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ON REMAND, COURT OF CLAIMS RULES TREASURY PROPERLY APPLIED STATUTORY APPORTIONMENT FORMULA

In a decision issued in May 2021 in *Vectren Infrastructure Svs Corp v Dep't of Treasury*, the Court of Claims, on remand, ruled that the gain from the sale of a business was properly excluded from the apportionment factor in determining the taxpayer's liability. The plaintiff is the successor to Minnesota Ltd, Inc. (MLI), a Minnesota based S-Corp. In March of 2011, the shareholders of MLI sold their shares to the plaintiff electing to treat the sale as an asset sale under IRC 338(h)(10). When the 2011 short year MBT return was filed, MLI reported the gain on sale in business income. MLI also reported the gain in the sales factor apportionment denominator. Treasury agreed the gain was properly included in business income but removed the gain from the apportionment formula because it failed to meet the statutory definition of sales. This increased the Michigan apportionment percentage from roughly 15% to 70%. MLI previously performed limited services in Michigan, however, in 2011 it had contracted with Enbridge to provide environmental clean up services on the Kalamazoo River, substantially increasing its Michigan revenue.

Having previously ruled for Treasury, this matter was back before the Court of Claims on remand from the Michigan Supreme Court. On the plaintiff's appeal of the original lower court ruling, the Court of Appeals remarked that it did "not necessarily disagree with [Treasury's] basic position on how to calculate the tax under the statutory formula." The panel remarked that Treasury's position regarding the statutory formula was "reasonable in light of the differing definitions of 'business activity,' 'business income,' and 'sales' and how those terms are employed in calculating the tax base and applying the sales factor to apportion the sales to Michigan." However, the panel reversed the lower court's decision because it concluded that application of the statutory formula in this case "would result in the imposition of a tax in violation of the Commerce Clause." As a result, the panel held that "allowing for an alternate formula, as plaintiff requested, is necessary to avoid the constitutional violation." The panel remanded to the Court of Claims "for the parties to determine an alternate method of apportionment."

On Treasury's application for leave to appeal, the Michigan Supreme Court vacated the decision of the Court of Appeals and remanded for the Court of Appeals "to address the plaintiff's arguments regarding the proper method for calculating the business tax due under the statutory formula." The Supreme Court's remand order stated, "[t]his foundational issue must be addressed before determining that MCL 208.1309 requires application of an alternative method of apportionment."

continued on page 2

IN THIS ISSUE

continued from page 1

Following remand from the Supreme Court, the Court of Appeals declared that the Court of Claims "never ruled on Count I of plaintiff's first amended complaint" and remanded for that court "to consider and decide the issues raised in Count I of plaintiff's first amended complaint."

On remand, the Court of Claims looked at the entity sale and considered whether it fit within the definition of "sale" under the Michigan Business Tax Act (MBTA). The court concluded the plain language of the MBTA does not support inclusion of the entity sale in the denominator of the sales factor formula. The court then addressed whether the assets sold were "inventory" under the MBTA, concluding the assets sold were not inventory but rather depreciable assets, which are the type expressly excluded from the definition of "inventory." The court also held that the evidence did not support the notion that MLI held or sold property that would be considered "inventory" under the MBTA or that the MLI sale should be included in the sales factor denominator.

The court then addressed the plaintiff's argument that the stock sale should be considered a sale of intangibles. The court rejected this argument based on the statute's definition of sales; finding the plaintiff did not identify any "rental, lease, licensing, or use" of tangible or intangible property included in the statute's definition of sales nor address that provision.

Finally, refusing to expand the scope of the remand order, which was limited to application of the statutory formula, the court rejected the plaintiff's argument on remand that the sale must be included in the sales factor denominator because it was also included in MLI's business activity.

The Court of Appeals retained jurisdiction in its Order on remand, so the court's decision may be reviewed directly by the Court of Appeals.

COURT OF APPEALS UPHOLDS USE TAX ASSESSMENTS AGAINST OPERATOR OF TUG VESSELS

On May 27, 2021, the Michigan Court of Appeals issued an unpublished decision in Andrie, Inc v Dep't of Treasury (Docket No. 351707) affirming the Court of Claims' November 8, 2019, decision (Docket No. 17-000164-MT) upholding Treasury's use tax assessments against Andrie, an operator of tug vessels. The issue framed by the Court of Appeals was whether Andrie is required to pay use tax on the fuel, supplies, and equipment ("Goods") it purchased to maintain and operate the vessels.

During the audit period, several companies contracted with Andrie to manage their vessels for a management fee. Under certain contracts, Andrie made purchases of the Goods in the name of the company and received payment from the company from which Andrie paid the vendors. For other contracts, the evidence (e.g., invoices) showed that Andrie was listed as the purchaser or was listed together with the company. The vendors billed Andrie directly and Andrie wrote the checks used to pay them. As the operator of the vessels, it was Andrie that had the discretion as to which Goods to purchase, where those Goods would be delivered, and consumption of those Goods when operating the vessels.

