid to the department after the expiration of 4 years after the date set for the filing of the original return.[4]

Suspensions of the Statute of Limitations Before PA 3. Prior to the enactment of PA 3, effective February 6, 2014, Section 27a(3) of the Revenue Act provided that the statute of limitations was suspended for:

> (a) The period pending a final determination of tax, including audit, conference, hearing, and litigation of liability for federal income tax or a tax administered by the department and for 1 year after that period.

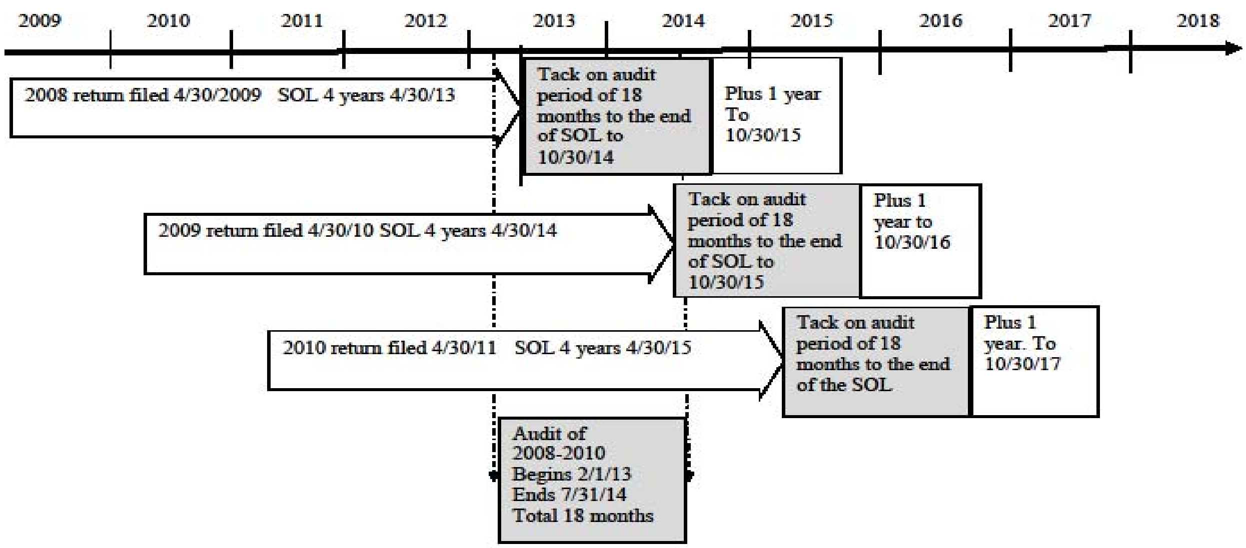
[2] *The New Provision for Tolling the Limitations Period for Seeking Tax Refunds: Its History, Operation and Policy, and Suggestions for Reform*, 65 Missouri Law Review 797, 802 (Fall 2000).
[3] *Id*. at 834.
[4] MCL 205.27a(2).

(b) The period for which the taxpayer and the state treasurer have consented to in writing that the period be extended.[5]

The statute of limitations is calculated under subsection (a) by starting from the date of the final tax determination and adding to that the balance of time that was remaining in the original 4-year limitations period and then adding one year to that date.[6] Alternatively stated, the statute of limitations is calculated by tacking on the remainder of the audit period to the end of the original 4-year statute of limitations period and then adding one year.

Example 1. ABC Corporation, a calendar year taxpayer, files its 2008 Michigan Business Tax (MBT) return on April 30, 2009, its 2009 MBT return on April 30, 2010, and its 2010 MBT return on April 30, 2011. ABC Corporation is audited by the Department for tax years 2008-2010 with an audit commencement date of February 1, 2013. The audit concludes 18 months later and the Department notifies the taxpayer of the final determination of tax by letter dated July 31, 2014. The statutes of limitation for the tax years audited are calculated as follows:

2008: Original SOL expiration date (4/30/13) + 18 months + 1 year = 10/30/15
2009: Original SOL expiration date (4/30/14) + 18 months + 1 year = 10/30/16
2010: Original SOL expiration date (4/30/15) + 18 months + 1 year = 10/30/17



Extension of the Statute of Limitations After PA 3. PA 3 changed the manner in which the statute of limitations is tolled, making the calculation of any extension dependent upon the type of event triggering the extension. For audits commenced after February 6, 2014, the 4-year statute of limitations period is extended in accordance with section 27a(3) of the Revenue Act for:

(a) The period pending a final determination of tax through audit, conference, hearing, and litigation of liability for federal income tax and for 1 year after that period.

