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U.S. Supreme Court Declines to Review Repeal of the Multistate Tax Compact

The U.S. Supreme Court has put an end to the litigation involving Michigan's repeal of the Multistate Tax Compact (Compact) when it recently denied taxpayers' requests for the Court to review the Michigan Court of Appeals' decisions upholding the validity of the retroactive repeal of the Compact. Public Act 282 of 2014 (PA 282) expressly repealed the Compact effective January 1, 2008, thereby eliminating the election to apportion income using the Compact's three-factor method in lieu of the single sales factor under state law.

In its September 20, 2015, decision in *Gillette Operations NA v Dep't of Treasury*, 312 Mich App 394 (2015), the Michigan Court of Appeals rejected the taxpayers' challenge to PA 282 as unconstitutional, holding among other things that the Legislature's retroactive repeal did not violate the Due Process Clauses of either the U.S. or Michigan constitutions and that the Compact did not contractually bind the Michigan Legislature to the Compact's provisions. The Court of Appeals ruled likewise in other cases pending before it. Taxpayers in these cases sought leave to appeal the Michigan Court of Appeals' decisions to the Michigan Supreme Court, which denied the taxpayers' applications for appeal.

On November 21, 2016, several taxpayers, in 6 separate consolidated dockets, petitioned the U.S. Supreme Court to review the Michigan Court of Appeals' decisions. The docket most commonly cited as representing these actions is *Sonoco Products Co v Michigan Dep't of Treasury*, Supreme Court Docket No. 16-687. On May 22, 2017, the Court denied the taxpayers' petitions for review. Treasury will provide further guidance on the resolution of matters involving three-factor apportionment and the Compact repeal in the coming months.

Tolling Applies to Audits that Began Before Enactment of 2014 PA 3

The March 2017 issue of Treasury Update explained the statute of limitations period for issuing final assessments and claiming refunds and how the limitations period can be extended after the enactment of Public Act 3 of 2014 (PA 3).

Since its enactment, effective February 6, 2014, practitioners have differed with Treasury on how PA 3 applies to state audits pending at the time of its passage. This difference was resolved in Treasury's favor in *Old Orchard Brands LLC v Dep't of Treasury*, decided by the Court of Claims on February 3, 2017.

In *Old Orchard*, Treasury began a use tax audit of the taxpayer

on June 14, 2011, notifying the taxpayer that the limitations period would be suspended for the duration of the audit. Almost three years later, PA 3 eliminated the tolling provision in the statute for state audits. Treasury completed its audit after the enactment of PA 3, issued an intent to assess, and after informal conference issued a final assessment.

The taxpayer agreed with Treasury that PA 3 applies prospectively, but disagreed on the meaning of prospective effect, arguing that PA 3 caused the assessment to be issued after the expiration of the statute of limitations. However, the court agreed with Treasury that to give PA 3 prospective

effect, the version of the statute in effect at the time the audit began controlled the determination of the limitations period. Since tolling was in effect under MCL 205.27a(3) at the time the audit began, tolling applied to calculate the limitations period applicable to the final assessment issued to Old Orchard. Judge Talbot denied reconsideration, and the taxpayer has appealed to the Court of Appeals.

The court's ruling echoes Treasury's conclusion in Letter Ruling 2015-2. Treasury will continue to follow LR 2015-2 unless otherwise directed by a published decision contrary to Judge Talbot's decision in *Old Orchard*.

Dental Prosthetics – Letter Ruling 1985-20 Revoked

Michigan has exempted various prosthetic devices from sales and use tax since 1955. In 1985 Treasury issued Letter Ruling 1985-20 addressing sales of a specific type of prosthetic (dental ceramics) finding that “when a dental lab manufactures a device in accordance with specifications provided by a dentist it provides a non-taxable service rather than making a [taxable] sale to the ultimate consumer.” This conclusion led Treasury to also find that, because there is no ultimate sale at retail, dental labs making such products are not eligible for the industrial processing exemption.

When LR 85-20 was issued, the sales and use tax acts exempted “any...apparatus, device, or equipment used to replace or substitute for a part of the human body....”

With the passage of 2004 PA 172 and 173, a specific definition of “prosthetic device” (with a corresponding exemption) was added to the sales and use tax acts. It defines a “prosthetic device” as “a replacement, corrective, or supportive device, other than contact lenses and dental prosthesis, dispensed pursuant to a prescription, including repair or replacement parts for that device, worn on or in the body...” Therefore, dental prosthetics are excluded from the exemption under the current definition of “prosthetic device”.

