Michigan Department of
TREASURY UPDATE

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In this issue:

Treasury Issues Guidance on the Eligibility of Personal Protection Equipment for the Industrial Processing Exemption from Sales and Use Tax

Sustaining business operations during the COVID-19 pandemic has heightened purchases of personal protective equipment (PPE), disinfectants, and other safety equipment used to prevent the spread of infectious diseases. The purchase and use of such equipment may, in some cases, be exempt from sales and use tax under the industrial processing exemption provided under the General Sales Tax Act and Use Tax Act. (See MCL 25.54t; MCL 205.94o.) To clarify the scope and application of that exemption, on July 20, 2020, Treasury published Revenue Administrative Bulletin (RAB) 2020-9 *Sales and Use Tax Industrial Processing Exemption Related to Infectious Disease Personal Protective Equipment and Safety Equipment.*

As covered in greater detail within the RAB, the purchase of PPE and other safety equipment will be exempt under the industrial processing exemption if all the following statutory elements are satisfied:

1. It is purchased by the industrial processor or another person engaged in an industrial processing activity on behalf of an industrial processor, including purchases made directly by an employee of an industrial processor;

2. It is used for the safety of employees or other authorized personnel; and

3. It is used in an industrial processing activity.

Within this framework, the primary issue for many taxpayers is determining whether the PPE or safety equipment is used or consumed in an industrial processing activity. In this regard, there are two alternative ways in which this requirement can be met:

1. The property is used or consumed within "industrial processing." For this purpose, "industrial processing" is defined, in pertinent part, as "[t]he activity of converting or conditioning tangible personal property by changing the form, composition, quality,

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Recently Issued Guidance from Treasury

Revenue Administrative Bulletins

RAB 2020-9 – Sales and Use Tax Industrial Processing Exemption Related to Infectious Disease Personal Protective Equipment and Safety Equipment (July 20, 2020)

RAB 2020-11 – Sales Tax – Sales of Automobiles by Leasing Companies and Other Sellers Not Licensed by Secretary of State (August 7, 2020)

Notices

- Corporate Income Tax Treatment of the IRC 163(j) Business Interest Limitation (June 8, 2020)
- Paid Preparer Return Requirements for Returns Prepared on Behalf of Individuals, Fiduciaries and Claimants (June 24, 2020)
- Treasury Rescinds Letter Ruling 2013-2 (August 10, 2020)

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combination, or character of the property for ultimate sale at retail or for use in the manufacturing of a product to be ultimately sold at retail." (MCL 205.54t(7)(a); 205.94o(7)(a)). To satisfy this general definition, the use or consumption of the property must occur within a particular timeframe, as "industrial processing begins when tangible personal property begins movement from raw materials storage to begin industrial processing and ends when finished goods come to rest in finished goods inventory storage." Property used or consumed outside of this timeframe is not eligible for the exemption under the general definition of "industrial processing."

2. The property is used or consumed within a statutorily enumerated "industrial processing activity." The Acts specifically designate certain activities as "industrial processing activities" in which any equipment used or consumed is eligible for the exemption and without regard to the temporal limitation discussed above. These activities include, for example, research or experimental activities, remanufacturing, and production materials handling. (MCL 205.54t(3); 205.94o(3)).

Where the PPE or safety equipment is exempt under this framework, a final limitation may apply. The amount of the industrial processing exemption is limited to the extent the property is used for an exempt purpose. If the property is used for both an exempt and nonexempt purpose, such as equipment that is worn by employees working both within and outside the industrial process, then the exemption must be apportioned based on the percentage of exempt use to total use, as determined by a reasonable formula approved by Treasury.

Consider the following example — an industrial processor purchases facemasks which will be worn to prevent the spread of COVID-19 by production-line employees engaged in an "industrial processing activity" and employees working in the marketing department. While the facemasks will be exempt when worn by the production-line employees engaged in the industrial processing activity, they will not similarly be exempt when worn by the employees in the marketing department (i.e., a non-industrial-processing activity). The exemption claimed on the purchase or use of these facemasks must therefore be limited to the percentage by which the facemasks will be worn by employees working on the production line. The RAB provides supplemental examples applying the industrial processing exemption to purchases of PPE and other safety equipment, including facemasks, signage, and disinfectants.