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[5] For the full text of MCL 205.27a(3) as it existed immediately prior to the passage of PA 3, see 2012 PA 211.
[6] See *Krueger v Dep't of Treasury*, 296 Mich App 656, 661 (2012), citing *Fegert v Dep't of Treasury*, unpublished opinion *per curiam* of the Court of Appeals, issued December 19, 2006 (Docket No. 270236), 2006 WL 3733889.

(b) The period for which the taxpayer and the state treasurer have consented to in writing that the period be extended.
(c) The period described in section 21(6) and (7)[7] or pending the completion of an appeal of a final assessment.
(d) A period of 90 days after a decision and order from an informal conference, or a court order that finally resolves an appeal of a decision of the department in a case in which a final assessment was not issued prior to appeal.

Federal Audits after PA 3. Where PA 3 applies, the statute of limitations is extended for the period by which an IRS determination of tax exceeds the 4-year statute of limitations, plus one year[8] or for any period that the Department and the taxpayer agree to in writing.[9] Thus, for federal audits, the statute of limitations is calculated under subsection 27a(3)(a) by adding one year to the date of the final determination of tax. Section 27a(3) as amended by PA 3 does not permit the balance of the original statute of limitations period to be tacked on to the one-year extension.

Extensions for Department Audits after PA 3. For Department audits, the statute of limitations is extended under PA 3 for the length of time beyond the limitations period that it takes to issue a preliminary audit determination (PAD) but no longer than one year.[10] So long as the PAD is issued within one year of the expiration of the statute of limitations, the limitations period is extended an additional nine months for issuance of a final assessment.[11] If a taxpayer requests that the Department reconsider its PAD for any reason or the taxpayer requests an informal conference, the Department may delay issuance of the final assessment beyond the nine months.[12] To ensure timely issuance of final assessments pursuant to section 21(7), documentation or information provided to the Department after the PAD has been issued is considered to be a request for reconsideration and must be accompanied by the appropriate Department form.

Other Extensions after PA 3. In addition to the above, the statute of limitations is also extended for the period pending the completion of an appeal of a final assessment[13] and for a period of 90 days after a decision and order from an informal conference or a court order that finally resolves an appeal of a decision of the Department in a case in which a final assessment was not issued prior to appeal.[14] There is no provision in the law for extension of the statute of limitations for refund claims due to a pending Department audit.

<u>Example 2</u>. ABC Corporation, a calendar year taxpayer, files its 2013 Corporate Income Tax (CIT) return with extension on December 30, 2014, and its 2014 CIT return with extension on December 30, 2015. ABC Corporation is audited by the Department for tax years 2013 and 2014 with an audit commencement date of August 25, 2018. Without any limitations period extension, the 4-year statute of limitations would expire on December 31, 2018, for tax year

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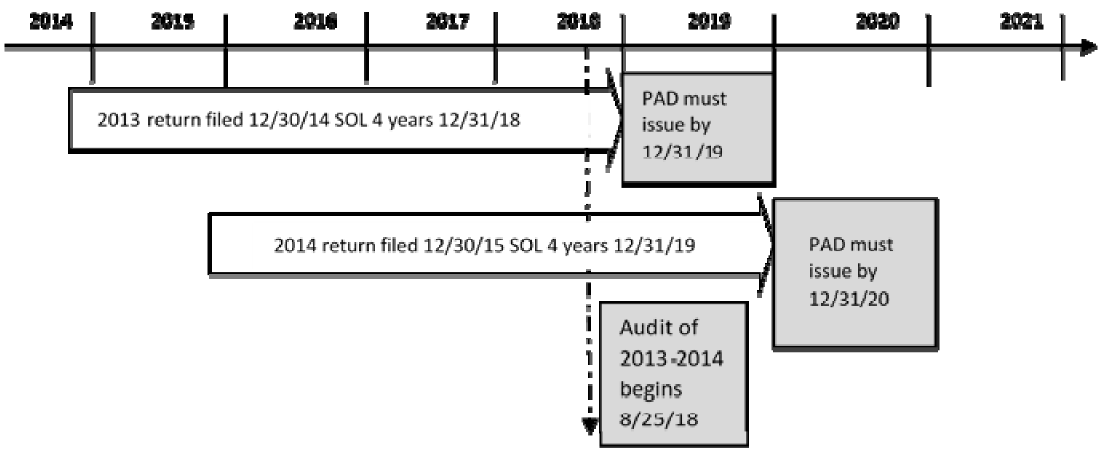
[7] Sections 21(6) and (7) refer to the one-year period for completion of audit fieldwork and the nine-month period for issuance of a final assessment. See MCL 205.21(6) and (7).
[8] MCL 205.27a(3)(a).
[9] MCL 205.27a(3)(b).
[10] MCL 205.27a(3)(c) and MCL 205.21(6).
[11] MCL 205.27a(3)(c) and MCL 205.21(7).
[12] MCL 205.21(7).
[13] MCL 205.27a(3)(c).
[14] MCL 205.27a(3)(d).