Treasury contended that due to Andrie's exercise of control over the Goods it purchased for its operation of the vessels under those contracts, Andrie stored, used, and/or consumed them in a manner subject to use tax. Andrie countered that it was merely an "agent" for these companies that never obtained title to the Goods such that they (and not Andrie) were each the proper "taxpayer" for use tax.

The Court of Appeals explained that the Use Tax Act imposes tax liability on "each person storing, using, or consuming" tangible personal property in Michigan and that "using" tangible personal property means the "exercise of a right or power … incident to the ownership of that property including transfer of the property in a transaction where possession is given." Relying on various precedential decisions, the Court of Appeals emphasized that "control" is merely one incident of ownership and "possession" is another. Rather than viewing Andrie as an agent, the Court of Appeals determined that Andrie was an independent contractor that "utilizes the things it purchases for the benefit of another, and charges a fee for doing so, in addition to obtaining reimbursement."

As the evidence demonstrated that Andrie obtained possession and control over the Goods it purchased, purchased the Goods in its own name, directed the nature and quantity of the Goods purchased, and used the Goods in operations of the vessels, the Court of Appeals ruled that Andrie's activities "fit neatly" into a taxable "use" of the Goods under the Use Tax Act. In addition, the Court of Appeals concluded that Andrie "consumed" the Goods according to the ordinary meaning of that term.

The taxpayer has not appealed the Court of Appeals decision.

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, contact your tax professional.

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SHARPER FOCUS: MORE FREQUENTLY ASKED QUESTIONS FROM PROFESSIONAL PHOTOGRAPHERS

The June 2020 issue of Treasury Update featured an article containing general sales tax information applicable to the photography industry entitled "Focusing In: Sales Tax Information for Photographers." The article also addressed a number of questions frequently asked by professional photographers regarding the taxability under Michigan law of specific types of sales made by photographers, as well as a few related issues. The popularity of the topic generated a second article answering additional frequently asked questions from photographers, published in the November 2020 issue of Treasury Update. After receiving even more questions following the publication of the second article, Treasury determined to compile this third and final set of photography-related questions.

Q1: Is it legally necessary for me to inform my customers that sales tax is included in the price of an item I am selling?

A1: No. There is no obligation under Michigan law that a seller specifically inform a customer that sales tax is included in the price of an item sold. However, MCL 205.73(1) does prohibit a seller from advertising that "sales tax is not considered as an element in the price to the consumer." This means that a seller cannot advertise, directly or indirectly, that taxable items are being sold tax-free, or that the seller is paying "the customer's" sales tax obligation. Michigan's sales tax is imposed on the privilege of doing business in the state; therefore, sellers are directly liable for the sales tax, not consumers (although the seller is permitted to pass the cost of the tax on to its customers). Additionally, remember that if you choose to include sales tax in the purchase price of items, your business's books and records must be kept consistent with that determination.

Q2: A previous newsletter contained a question about photo restoration services. What I understood from Treasury's answer is that all photo restoration is a service and is therefore not taxable. Is that understanding correct?

A2: No. The specific question you reference was published in the article that appeared in the November 2020 newsletter. Treasury stated there as follows:

> Coloring, tinting, retouching, restoration, and similar services, if performed by the photographer on images or photographs owned by the customer, are nontaxable. However, if such services are performed as part of a package that includes tangible personal property, or in connection with the photographer's creation of photographic images to be sold as prints or other tangible personal property, the total amount charged to the customer is taxable.

To illustrate a taxable sale, assume that a customer brings in a small, torn and water-damaged photograph of a 1925 wedding. He wants the image restored and digitally improved, then enlarged to 11x14, printed, matted, and framed so that he can ultimately give the restored image as a gift. In this case, the photographer is performing restoration services in connection with the sale of a print and related tangible personal property. The total amount charged to the customer, including the charge for restoration of the image, would be taxable in this example.

Q3: With respect to the taxability of my sitting fee or session fee, does the contract need to state that there is no obligation to purchase anything else, or is lack of a statement saying that a purchase is required sufficient?

A3: In the June 2020 photography article, Treasury answered a question about the taxability of sitting or session fees, stating that:

> If the sitting fee is not part of a package of goods, is charged as a separate transaction, and the client paying the sitting fee is not required to purchase any additional prints or other products, then the sitting fee is a charge for a service which is nontaxable.

Your question relates to the kind of documentation you might need in order to demonstrate that your clients paying only a sitting fee in fact have no obligation to purchase anything else. This issue might come up during a sales tax audit of your business. While Treasury cannot recommend specific contract language, keep in mind that the purpose of an audit is to examine the taxpayer's books and records in order to ensure that the correct amount of sales tax has been reported and remitted. If you sometimes have clients that come in for only a sitting, and those clients have no obligation to purchase prints or other items, causing the sitting fee to become a nontaxable service, consider what supporting documentation you yourself might find persuasive. In general, a clear, affirmative statement in writing to the customer will constitute the best support. For advice on specific contract wording, you may want to seek legal counsel.