RAB 2020-9 is accessible at: https://www.michigan.gov/taxes/0,4676,7-238-43551_84522-534455--,00.html. For additional information on sales and use taxes, please visit Treasury's website at www.michigan.gov/taxes or contact Treasury at (517) 636-4357.

Michigan Supreme Court Explains Key Aspect of Industrial Processing Exemptions Under the Sales and Use Tax Acts

In a unanimous decision issued June 16, 2020, in the matter of *Tomra of N America v Dep't of Treasury* (Docket Nos. 158333 and 158335), the Michigan Supreme Court held that the temporal limitations under MCL 205.54t(7)(a) and MCL 205.94o(7)(a) do not apply to activities listed under MCL 205.54t(3) and MCL 205.94o(3).

The general issue in the case concerned whether TOMRA's reverse vending machines – the machines located in grocery stores and other retail establishments that receive and process cans and bottles for deposit returns – and repair parts are eligible for the industrial processing exemptions under MCL 205.54t and MCL 205.94o. The specific issue before the Court was whether the temporal limitations contained in the definition of "industrial processing" under MCL 205.54t(7)(a) and MCL 205.94o(7)(a) apply to the enumerated list of "industrial processing" activities under MCL 205.54t(3) and MCL 205.94o(3). The temporal limitations state that "industrial processing begins when tangible personal property begins movement from raw materials storage to begin industrial processing and ends when finished goods first come to rest in finished goods inventory storage."

To determine whether these temporal limitations apply to the specific activities listed in these statutes as "industrial processing" activities, the Court applied various interpretive canons and principles of statutory construction. For example, the Court read the statutory provisions "as a whole" and emphasized that "context" is a "primary determinant of meaning." It also used the interpretive canon that words should not, if possible, be read out of a statute or otherwise rendered surplusage to reason that if the temporal limitations were applied to each of the enumerated activities under MCL 205.54t(3) and MCL 205.94o(3), many of those activities would be left "without meaning or function within the statute." The Court also applied the contextual canon establishing that where a statute contains a general provision and a specific one, the specific provision controls. The Court found that principle "tailor-made" for this case as it viewed MCL 205.54t(7)(a) and MCL 205.94o(7)(a) as providing a general definition and the enumerated activities listed in MCL 205.54t(3) and MCL 205.94o(3) as specific provisions defining particular standalone activities that constitute industrial processing.

Applying these principles and canons to the case, the Court held that as to any of the activities enumerated in MCL 205.54t(3) and MCL 205.94o(3), the temporal limitation under either MCL 205.54t(7)(a) or MCL 205.94o(7)(a) "does not apply" to them. Accordingly, the

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

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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. "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:
No cases this quarter

NON-ACQUIESCENCE:
No cases this quarter

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Court affirmed the decision of the Court of Appeals (for discussion of that decision, please refer to the Department's September 2018 *Treasury Update*) and remanded the case to the Court of Claims for further proceedings consistent with its decision. The Court did not address other important provisions of the industrial processing exemption statutes such as apportionment under MCL 205.54t(2) and MCL 205.94o(2) and the activities specifically excluded from industrial processing under MCL 205.54t(6) and MCL 205.94o(6). Those provisions are among those likely to be addressed by the Court of Claims on remand.

Composite Return Extensions and their Effect on the Statute of Limitations

The Michigan Income Tax Act allows a flow-through entity to file a composite return on behalf of its nonresident members. While the filing of the composite return typically satisfies the reporting obligations for any participants of that return, each participant may still separately file a standalone Michigan individual income tax return and, if applicable, claim a refund. This article explores the potential impact on determining the 4-year statute of limitations for refund claims by participants of a composite return when an extension of time has been granted to file that return.

For both composite and individual filers, the due date of the original return is generally April 15 each year. Upon the filing of an application for extension (Form 4), however, the due date for the filing of that return may be extended to October 15 of that year. The due date established for the original return, including any extension, is thereafter used to determine the 4-year statute of limitations for refund claims, as Section 27a(2) of the Revenue Act, MCL 205.27a(2), provides, in pertinent part:

> 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.