Upon further review of LR 85-20, and in light of current law, Treasury revokes LR 85-20 effective July 1, 2017. For transactions prior to this date, dental labs may continue to rely on LR 85-20 (i.e., treat sales of custom dental products as nontaxable sales and not claim the industrial processing exemption).

However, after July 1, dental lab sales of dental prostheses are subject to sales tax based on the sales price of the prosthetic. Because the transaction will now be treated as a sale at retail, dental labs may claim the industrial processing exemption for property used in manufacturing its products, if the property used to make such dental products qualifies for the industrial processing exemption under MCL 205.54t and MCL 205.94o.

New Core Charge Exemptions

Public Acts 515 and 516 of 2016 amended the General Sales Tax Act and the Use Tax Act to provide a credit or exemption for certain core charges on or after January 1, 2017.

A “core charge” is similar to a bottle deposit; a customer who purchases certain vehicle parts or batteries is charged a “core charge” that is either refunded or used as credit for the purchase of a new core when the core (the part or battery) is returned. Generally, sales or use tax is imposed on the value of all consideration used in exchange for the purchase of taxable tangible personal property. This typically includes credit for any property that is traded-in (such as the part subject to the core charge).

However, as of January 1, 2017, credit for a core charge attributable to a recycling fee, deposit, or disposal fee for a motor vehicle or recreation vehicle part or battery is not subject to sales or use tax so long as the core charge credit is separately stated on the invoice, bill of sale, or similar document that is given to the purchaser.

To read the new laws in their entirety, please refer to 2016 PA 515 and 516, MCL 205.51(1)(d) (xiii) and MCL 205.92(f)(xiii).

Recently Issued Guidance from Treasury

Revenue Administrative Bulletins

- **RAB 2017 – 8**
Individual Income Tax – Homestead Property Tax Credit for Permanent Resident of Special Housing
 - **RAB 2017-10**
Michigan Business Tax – Credit for Cash Contributions to Shelters for Homeless Persons, Food Kitchens and Food Banks
 - **RAB 2017-11**
Michigan Business Tax – Community and Education Foundation Tax Credits
 - **RAB 2017-12**
Environmental Protection Regulatory Fee
 - **RAB 2017-13**
Individual Income Tax – Reciprocal Agreements
 - **RAB 2017-14**
Income Tax – Computing and Using a Net Operating Loss for Michigan Income Tax and Household Income Purposes
-

Letter Rulings

- **Letter Ruling 2017-1**
Sales and Use Tax treatment of transfers of human tissues for research and training purposes, March 21, 2017
 - **Letter Ruling 2017-2**
Taxability of a qualified settlement fund under the Michigan Corporate Income Tax Act, April 10, 2017
-

Technical Advice Letters

- Sales/Use: Subscription Program, Issued October 11, 2016
 - Sales/Use: Components for Modular Homes, Issued December 22, 2016
 - Sales/Use: Bone Grafting Products, Issued January 9, 2017
-

Other Guidance

- Notice to Taxpayers Regarding Tax Treatment of HMOs Under the Corporate Income Tax (May 18, 2017)
- Notice to Taxpayers Regarding *Labelle Management Inc v Department of Treasury*
- Notice to Taxpayers Regarding “Materials and Supplies” under the Michigan Business Tax Act

The guidance listed above can be found on the website at Michigan.gov/Treasury under the **Reports and Legal Resources** tab.

Treasury Issues Instruction to Unitary Business Groups for *LaBelle* Compliance

In the March 2017 issue of Treasury Update, Treasury advised readers that the decision in *LaBelle Mgt, Inc v Dep't of Treasury*, 315 Mich App 23 (2016), had become final after the Michigan Supreme Court's denial of leave to appeal and that guidance would be forthcoming. Accordingly, on February 28, 2017, Treasury issued "Notice to Taxpayers Regarding *LaBelle Mgt Inc v Dep't of Treasury*," in which it announced that it would give the decision full retroactive effect.

Taxpayers are directed to correct their filings pursuant to the Notice, for all open years to conform to the decision. Penalties will not be imposed for amended unitary business group returns or original stand-alone returns that directly result from compliance with *LaBelle*. To encourage taxpayers to take swift corrective action, Treasury will waive interest for corrected returns that are filed by December 31, 2017.