Q4: I'm an event photographer, and I also provide photo booth services, using a photo booth that is owned by my business. For example, I may be engaged to take photographs at a wedding, and the contract will also include the rental of the photo booth. Typically, the booth will be set up in the reception area and guests use it in small groups to pose for impromptu, fun photos. The photos taken by guests in the booth print out as photo strips, which the guests can take home. I charge only a per-hour fee for the rental of the photo booth, which is separately itemized on the client's invoice. Is the photo booth rental income subject to Michigan sales or use tax?

A4: If you paid 6% Michigan sales tax on the purchase price of the photo booth at the time it was acquired by your business, then no further sales or use taxes are owed on the amounts charged when you rent out the booth to clients. However, in lieu of paying sales tax on the purchase price, a lessor in Michigan may opt to collect and remit 6% use tax on all future rental receipts generated by the tangible personal property being rented or leased. For more information on this topic, see Revenue Administrative Bulletin 2020-16.

Q5: I occasionally send my clients gifts of tangible personal property, like canvases or other general photography supplies. I do not charge my clients for these gifts. How should I be reporting these gifts for sales and use tax purposes?

continued on page 4

continued from page 3

A5: The answer to this question is not specific to the photography industry but can be applied to many types of transactions across myriad industries involving gifts to clients. Because there is no consideration exchanged between you and your client for the property, the transaction is not a sale at retail that is subject to sales tax. In making the gift, however, you have used that canvas or other property as part of your business operations and are therefore required to pay use tax on that property when you withdraw it from inventory to make the gift (unless you previously paid sales tax on the property at the time it was acquired). The use tax is applied to the purchase price of that property acquired.

Q6: My standard client contract requires electronic delivery of all final images through digital download or a drop box. Let's say that, after delivering all images to a client in this manner, the client later requests a thumb drive with the pictures. I provide one at no additional charge to the client. Is the entire transaction now subject to tax simply because I included the thumb drive, an item of tangible personal property?

A6: In this specific scenario, no. Under the terms of the prior client contract, the original transaction was for the delivery of digital photographs, a transaction which is not taxable under the General Sales Tax Act. You satisfied the contractual obligations with the delivery of the digital photographs; therefore, the subsequent delivery of the thumb drive to the client constitutes a separate transaction that will not impact the tax treatment of the original sale.

Q7: Okay, the prior transaction is not subject to tax, but what about the new transaction with the thumb drive? Since I did not charge my client a fee for the thumb drive in this new transaction, do I have any particular tax obligations with respect to that transaction?

A7: Yes. If you did not pay sales tax upon acquisition of the thumb drive – for example, if you originally bought the thumb drive pursuant to the resale exemption, expecting to include it as part of a sale at retail – then you would need to remit use tax on the purchase price of the thumb drive.

Q8: Your June 2020 photography article discussed the industrial processing exemption with respect to "old school" development of non-digital images. Does the application of that exemption mean that all of the various equipment used to create photos developed in that manner will automatically be exempt? For example, I use my digital camera and various lenses to create the photograph that is developed using "old school" techniques. Are those exempt under the industrial processing exemption?

A8: Not necessarily. As stated in that article, the industrial processing exemption refers to the "converting or conditioning of tangible personal property by changing the form, composition, quality, combination, or character of property for ultimate sale at retail." Only certain types of equipment used in certain industrial processing activities will be eligible. In this case, the digital camera and lenses do not actually convert or condition any tangible personal property. Therefore, that equipment would remain taxable. The equipment that is involved directly in the photographic development process, however, such as the equipment and materials used in a traditional "darkroom," would qualify for the exemption.

Q9: What about all of the various props and lighting that I use in the creation of my photographs? Are those types of equipment exempt if they are involved in the creation of a print photo?

A9: No. Even if the end product is a photographic print that is sold at retail, equipment such as props and lighting do not become a component part of the photographic print and are therefore not eligible for the industrial processing exemption.

Q10: For the equipment that I purchase that is eligible for the industrial processing exemption, does it matter if I won't always use the equipment in industrial processing, and will sometimes use it for other purposes?

A10: Yes. The industrial processing exemption is limited to the extent that the eligible equipment is used for an exempt purpose. If you will also use the equipment for a non-exempt use, you must reduce the exemption based on the estimated percentage of time that the equipment will not be used for an exempt purpose.

For More Information:

Taxpayers can register for Michigan sales tax, and obtain more information, by visiting the Sales and Use Tax page on Treasury's website. This page contains links to, among other things, New Business Registration, the text of the Sales Tax Act and related administrative rules, Form and Instructions, and Frequently Asked Questions regarding many common sales and use tax topics. Taxpayers needing additional information regarding sales and use tax should contact Treasury's Tax Technical Services division at 517-636-4357.

LOOKING BEHIND THE SMALL BUSINESS TAX AUDIT

Tax audits are part of the reality of being a business owner. Yet taxpayers, particularly owners of small and medium-sizes businesses, may find themselves unprepared for the audit process. Moreover, they may not fully understand the purpose of the audit being conducted, or the necessity for the scope of the auditor's inquiries. While auditors from the Department of Treasury are trained and expected to be courteous and professional, and strive to establish good rapport with taxpayers, a busy taxpayer under audit may not always have time or feel comfortable asking questions about the process. The purpose of this article is to provide more information about why Treasury conducts audits, and exactly what information auditors are seeking to verify.