In the case of a potential refund claim by a flow-through entity, the effect of an extension under Section 27a(2) is relatively straightforward – an extension that delays the filing of the composite return from April 15 to October 15 modifies the "date set for the filing of the original return" under Section 27a(2). That is, October 15 becomes the date used for computing the statute of limitations for subsequent refund claims made by the flow-through entity. While a simple analysis and conclusion for the flow-through entity, a more complicated issue arises for the participants of that composite return filed by the flow-through entity — does the effect on the statute of limitations from an extension of that composite return similarly apply to those participants?

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The answer lies in the treatment of individuals and flow-throw entities under the Income Tax Act. Under Part 1 of the Act, flow-through entities are not regarded as "taxpayers," as the term is instead limited to persons subject to the tax imposed under that part (e.g., individuals, trusts, and estates). For this reason, the composite return is regarded as an optional filing of the flow-through entity in which nonresident members may separately elect to participate. See MCL 206.315(3). Notwithstanding participation in that return, each individual may also choose to file a standalone individual income tax return and claim a refund or credit for any tax paid on the composite return, and in certain cases may be required to do so - such as when the participant on the return has other Michigan sourced income. (See Revenue Administrative Bulletin 2004-1).

The composite return of the flow-through entity is therefore not a replacement of a return otherwise required by any "taxpayer" but, rather, a supplement to that return generally used for reasons of administrative convenience. The distinction between the flow-through entity and the individual that is preserved throughout the Income Tax Act belies an application of "the taxpayer" within Section 27a(2) of the Revenue Act, which treats the flow-through entity and the individual as one in the same.

In other words, because only the flow-through entity sought and received the extension for the composite return, only the flow-through entity's original return filing date is extended for purposes of determining the 4-year statute of limitations. The "date set for the filing of the original return" for the individual participant – "the taxpayer" under Section 27a(2) – remains the original return due date of April 15. An extension of time to file the composite return, therefore, does not automatically extend the return filing date of the individual participants. Instead, those participants must separately file an application for extension to modify the filing date used for determining the 4-year statute of limitations.

Example: A flow-through entity received an extension of time to file the 2016 composite return and did so timely on October 15, 2017. In 2021, certain individual participants learn of a potential refund opportunity. The statute of limitations is applied to those individuals as follows:

- One individual participant did not file a standalone return and instead satisfied its Michigan return filing obligation through participation in the composite return. That individual's refund claim must be made before April 16, 2021 to be timely under Section 27a(2). Because this individual did not previously file a standalone return, the refund claim should be made on an original Michigan individual income tax return.

MSU and U of M Tax Schools . . . Did You Know?

In partnership with the Michigan State University and University of Michigan Tax Schools, Treasury annually issues a Tax Text manual. Attendees of the Tax Schools receive a copy during their Fall and Winter sessions, and in late January or early February, Treasury publishes the electronic version of the manual on its website in the Tax Professionals webpage. The Tax Text is a very useful resource for taxpayers and tax practitioners, including a comprehensive primer on the individual income tax (IIT), the corporate income tax (CIT), sales, use and withholding taxes (SUW), and other taxes, fees and assessments administered by Treasury, as well as guidance on various issues of administration, such as the Taxpayer Bill of Rights and e-filing programs.

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- Another individual participant elected to file a standalone return for 2016 and received an extension until October 15, 2017 to do so. That individual's refund claim must be made before October 16, 2021 to be timely under Section 27a(2). Because this individual previously filed a standalone return, the refund claim should be made on an amended Michigan individual income tax return.

For additional information on the composite return, refer to Revenue Administrative Bulletin (RAB) 2004-1. Taxpayers with additional questions regarding the composite return may contact Treasury at (517)636-4486.

Court of Appeals Denies Refund of Use Tax on Medical Instruments Given to Michigan Customers

In *Zimmer US, Inc v Department of Treasury*, an unpublished decision of the Michigan Court of Appeals issued on July 23, 2020, the court found that medical instruments given to Michigan hospitals by an out-of-state retailer were properly subject to use tax.