The following list highlights a number of important instructions included in the Notice to streamline the corrective filing process and to ensure that the LaBelle decision is properly implemented:

- Corrected filings must attach written correspondence to the return identifying it as a "LaBelle" return.
- If a taxpayer entitled to a refund as a result of a corrected filing desires to transfer the overpayment to former members of the group that are now filing separately, the taxpayers involved in the transfer must file (mail) their respective returns together.
- Any request that Treasury transfer a payment or overpayment must attach written correspondence specifying the date the payment was made, the amount of the payment, and the manner in which the payment or overpayment is to be allocated.
- To ensure appropriate authorization to discuss and receive information, entities affected by the *LaBelle* decision should review the authorizations (e.g., Form 151) on file and, if necessary, execute and submit new forms designating authorized representatives.



Quick Briefing: Farmers' Cooperatives

Farmers' cooperatives are, generally, agricultural associations organized and operated on a cooperative basis for the purpose of marketing the products of members and purchasing supplies and equipment for those same members.

So long as the farmers' cooperative is organized and operated under IRC 521, the cooperative will be considered a tax exempt entity for federal income tax purposes and will also be exempt from the MBT and CIT under MCL 208.1207(1)(b) and MCL 206.625(1)(b).

Treasury has observed that some farmers' cooperatives are filing and paying the MBT and CIT. Those cooperatives should examine their federal tax status and consult with their tax advisors to determine if those filings are required.

Sales and Use Tax Acts: Record Retention Rules

Retailers registered in Michigan who collect and remit sales and use tax are required to keep accurate records of all sales and purchases. Such records are used to prepare and complete sales and use tax returns and will also serve as documentation in the event of an audit. This article does not provide an exhaustive list of the records that must be kept. However, it does give an overview of the requirements, and provides reference to more resources on recordkeeping requirements.

Recordkeeping Requirements

Michigan law requires that retailers maintain:

- accurate and complete beginning and annual inventory
- purchase records of additions to inventory
- complete daily sales records
- receipts
- invoices
- bills of lading
- any other pertinent documents

This means a retailer's records must be dated, kept in good order, and provide sufficient detail to independently determine the taxable status of each sale and the amount of tax due and collected. Additionally, a retailer must be able, through its records, to connect an exempt sale to the exemption certificate on file for the sale. Further, if an exemption from use tax is claimed by a person because the sale is for resale at retail, a record must be kept of the sales tax license number if the person has a sales tax license. And, if a retailer provides an exemption certificate when it makes a purchase, it must

maintain a record of the purchase and be able to prove the exempt use. MCL 205.62; MCL 205.68; MCL 205.104a; MCL 205.104b; RAB 2016-14; Mich Admin Code, R 205.4101-4113.

Record Retention Period

A retailer must keep all required records for a minimum of four years after the date set for the filing of the required return or after the date the return is filed, whichever is later. Records must be available to Treasury upon request. Treasury may require taxpayers to keep records for a longer period of time, such as when the records are the subject of an audit, court case, or other proceeding. MCL 205.27a; MCL 205.28(3).

Data from Point of Sale (POS) systems that lack the storage capacity to comply with the four year retention period must be transferred, maintained, and be available in a machine-sensible and auditable form. If a taxpayer changes POS systems, the data from the old system must be transferred, maintained, and available in a machine-sensible and auditable form. Rule 205.4105.

Maintaining Records Electronically

All the requirements for paper records also apply to records created and stored electronically. For example, the retained records should contain information including, but not limited to:

- vendor name
- invoice date
- product description
- quantity purchased

- price
- amount of tax
- indication of tax status
- shipping detail

The retailer may use codes to identify some or all of the data elements, provided that the retailer provides a method that allows Treasury to interpret the coded information.

Records that are maintained in an electronic format must be made available to Treasury in an electronically readable form. Rule 205.4105.

Separate Businesses

If a retailer is also engaged in some other kind of business, occupation, or profession that is not subject to the sales tax, the retailer must maintain separate records, otherwise all receipts will be taxable. MCL 205.52(3).

Failure to Maintain Records

If a retailer fails to file a return, or to maintain or preserve sufficient and accurate records, Treasury is authorized by statute to assess the amount of the tax due based on an indirect audit procedure or any other information that is available or that may become available to Treasury. MCL 205.68(4); MCL 205.104a (4); Rule 205.2001.