A tax audit is an in-depth examination of a business's tax returns for a particular tax type, such as sales tax, typically covering a period of years. An audit is performed in order to verify that the taxpayer in question has properly accrued and paid all applicable taxes for the designated period. Treasury's authority to audit taxpayers is provided by law, in Section 3(a) of the Revenue Act, MCL 205.3(a). Being selected for audit does not necessarily mean that a taxpayer has done anything wrong.

continued on page 5

continued from page 4

In the modern business world, most small businesses automate their financial transactions by using computer-based accounting software such as QuickBooks. Such software typically incorporates accounting journals and a general ledger, the record keeping system used to sort, store, and summarize all of a business's financial transactions. Individual entries are made into the computerized accounting system, usually by the company's bookkeeper, a trained person who records and classifies the company's daily financial transactions such as sales, payroll, and payment of bills. The bookkeeper makes entries into the accounting system using what are known in the accounting world as "source documents." Source documents are an integral part of the bookkeeping and accounting process. A source document is the original document that contains the details of an individual business transaction. A source document typically captures all of the pertinent information regarding a transaction, such as the names of the parties involved, the amount paid, the date, and the substance of the transaction. Examples of source documents include things such as cancelled checks, credit memos, deposit slips, invoices, purchase orders, cash register tapes, and sales receipts.

Once sales, inventory purchases, and related transactions have been entered into the software system, there is a tendency for taxpayers to think of that neatly stored and organized financial data as not merely reliable, but as the business's original or primary data, and therefore essentially inviolable. Taxpayers might therefore become frustrated when an auditor indicates a need to look beyond the software system and review additional records. However, while the data residing in the computerized accounting system is obviously intended to reflect original data, it does not constitute original data. Only the source documents used to create the individual entries input into the accounting system constitute original data. Therefore, no matter how reliable a computerized accounting system might be, source documents must still be maintained by the business for all transactions, because only the source documents can provide definitive proof that certain business transactions actually took place. Only source documents serve to back up or support the information in the accounting journals and general ledger, creating what is known as an "audit trail."

Accordingly, in a tax audit, although the auditor will likely use many reports, financial statements and other data generated by the company's computerized accounting system, the auditor cannot rely exclusively on such data or reports, precisely because that data is not original. Only the original data, the source documents, can provide evidentiary proof that an input transaction actually took place. For example, the auditor may use a profit and loss statement to determine the company's inventory purchases for a particular month. The auditor will then ensure that the number reported on the profit and loss statement is backed up by invoices and vendor checks. Remember that auditors often use sampling methods rather than reviewing all of a business's records, with the results of the sample being projected over the entire audit period.

As part of the audit, the auditor will also review and evaluate the business's internal controls with respect to its accounting and reporting systems. Internal controls are the mechanisms and procedures implemented by a company to ensure the integrity of its financial and accounting information, promote accountability, and prevent fraud. Internal controls are typically comprised of activities such as authorization, documentation, reconciliation, security, and the separation of duties. Examples of internal controls might be counting cash at the start of the day, entering all sales into the cash register, requiring that a cashier get authorization from a manager before a sale can be voided, and having different employees count cash and make bank deposits. Besides ensuring compliance with laws and regulations and preventing employee theft and fraud, good internal controls improve operational efficiency and the accuracy of financial reporting by ensuring that business transactions are sufficiently documented, creating the "audit trail" mentioned previously. Any problems or inadequacies in a company's internal controls identified by the auditor should be addressed by the taxpayer to ensure that issues that may have given rise to tax discrepancies are resolved rather than repeated in the future.

For more detailed information, see the Audit Information page on Treasury's website.

ON REMAND, COURT OF APPEALS REAFFIRMS AGRICULTURE PRODUCTION EXEMPTION DOES NOT APPLY TO LAWN CARE

On April 20, 2020, the Michigan Court of Appeals issued its decision in *TruGreen Ltd Partnership v Dep't of Treasury*, holding that a lawncare company was not entitled to an agricultural production exemption from the sales and use tax statutes based on the taxpayer's claim that it was "engaged in the business enterprise of…caring for…things of the soil" under those statutes. The court found that the history of the exemption and the context within which the phrase "caring for the things of the soil" is placed indicates that the exemption is available only to those engaged in the business of producing agricultural products. The taxpayer appealed the court's decision to the Michigan Supreme Court. On May 28, 2021, the Michigan Supreme Court, in lieu of granting the taxpayer's appeal, vacated the Court of Appeals' April 20, 2020, opinion and remanded it back to the Court of Appeals to reconsider its decision in light of the Supreme Court's June 16, 2020, decision in *TOMRA of North America, Inc v Dep't of Treasury*.