Zimmer US Inc. is a medical device retailer based out of Indiana that manufactures and markets orthopedic implants. Those implants can only be installed using certain instruments also manufactured by Zimmer. Zimmer provides purchasers of its implants with this instrument at no extra charge and allows those customers to keep the instruments on an indefinite basis. While possession of the instruments is given to customers in this manner, Zimmer nonetheless retains ownership of the instruments, and its contracts require reimbursement to Zimmer for any instruments that are lost or damaged. Zimmer originally paid use tax in Michigan on the instruments provided to its Michigan customers, but later asserted it did not "use" the instruments in Michigan because it ceded control over the instruments upon delivery to a common carrier outside of the state.

For determining a taxable use under the Use Tax Act, "use" is defined, in relevant part, as "the exercise of a right or power over tangible personal property incident to the ownership of that property." (MCL 205.92(b)). "Contrary to Zimmer's position before the court, Zimmer's "use" of the instruments was established by the contractual provisions through which Zimmer not only retained ownership of instruments given to Michigan customers, but also received reimbursement for any instruments lost or damaged." Although Zimmer characterized these provisions as merely allowing for replacement instruments to be issued to its customers, the court found that rationale to be irrelevant. Rather, the court noted, the

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sole consideration regarding "use" in this case was whether Zimmer exercised some control in Michigan or totally relinquished that control outside of Michigan. Because Zimmer's contracts clearly imposed conditions on instruments given to customers in Michigan, the instruments were "used" in Michigan and therefore taxable under the Use Tax Act. On this basis, the court affirmed Treasury's denial of the refund of use tax claimed by Zimmer.

Court of Appeals Rules Quality Assurance Assessment Not Subject to Revenue Act

On July 23, 2020, the Michigan Court of Appeals issued its opinion in the matter of *Maple Manor Rehab Center, LLC, et al. v Dep't of Treasury and Dep't of Health and Human Services*, affirming the Court of Claims' grant of summary disposition in favor of Treasury. The case involved a refund request made by Maple Manor, an operator of nursing homes, to recover certain claimed overpayments of a tax known as the Medicaid Long-Term Care Quality Assurance Assessment (QAA).

The QAA, part of Michigan's Public Health Code, helps provide funding for state Medicaid programs. The Michigan Department of Health and Human Services (DHHS) administers and enforces the QAA. DHHS uses aggregated annual cost reports submitted by covered entities to set new QAA rates each year. When DHHS notifies entities of their QAA liability for the upcoming year, it imposes a 10-day deadline by which they must notify DHHS of any disagreement with the underlying numbers on which their liability is based. After the 10-day deadline, DHHS will make changes on a prospective basis only.

In 2017, Maple Manor discovered an error in its cost reporting, which caused two of its facilities to overpay the QAA for 2015, 2016 and 2017 in an aggregate claimed amount of approximately $500,000. In December of 2017, Maple Manor's counsel sent a letter to DHHS, explaining the errors in the cost reports for the years at issue, asking that the reports be corrected, and requesting refunds of the overpaid amounts.

In January 2018, DHHS notified Maple Manor that it would correct the cost-reporting errors on a prospective basis, but that it would not refund any of the overpayments, since the error had been reported outside of the 10-day notification period. Maple Manor did not appeal that decision, but instead filed a petition for refund with Treasury, aptly noting in its request that Treasury holds the QAA funds.

In October 2018, Treasury advised Maple Manor that it had no jurisdiction over the matter and therefore would "not process or take action to review Maple Manor's petition." Treasury noted that, because the QAA is not administered under the Revenue Act, the refund provisions of that act were not applicable to Maple Manor's refund request.

Maple Manor subsequently filed a complaint in the Court of Claims, asserting that Treasury had violated the Revenue Act by refusing to process its refund request. Treasury moved for summary disposition, arguing that it had no authority to issue refunds of any QAA overpayments for the relevant years. The Court of Claims granted Treasury's motion, concluding that the QAA is not subject to the refund procedures of the Revenue Act because DHHS, not Treasury, was unambiguously given authority over the administration and enforcement of the QAA.