If you have any questions regarding whether you are maintaining adequate records or properly filing your returns, you should contact your tax advisor.

Statement of Acquiescence/ Non-Acquiescence Regarding Certain Court Decisions

In each issue of the quarterly Treasury Update, Treasury will publish a list of final (unappealed), non-binding, adverse decisions issued by the Court of Appeals, the Court of Claims and the Michigan Tax Tribunal, and state its acquiescence or non-acquiescence with respect to each. The current quarterly list applying Treasury's acquiescence policy appears below. "Acquiescence" means that Treasury accepts the holding of the court in that case and will follow it in similar cases with the same controlling facts. However, "acquiescence" does not necessarily indicate Treasury's approval of the reasoning used by the court in that decision. "Non-acquiescence" means that Treasury disagrees with the holding of the court and will not follow the decision in similar matters involving other taxpayers.

ACQUIESCENCE:

- *Plastic Surgery Assoc, PC v Dep't of Treasury*, No 16-000011 (Mich Tax Trib Nov 15, 2016) (result only, see Notice to Taxpayers regarding "Materials and Supplies" under the MBT)
- *Andrie Inc v Dep't of Treasury*, No 15-000135-MT (Mich Ct Cl Jan 24, 2017) (result only, see Notice to Taxpayers regarding "Materials and Supplies" under the MBT)
- *Total Foundations, LLC v Dep't of Treasury*, unpublished decision per curiam of the Court of Appeals, issued Mar 22, 2016 (Docket No. 322983)

NON-ACQUIESCENCE:

No cases this quarter

Are You Thinking Of Renting Your Summer Cottage?

In an earlier *Treasury Update* the tax implications of the "sharing economy," was discussed. As we noted in that article, the "sharing economy" includes the housing sector. This means that whether you are a host renting your summer cottage or a customer booking a cottage, you are participating in the "sharing economy." In Michigan, homeowners who rent out their homes to the public for temporary lodging must remit use tax on those accommodations. Michigan's 6% use tax applies to any stay of 30 days or less. This includes the rental of a vacation home, cabin, lodge, condominium, townhouse, room in a private residence, or any other structure. The tax applies to hotel chains, bed and breakfast establishments, and private homeowners; and applies whether the accommodations are rented directly by the host, or through a third-party provider like Airbnb or HomeAway.

A host providing accommodations is required to keep proper records in order to substantiate whether, and in what amount, the host may owe sales or use tax. As noted in our earlier article, if a person owes sales or use tax, he or she also needs to register with Treasury. The registration process is outlined in Form 518, Michigan Business Taxes Registration Booklet. In some situations, a third party provider may be authorized to collect and remit taxes on behalf of a host. Hosts may want to contact the third party providers they are working with to see what policies the providers have regarding the remittance of state and local taxes.

If after reading this article you think you may be responsible for remitting sales or use tax, please consult your tax advisor.



Use Taxes for Contractors

Generally, a contractor is liable for use tax for all property it uses or consumes in the course of performing a construction contract, so long as it did not pay sales tax on the property when purchasing it. However, there are limited exemptions available when a contractor is affixing property to real estate owned by certain entities, such as nonprofit hospitals, churches, qualified nonprofit housing, and others described in RAB 2016-18. These exemptions may be further limited to certain property or portions of the real estate being improved.

For example, property used by a contractor in building or improving a church sanctuary is exempt from sales and use tax. However a “sanctuary” only includes the portion of the building used for public worship and those portions of the building structurally necessary to the portion of the building that is used for worship. If a contractor makes real estate improvements to any area that is not a “sanctuary,” the contractor is liable for use tax for the property consumed in making those improvements.

This can cause problems for the contractor, because at the time it is performing the contract it may not know which portions of the building will be used for exempt purposes. Despite this difficulty, the contractor nonetheless bears the burden of the use tax in such situations.



When an entity such as a church or hospital signs a construction contract with a contractor, that entity should provide the contractor with a completed Michigan Sales and Use Tax Contractor Eligibility Statement (Form 3520). This form verifies to the contractor that the work to be performed is exempt. If any portion of the real estate improvements will not be exempt, the entity should inform the contractor of those specific areas so that the contractor is aware of use tax liability that may arise from performing its work. If an entity fails to do this, that entity may be subject to a private cause of action under the terms of the contract.