On July 29, 2021, on remand, the Court of Appeals, in a 2-1 ruling, affirmed its earlier decision that the taxpayer was not entitled to the agricultural production exemption. The court noted that while the terms "plants" and "caring for things of the soil" read in isolation from the whole text of the statute might infer that the exemption applies to lawn care, doing so risks an interpretation in conflict with the whole text's logical and natural meaning. The court reiterated that the meaning of statutory language depends on context, noting that the Supreme Court in its *TOMRA* decision stressed that "context is a primary determinant of meaning." The court looked to other verbiage in the surrounding statutory text to conclude that the term "things of the soil" that was the focus of the case related to activities taking place on farms (thus associated with agricultural production) and not the caring for decorative grass associated with lawn care.

MICHIGAN TAX TRIBUNAL RULES THAT *RES JUDICATA* BARS REFUND CLAIM

In a decision entered March 10, 2021, the Michigan Tax Tribunal in *Andersons Albion Ethanol LLC v Dep't of Treasury* ruled in favor of Treasury in a case involving a refund request related to a claimed Renaissance Zone Credit under the Michigan Business Tax (MBT).

In May 2014, Treasury issued an assessment reflecting additional tax due as a result of adjustments made to Petitioner's 2010 MBT return. Petitioner appealed the assessment to the Tribunal and prevailed on summary disposition. The Michigan Court of Appeals reversed and remanded the case, finding that the Tribunal should have granted summary disposition in favor of Treasury. The Michigan Supreme Court denied leave to appeal, and in June 2017, the Tribunal entered its final order on remand.

In August 2017, Petitioner submitted an amended MBT return for the 2010 tax year, seeking to recompute the amount of the previously appealed Renaissance Zone Credit on the basis of a purported increase in the payroll factor contained in the calculation of the Renaissance Zone Credit. The claimed increase in Petitioner's Michigan payroll effectively doubled the amount of the claimed credit. Treasury denied the amended return and requested refund, and Petitioner appealed the informal conference determination upholding the denial to the Tribunal.

Treasury promptly moved for summary disposition on the grounds that Petitioner's challenge was a collateral attack on the prior assessment previously upheld by the Court of Appeals and that the Tribunal had no jurisdiction over the matter. Treasury argued that Petitioner's claims were barred by *res judicata*, a legal doctrine holding that a cause of action may not be relitigated between parties once it has been finally decided on the merits. The doctrine was applicable, Treasury maintained, because the prior case was between the same parties, had been decided on the merits, and the claims raised in the present matter could have been resolved in the earlier case. Petitioner argued in response that the amended 2010 MBT return was permissible and that *res judicata* did not apply because the recomputation of the Renaissance Zone Credit merely corrected a "factual error" – Petitioner's alleged mistaken belief that it had no payroll for purposes of the credit.

Because the purported "factual error" was not discovered until after the previous litigation, Petitioner averred, the present refund claim could not have been resolved as part of that previous case.

The Tribunal rejected Treasury's jurisdictional argument but concluded that the 2014 assessment was final and enforceable following the Court of Appeal's decision and the Supreme Court's 2017 denial of Petitioner's application for leave to appeal. The Tribunal further found that Petitioner's refund request claimed pursuant to the amended 2010 return was barred not only by the doctrine of *res judicata*, but also by the statute of limitations. With respect to *res judicata*, the Tribunal found that the prior action was decided on the merits and that both cases involved the same parties, leaving as the sole question whether the present matter was or could have been resolved in the previous litigation. To determine whether Petitioner's claims could have been resolved as part of the earlier litigation, the Tribunal applied the "transactional test," a standard providing that "the assertion of different kinds or theories of relief still constitutes a single cause of action if a single group of operative facts give rise to the assertion of relief." In what it called a pragmatic determination, the Tribunal found that Petitioner's claims were indeed part of "a single group of operative facts" related in "time, space, origin, or motivation" such that they constituted a single transaction for purposes of *res judicata*. Because both cases involved the same tax, the same tax credit, and the same tax year, the Tribunal concluded that the requisite relationship existed, and further determined that Petitioner either knew or should have known of the "alleged factual error" involving its Michigan payroll at the time of the prior action. Accordingly, the Tribunal concluded that *res judicata* applied as a bar to Petitioner's claims.

The Tribunal also determined that Petitioner's refund claim was barred by the statute of limitations, because the limitations period expired at the end of 2014 (four years after the due date of Petitioner's 2010 MBT return), and the amended return was not filed until 2017. The Tribunal therefore granted Treasury's motion for summary disposition and dismissed the case. Petitioner has not appealed the Tribunal's decision to the Court of Appeals.