On appeal, the Court of Appeals determined that the lower court had lacked subject matter jurisdiction over the matter because Treasury did not issue an adverse decision with respect to Maple Manor's refund request. It further found that the QAA is not subject to the refund procedures of the Revenue Act, meaning that Treasury's refusal to process the refund request was similarly not a "decision" appealable under the Revenue Act.

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Although agreeing that the QAA was a "tax," the court nevertheless deemed Maple Manor's reading of Section 20 of the Revenue Act "too simplistic." Section 20 states that, unless otherwise provided by specific statutory authority, all taxes are subject to certain key provisions of the Revenue Act. The court emphasized that the two statutes must be read together "as a harmonious whole," rather than "selectively" and "in a vacuum" as Maple Manor had done.

The court found that any conflict between the two statutes was merely superficial. Applying the Revenue Act to the QAA – because Section 20 makes the Act applicable to "all taxes" – would render the administration of the QAA inconsistent with the mandate that the QAA be administered and enforced by DHHS, as well as with federal law. Rather, explained the court, the statutory schemes must be read together in order to give force and effect to each, and in a way that avoids conflict. This approach compels the conclusion that the QAA is not subject to certain key provisions of the Revenue Act.

The court further reasoned that, had the legislature intended for the Revenue Act to apply to the QAA, it could have specifically stated so, as it has typically done in other tax statutes administered by Treasury. Moreover, the fact that Treasury was expressly given a very limited role as custodian of QAA funds further supports the conclusion that the legislature did not intend to grant Treasury the "expansive powers" it possesses under the Revenue Act with respect to the QAA.

The court concluded that Treasury had no authority to issue a decision with respect to Maple Manor's petition for refund. Because Treasury did not make an adverse decision with respect to the refund request, the Court of Claims lacked subject matter jurisdiction to review Maple Manor's appeal. The Court of Appeals therefore affirmed the lower court's summary disposition of the case in favor of Treasury.

Income Tax Act Amended to Clarify and Expand Election of Surviving Spouse Deduction for Retirement Benefits

The Michigan Income Tax Act was recently amended by 2020 PA 65 to:

1. Clarify that an un-remarried surviving spouse (survivor) may claim the retirement benefits deduction of the deceased spouse (decedent) if it is greater than the survivor's retirement deduction. This change codifies the Department's current practice.

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2. Allow an un-remarried surviving spouse to elect the higher of the survivor's standard deduction of $20,000 against all income or the decedent's retirement benefit deduction. Prior to the new act, the Department required the survivor to take the standard deduction at age 67.

General overview of the retirement benefit deduction. In 2020, only Tier 1 taxpayers (born before 1946) may deduct retirement benefits. Tier 2 taxpayers (born in 1946-1952) may claim a standard deduction of $20,000 single/$40,000 joint against all income instead of a retirement benefits deduction. Tier 3 taxpayers (born 1953 or later) do not deduct retirement benefits except for those receiving certain benefits from employment exempt from the Social Security Act. Tier 3 taxpayers who are 67 (in 2020, only those Tier 3 born in 1953 turn 67) may claim a standard deduction of $20,000 single/$40,000 joint against all income, but it is reduced by personal exemptions and by social security included in AGI.

The retirement deduction for a joint return is based on the date of birth of the oldest spouse. The Department has allowed a survivor to claim a retirement benefits deduction based on the birth date of an older decedent. on the survivor's single return. That is, the survivor could claim the Tier level retirement deduction of the decedent. But, at age 67, for survivors born after 1945, the survivors must switch to the standard deduction.

Effect of 2020 PA 65. The new law codifies the Department's policy of allowing the survivor to take a retirement benefit deduction based on date of birth of the older of the two spouses. But the new law goes beyond the Department's policy by permitting a survivor to elect to keep the retirement benefits deduction based on the date of birth of a decedent if that election produces a higher deduction than the survivor's standard deduction once the survivor reached age 67.