2013 and on December 31, 2019, for tax year 2014. But under PA 3, the limitations period is extended up to December 31, 2019, and up to December 31, 2020, for tax years 2013 and 2014, respectively, for purposes of issuing a PAD and an additional nine months from the date of the PAD for issuance of final assessments.



Prospective Application of PA 3. Because PA 3 contains no language indicating an intent to apply it retroactively and because the Act necessarily affects substantive rights, PA 3 applies prospectively only.[15] Therefore, the tolling provision contained in former section 27a(3)(a)[16] of the Revenue Act applies for audits commenced before February 6, 2014. The new section 27a(3)(c) extension provision, which incorporates section 21(6) and (7), applies where the audit commences on or after October 1, 2014.

For the period in between, February 6, 2014 through September 30, 2014, neither tolling nor extension of the statute of limitations is permitted. Because PA 3 delayed implementation of the provision allowing extensions of the statute of limitations until October 1, 2014, no extension of the statute of limitations applies to Department audits commenced on or after February 6, 2014, and before October 1, 2014, unless the taxpayer and Department agree in writing. Final assessments resulting from audits commenced during this period must therefore be issued within the 4-year statute of limitations, unless the taxpayer and the Department otherwise agree.[17]

Agreements to Extend the Statute of Limitations. Historically, the Department relied upon written agreements, referred to as waivers, to suspend the statute of limitations when auditing taxpayers. In December 2008, the Department published RAB 2008-8 announcing its intent to discontinue the use of waivers, choosing instead to rely upon the statutory suspension of the limitations period.

Because the statute of limitations is no longer suspended for the duration of a Department audit under PA 3, the Department may seek an agreement to extend the statute of limitations if the

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[15] *Lenawee Co v Wagley*, 301 Mich App 134, 174-175 (2013); *Davis v State Employees' Retirement Bd*, 272 Mich App 151, 156-158 (2006); *Rzadkowolski v Pefley*, 237 Mich App 405, 411 (1999).
[16] Subsection (3)(a) of former section 27a of the Revenue Act states: "The running of the statute of limitations is suspended for the following: (a) the period pending a final determination of tax, including audit, conference, hearing, and litigation of liability for federal income tax or a tax administered by the department and for 1 year after that period."
[17] Refund requests must also be made within the statute of limitations, unless the taxpayer and the Department otherwise agree.

audit is expected to exceed the statutory time frame for the issuance of a preliminary audit determination and final assessment. The agreement will serve to extend the statute of limitations for each tax type and tax period involved in an audit to a date certain agreed upon by both the taxpayer and the Department. Agreements to extend the statute of limitations that are executed by a designated member of a unitary group on behalf of the group are effective for all unitary group members for the years specified.

The amount of time granted in the agreement may be extended for an additional period of time if the Department and the taxpayer agree. This additional extension must be secured before the expiration of the original agreement period. The agreement shall indicate whether it is an extension of a previously agreed-upon extension.

A statute of limitations agreement is beneficial to both the Department and the taxpayer as it extends the time within which the Department can audit a taxpayer's returns and issue assessments as well as the time within which a taxpayer can amend returns or claim a credit or refund. Additionally, it affords a taxpayer the convenience of scheduling an audit around other business needs and allows the time needed to produce supporting documentation and to fully develop the position taken on a return. Affording additional time for production and review of documentation at the audit stage may permit any issues to be resolved as early in the process as possible and may also avoid the need to resort to other administrative or legal remedies such as informal conference or litigation at a later stage. A taxpayer is not required to sign an extension agreement, but if the taxpayer declines to agree to extend the statute of limitations, the Department's audit determination will be based on the best information available to it at that time.