RECENTLY ISSUED GUIDANCE FROM TREASURY

Revenue Administrative Bulletins

Revenue Administrative Bulletin 2021-8 Tobacco Products Tax Act: Interpretative Bulletin for Manufacturers Under 2020 PA 326 Approved: May 28, 2021

(all other 2021 RAB so far are Prepaid Sales tax, Interest rate and MBT Education Foundation Credit)

Statement of Non-Acquiescence Regarding Certain Court Decisions

Cargill Inc v Michigan Dep't of Treasury, 19-000067MT

Notices

- Estimated Tax Penalty and Interest Waiver for Individuals Who Received Unemployment Benefits in Tax Year 2020 Issued: February 9, 2021
- Treatment of Unemployment Compensation for Tax Year 2020 Issued: April 1, 2021
- Treatment of Paycheck Protection Program (PPP) Loans Under the Michigan Income Tax Act Issued: April 19, 2021
- Update: Notice on the Status of the City of Detroit Individual Income Tax Due Extended to May 17 Issued April 26, 2021
- Update to April 1, 2021 Notice Regarding the Treatment of Unemployment Compensation for Tax Year 2020 Issued: April 27, 2021
- Automatic Extension to May 17, 2021 for Individual and Composite State Income Tax Returns Originally Due on April 15, 2021. Issued: April 28, 2021
- Notice Regarding Bottle Deposit Return Program Issued June 29, 2021

COURT REJECTS INDUSTRIAL PROCESSING EXEMPTION CLAIMS FOR REVERSE VENDING MACHINES

In two related cases involving the industrial processing exemption to sales tax, and on remand from the Michigan Supreme Court's decision in *Tomra of North America, Inc v Dep't of Treasury*, 505 Mich 333 (2020), the Court of Claims recently ruled in favor of Treasury's motions for summary disposition and denied TOMRA's refund and other claims based on the industrial processing exemption.

***Tomra of North America, Inc v Dep't of Treasury*, Court of Claims Docket No. 14-000091-MT**

TOMRA sought a refund of sales taxes it collected from its customers and remitted to Treasury for reverse vending machines it sold and/or leased to them on the grounds the transactions were exempt from sales tax under section 4t of the General Sales Tax Act (GSTA), MCL 205.54t. As an overarching principle, the court noted that TOMRA carried the burden of proving entitlement to the exemption. The court's analysis began with an examination of subsection 4t(1) of the GSTA, MCL 205.54t(1), as that subsection establishes the three ways in which a taxpayer can show entitlement to the exemption.

Applying the definition of an "industrial processor" under subsection 4t(7)(b), MCL 205.54t(7)(b), the court determined that there was insufficient evidence in the record to establish that: (1) TOMRA's customers convert or condition tangible personal property for ultimate sale at retail, as the court found that all that is done by them is "to compact and/or sort the materials and wait for others to pick up the compacted and sorted materials"; (2) anyone other than TOMRA's customers used the reverse vending machines, so there was no use "by an industrial processor," and; (3) TOMRA's customers use the reverse vending machines "for or on behalf of industrial processors." Even though the court explained that this was enough to grant Treasury's motion for summary disposition, the court also examined whether TOMRA carried its burden of demonstrating that "industrial processing" occurred.

As to that issue, the court rejected TOMRA's argument that the reverse vending machines perform various "industrial processing" activities listed in subsection 54t(3), MCL 205.54t(3). The court dismissed TOMRA's arguments concerning the activities listed in (g), (i), and (j) of subsection 4t(3), MCL 205.54t(3)(g), (i), and (j) , because TOMRA did "not address these in a meaningful fashion," offered "little explanation," or merely asserted that compacting and sorting of cans and bottles by reverse vending machines amounted to "recycling." Regarding TOMRA's primary argument, that the reverse vending machines perform "inspection, quality control or testing" of raw materials under subsection 4t, MCL 205.54t, the court found that "at best, the [reverse vending machines] receive and store raw materials, which falls under the exclusion from 'industrial processing' set forth in MCL 205.54t(6)(a)." In addition, the court observed that any "inspection" the machines may undertake "only occurs to further [TOMRA's] customers' statutory obligations … under the State's Bottle Bill" and not "as required by MCL 205.54t(3)(d), to determine whether 'particular units or products or processes conform to specified parameters' in a way that relates to industrial processing."

Consistent with the Court of Appeals' November 19, 2020 decision in *Emagine Entertainment, Inc v Dep't of Treasury* (Docket Nos. 350376; 350881), the court also ruled that to allow TOMRA to receive a refund, even though it had not refunded its customers the sales tax collected from them, would amount to unjust enrichment. The court also rejected TOMRA's argument that the Uniform Unclaimed Property Act was controlling.

***Tomra of North America, Inc v Dep't of Treasury*, Court of Claims Docket No. 14-000185-MT**

This case involved the same underlying facts as Docket No. 14-000091-MT and alleged that: (1) Treasury improperly denied the industrial processing exemption; (2) Treasury unlawfully assessed sales tax on property that was exempt under the industrial processing exemption; and, (3) that the 10% negligence penalty imposed by Treasury was unwarranted.

The court dispensed with the first allegation as it incorporated its reasoning from its opinion in Docket No. 14-000091-MT. Regarding the second issue, the primary dispute was whether TOMRA accurately reported its gross sales and taxable sales during the audit period. The court ruled that Treasury had supported its request for summary disposition by demonstrating that TOMRA's accounting records "showed a greater amount of gross sales in this state than taxable sales" and there was insufficient evidence to show whether the unreported sales were exempt "which supported the notion that a deficiency existed." The court also rejected TOMRA's reliance on exemption certificates belatedly provided by TOMRA's customers because section 12 of the GSTA, MCL 205.62(5), "only permits a seller to avoid liability if that seller 'complies with the requirements of this section …'" and the court found that TOMRA failed to "maintain a proper record of all exempt transactions" or "provide the record if requested by the Department" as required by subsection 12(4), MCL 205.62(4).