Treasury is also aware that entities holding direct pay permits under MCL 205.98 sometimes erroneously tell their contractors that the property affixed to real estate is not taxable to the contractor, but rather the direct pay permit holder will determine the

proper use tax treatment and report and remit the appropriate amount of use tax. However, that is incorrect because a direct pay permit only authorizes its holder to purchase tangible personal property without paying sales tax; it does not provide an exemption for real estate improvements. Absent an applicable exemption, a contractor performing work for a direct pay permit holder is liable for use tax for any property it uses or consumes in improving the real estate of the direct pay permit holder.

For more information regarding the sales and use tax treatment of the construction industry refer to RAB 2016-18, available on the Department’s website, www.michigan.gov/treasury.

Fundraising for Our Troops

The General Sales Tax Act was recently amended to add an exemption for sales of tangible personal property by certain veterans' organizations for the purpose of raising funds for the benefit of an active duty service member or a veteran.

Prior to the enactment of amendments to MCL 205.54o, the exemption from sales tax for community-based efforts to assist disabled and unemployed active duty service members or veterans was limited to certain nonprofit organizations and did not include veterans' organizations. 2016 PA 503 extended the exemption for fundraising for active duty service members or veterans to include sales of tangible personal property by those veterans' organizations that are exempt from federal income tax under IRC 501(c)(19).

EXEMPTION AMOUNT: The exemption is limited to \$25,000 in aggregate sales for each individual fundraising event. This exemption amount is higher than the exemption to which other entities are entitled under MCL 205.54o. Also, be aware that a club, association, auxiliary, or other organization affiliated with a 501(c)(19) veterans' organization entity is not considered a separate person for purposes of the aggregate exemption amount.

DEFINITIONS: The Act provides the following definitions:

- **"Active duty"** means active duty pursuant to an executive order of the president of the United States, an act of congress, or an order of the governor.
- **"Armed forces of the United States"** means the Army, Air Force, Navy, Marine Corps, Coast Guard, or other military force designated by Congress as a part of the armed forces of the United States.
- **"Service member"** means a member of the armed forces of the United States, a reserve branch of the armed forces of the United States, or the National Guard.
- **"Veteran"** means any of the following:
 - A person who served on active duty in the U.S. Armed Forces for a period of more than 180 days and separated from the Armed Forces in a manner other than a dishonorable discharge.
 - A person discharged or released from active duty because of a service-related disability.
 - A member of a reserve branch of the U.S. Armed Forces at the time he or she was ordered to active duty, who served on active duty during a period of war, or in a campaign or expedition for which a campaign badge is authorized, and was released from active duty in a manner other than a dishonorable discharge.

VETERANS' ORGANIZATIONS ELIGIBLE FOR EXEMPTION:

Veterans' organizations eligible for the sales tax exemption are those entities that have an exemption under Section 501(c)(19) of the Internal Revenue Code. IRC 501(c)(19) exempts from Federal income tax a post or organization of past or present members of the U.S. Armed Forces that meets the following criteria:

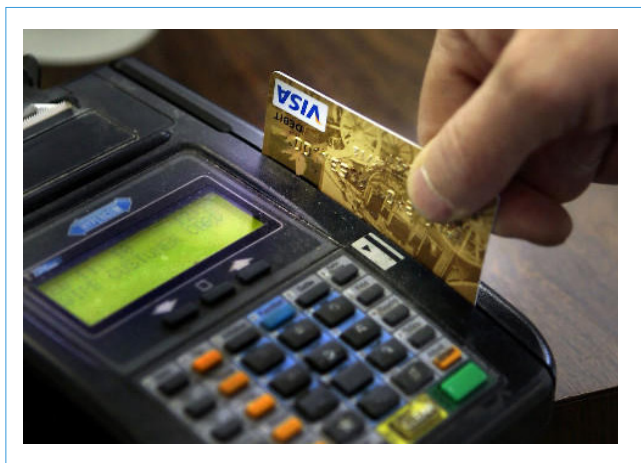
- It is organized in the United States or any of its possessions.
- At least 75% of the members are past or present members of the U.S. Armed Forces and substantially all of the other members are cadets or are spouses, widows, widowers, ancestors, or descendants of past or present members of the Armed Forces or of cadets.
- None of the net earnings of the post or organization benefits any private shareholder or individual.