Applying the reasoning of the Michigan Court of Appeals in *Jim's Body Shop, Inc v Dep't of Treasury*, 328 Mich App 187 (2019), the court upheld Treasury's imposition of the 10% negligence penalty because: (1) TOMRA's internal accounting records showed a higher gross sales total than what TOMRA reported on its tax returns; (2) TOMRA did not possess exemption certificates (at the time) for sales TOMRA claimed were exempt; and (3) TOMRA lacked adequate records required by the statute regarding its sales to customers.

Each of these matters is currently on appeal before the Michigan Court of Appeals.

COURT OF CLAIMS: CASINO DISCOUNTS ON GAMBLING DEBTS ARE NOT 'UNCOLLECTABLE GAMING RECEIVABLES'

In *MGM v Dep't of Treasury*, issued March 11, 2021, the Court of Claims held that amounts forgiven through a casino's predetermined player discount agreement and player allowance form are not "uncollectable gaming receivables" excluded from "adjusted gross receipts" for purposes of the Gaming Control and Revenue Act's (GCRA) wagering tax.

The GCRA (MCL 432.201, *et seq.*) imposes an 18% tax on a casino's "adjusted gross receipts" received from gaming (the "wagering tax"), which includes a deduction for uncollectible gaming receivables. During the 2015 and 2016 tax years, MGM offered select patrons discounts on their gambling debts as a marketing incentive. The casino offered to discount the debt from accumulated gambling losses if the patron agreed in advance, as part of extension of credit, to pay a percentage of the debt. It then claimed a deduction for those discount amounts as uncollectable gaming receivables and requested refunds of previously-remitted tax.

Treasury denied the requests based on MGM's lack of collection efforts, and MGM filed separate lawsuits challenging the denials. In those cases, both parties filed motions for summary disposition. MGM argued that the discount amounts were uncollectible gaming receivables due to MGM's contractual agreements with its patrons, and Treasury argued that because the amounts were voluntarily forgiven in advance, they did not qualify for the deduction.

The Court of Claims granted Treasury's motion and denied MGM's motion, concluding that the evidence presented by Treasury and the plain language of the GCRA demonstrated that the discount amounts were not uncollectible gaming receivables. In reaching that conclusion, the court consulted dictionary definitions of the statutorily-undefined terms "uncollectable" and "receivable." The court found that the debts were neither "uncollectible" nor "receivables." The court stated that the term "uncollectible" "connotes an inability to pay the debt owed" and found that they were not "uncollectible" because the predetermined discounts were unrelated to attempts to collect the debt. Further, the court found that the discounted debts were not "receivables," a term, the court said, referred to an account where the creditor is "[a]waiting receipt of payment," which is not the situation at issue because the casino never expected to receive payment of the discounted amounts.

MGM did not appeal the court's order.

COURT OF CLAIMS APPLICATION OF SALES/USE TAX TO MENSTRUAL PRODUCTS DOES NOT VIOLATE CONSTITUTIONAL GUARANTEE OF EQUAL PROTECTION

In *Beggs et al v State of Michigan*, issued June 9, 2021, the Court of Claims held that application of sales/use tax to menstrual products does not violate state or federal constitutional guarantees of equal protection.

The named plaintiffs, purchasers of menstrual products in the state, sought to bring a class action alleging that defendants' actions in administering and enforcing the sales/use tax on menstrual products are unconstitutional because imposition of the taxes constitutes disparate treatment of women and discrimination based on gender.

Before beginning its analysis, the court noted three things about the plaintiffs' complaint: (1) while the complaint alleges five counts, those counts all involve the same equal protection claim; (2) what the complaint characterizes as a "tampon tax" is more accurately described as a lack of an exemption for menstrual products from the two broad-based taxes on tangible personal property at issue; and (3) the legal issue presented is "wrapped" in policy arguments, which the court clarified were not its concern.

The Michigan and U.S. Constitutions' guarantee of equal protection requires that persons similarly situated be treated alike. Or, in other words, the government may not treat persons differently because of characteristics that do not justify disparate treatment. When analyzing whether legislation or other governmental action may violate a person's constitutional guarantee of equal protection, courts examine the character of the classification in question, the individual's interests affected by the classification, and the government's interests asserted in supporting the classification. Courts employ various levels of scrutiny – strict scrutiny, intermediate scrutiny or rational-basis review – dependent upon the particular class affected.

The court first addressed whether intermediate scrutiny applied. In determining that it did not, the court found that the General Sales Tax Act and Use Tax Act are facially neutral because they impose tax on "tangible personal property," a term that is defined broadly and without reference to gender. The court also found that while application of the taxes to menstrual products clearly results in a disparate impact on women, the plaintiffs failed to demonstrate a legislative intent to discriminate. Finally, the court noted its determination that intermediate scrutiny did not apply was bolstered by a recently decided Ohio Court of Appeals case (*Rowitz v McClain*) addressing a similar challenge.

As to the plaintiffs' claim that Treasury administered and enforced the laws with discriminatory intent, the court found that such claim could not, as a matter of law, support an equal protection challenge because "only the Legislature may impose tax or exempt items from taxation." As the statutes at issue do not provide an exemption for menstrual products, Treasury could not unilaterally grant one.

continued on page 9

continued from page 8

Having concluded that intermediate scrutiny did not apply, the court next found that the challenged statutes survive a rational basis review because they "help the Legislature fulfill its constitutional directive to raise revenue in order to pay for the expenses of state government." Further, the court found that "offering a limited number of exemptions, while declining to exempt all products that could conceivably be exempted for various policy reasons, is consistent with the legitimate purpose of raising state revenues."

The plaintiffs have appealed the court's decision to the Michigan Court of Appeals.

WHAT AUTHORITY DOES CHECKING THE BOX PROVIDE THE TAX PREPARER

Each income tax season Treasury is asked what authority is a taxpayer giving their tax preparer by checking the box on their individual income tax return. At the bottom of page 2 of the MI-1040 under "Taxpayer Certification" there is a statement that says "By checking this box, I authorize Treasury to discuss my return with my preparer." For some taxpayers, it seems to be a fairly, straight forward statement, yet for others, it generates questions and even strong disagreements.

Treasury's interpretation of what authority checking the box provides is grounded in section 8 of the Revenue Act, MCL 205.8, and Michigan Administrative Rule R 205.1006d. Rule 205.1006d details what information is and is not authorized by checking the box on a return.

Checking the box authorizes the tax preparer to:

- Provide Treasury with information missing from the return.
- Contact Treasury to obtain information about the status of the return, refund or payments related to the return.
- Request copies of correspondence related to matters concerning the return, such as math errors, return preparation and adjustments.
- Respond to correspondence related to matters concerning the return.

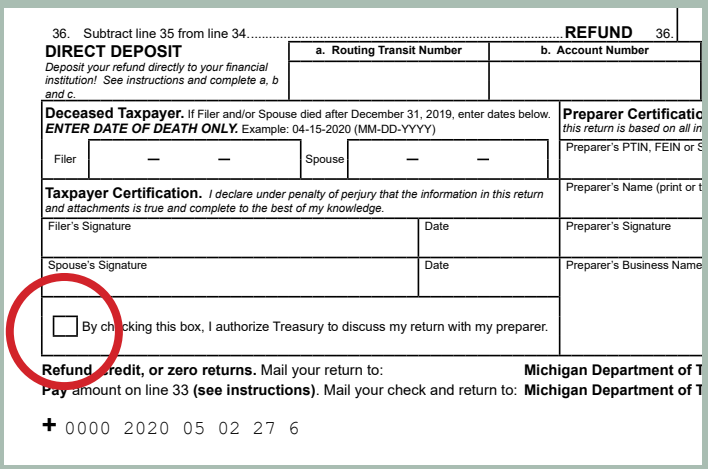
Checking the box **does not** authorize Treasury to:

- Discuss any other tax return with the tax preparer.
- Provide the tax preparer with information regarding an audit, assessment, or collection activities on the taxpayer's account.

Checking the box **does not** authorize the tax preparer to:

- Take any action on behalf of the taxpayer.
- Request an informal conference.
- Appeal any assessment or order of the determination.
- Receive the taxpayer's refund check.
- Represent the taxpayer before Treasury.

A taxpayer wishing to give their tax preparer additional authorization beyond the return as submitted must complete Michigan Department of Treasury Form 151, Authorized Representative Declaration (Power of Attorney) or other written authorization designating the tax preparer as its representative. The *Authorized Representative Declaration (Power of Attorney)* (Form 151), may be found on Treasury's website www.michigan.gov/taxes.


36. Subtract line 35 from line 34 ..... **REFUND** 36.

DIRECT DEPOSIT
Deposit your refund directly to your financial institution! See instructions and complete a, b and c.

a. Routing Transit Number | b. Account Number

Deceased Taxpayer. If Filer and/or Spouse died after December 31, 2019, enter dates below. ***ENTER DATE OF DEATH ONLY.*** Example: 04-15-2020 (MM-DD-YYYY)

Filer — — Spouse — —

Preparer Certificatio *this return is based on all in*

Preparer's PTIN, FEIN or S

Taxpayer Certification. *I declare under penalty of perjury that the information in this return and attachments is true and complete to the best of my knowledge.*

Filer's Signature | Date

Spouse's Signature | Date

Preparer's Name (print or t

Preparer's Signature

Preparer's Business Name

☐ By checking this box, I authorize Treasury to discuss my return with my preparer.

Refund, credit, or zero returns. Mail your return to: **Michigan Department of T**

Pay amount on line 33 **(see instructions)**. Mail your check and return to: **Michigan Department of T**

+ 0000 2020 05 02 27 6

Michigan Department of TREASURY

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

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