Requirement to Remit Sales Tax on Sales in Excess of \$25,000. If aggregate sales for a single fundraising event held by a veterans' organization eligible for the sales tax exemption exceeds \$25,000, the organization holding the fundraiser is required to pay sales tax on the excess amount sold and must report and remit the tax to the Department.

FUTURE UPDATES: Note that RAB 1995-3 and Mich Admin Code, R 205.140, do not yet reflect the new exemption.

Don't Get Zapped!

Point of sales (POS) systems in the retail sector are important components of a comprehensive sales and accounting system, for businesses. However, they can also be used to commit fraud. Some business owners integrate “electronic sales suppression” techniques or “zappers” into their business POS systems for the purpose of facilitating tax evasion. These techniques result in millions of dollars in revenue loss for federal, state and local governments.



A “zapper” program works like this: it deletes some or all business cash transactions and then reconciles the books of the business. The result is that the business books appear to be complete and accurate, but are

in fact false because they reflect fewer sales than were actually made. Zappers are typically found in restaurants and other small retail businesses that deal in cash receipts. Zappers can be stored on a portable USB device or even reside in “the cloud” and can quickly and easily be linked to a cash register system.

In Michigan, as in many other states, it is illegal to use “zappers” or any other technique to willfully underreport sales, whether in connection with the use of a POS system or otherwise. Specifically, MCL 750.411w provides that it is a felony to knowingly sell, purchase, install, transfer or possess a sales suppression device. There is a one-year minimum mandatory jail term, and a fine of up to \$100,000 upon conviction. In addition, the offender must disgorge all profits associated with the sale or use of a zapper and is responsible for all Michigan sales, withholding and other taxes, penalties and interest.

It is also important to be aware that business owners themselves can become victims of zapper scams when managers or other employees use zappers to hide embezzlement activity. This is especially likely for absentee owners and entities with multiple locations. If you suspect you have been a victim of a sales suppression device scheme you should contact your tax advisor immediately for assistance.

About Treasury Update

Treasury Update is a periodic publication of the Tax Policy Division of the Michigan Department of Treasury.

It is distributed for general information purposes only and discusses topics of broad applicability. It is not intended to constitute legal, tax or other advice. For information or advice regarding your specific tax situation, please contact your tax professional.

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Archives of Treasury Update can be found on the website at Michigan.gov/Treasury under the Reports and Legal Resources tab.

Chief Deputy Treasurer Retirement; Transitions in Leadership

Chief Deputy Treasurer Joseph L. Fielek will be retiring after 40 years of service with the Michigan Department of Treasury.

Fielek has served as the deputy treasurer of Treasury's Financial and Administrative Services Group since his appointment in September 2013 and became chief deputy treasurer in June 2016. He oversees the Offices of Accounting Services, Collections, Departmental Services, Financial Services and Privacy and Security, as well as acts as a backup to the state treasurer during sickness or absence.

"Joe's contributions to Treasury are admired and respected," Treasurer Nick Khouri said. "I appreciate his willingness and ability to quickly shift priorities when needed. Joe has also been a great mentor and coach to countless employees throughout the years."

Fielek has held several cash and debt management positions within Treasury, the most recent being the director of the Bureau of State and Authority Finance and also the executive director of the Michigan Finance Authority. Prior to working in the cash and debt management area, he was an internal auditor for the department.

With the upcoming retirement of Fielek, Treasurer Khouri has announced the selection of Ann Good as the deputy treasurer of the Financial and Administrative Services Group.

"Ann's experience and knowledge about the department makes her ideal for this position," Khouri said. "With her leadership, management and technology skills and ability to build relationships, she will comfortably fulfill the duties required for the position."

Good has been with Treasury since 2002 and most recently served as the Director of the Office of Collections, which is responsible for the collection of delinquent taxes and other state agency debts. In that role, she oversaw more than 200 staff members with annual collection revenues exceeding \$450 million.

In addition, Good's transition has resulted in the following leadership changes within Treasury:

- Lynn Boyes, who served as the Director of the Tax Compliance Bureau, has been named the new Director of the Office of Collections.
- Kathy Debien, who served as field manager of Treasury's Grand Rapids Office, has been named Director of the Tax Compliance Bureau, which oversees compliance of state tax laws.



*Pictured above (top to bottom):
Joe Fielek, Ann Good, Lynn Boyes,
Kathy Debien*