STATE OF MICHIGAN
DEPARTMENT OF LICENSING & REGULATORY AFFAIRS
MICHIGAN ADMINISTRATIVE HEARING SYSTEM
MICHIGAN TAX TRIBUNAL

James and Randi Koester,
Petitioner,

v

MTT Docket No. 16-003317

Michigan Department of Treasury,
Respondent.

Tribunal Judge Presiding
Steven H. Lasher

ORDER GRANTING RESPONDENT'S MOTION FOR SUMMARY DISPOSITION

ORDER DENYING RESPONDENT'S MOTION FOR COSTS

FINAL OPINION AND JUDGMENT

The Tribunal issued a Proposed Opinion and Judgment ("POJ") on September 6, 2017. The POJ states, in pertinent part, "[t]he parties have 20 days from date of entry of this POJ to notify the Tribunal **in writing, by mail or by electronic filing, if available,** if they do not agree with the POJ and to state in writing why they do not agree with the POJ (i.e., exceptions)."

On September 26, 2017, Petitioners filed exceptions to the POJ. In the exceptions, Petitioners state they have been denied the right to be heard in this case. Petitioners make several contentions regarding the applicability of the unitary taxation and a recent court determination regarding unitary business group issues. Petitioners also contend in their assertions that there are genuine issues of material fact remaining and that they were not able to establish the same because the Tribunal did not allow a hearing and time for Petitioners to present testimony and five banker boxes of source documents.

On October 4, 2017, Respondent filed a response to the exceptions. In the response, Respondent states that Petitioners misstate basic civil procedure in contending they were denied the right to be heard. Respondent also contends that Petitioners are presenting unpled theories which are not properly pending and are in violation of notice pleading.

The Tribunal has considered the exceptions, response, and the case file and finds that Petitioners contend they have been "denied their right to be heard" because they were not "able to provide legal arguments in support of the credits claimed." However, the Tribunal finds that Petitioners were provided both notice and an opportunity to present their legal arguments. More specifically, Petitioners filed this appeal on July 13, 2016. The Tribunal conducted a Status Conference on November 15, 2016, after which it entered the Original Scheduling Order which stated that discovery was to close January 17, 2017. An additional status conference was held on December 15, 2016, after which the Tribunal extended discovery by two weeks and further indicated that dispositive motions on the matter and prehearing statements were due on January

31, 2017, the same day as the closing of discovery. As such, the Tribunal finds that Petitioners had ample notice and time to conduct discovery and prepare its case. Respondent's Motion for Summary Disposition was filed on January 31, 2017, and Petitioners filed their response and Brief in Support on February 16, 2017. The Tribunal again finds that Petitioners had sufficient notice of Respondent's Motion and ample time to file their response and Brief, which set forth their legal arguments. In addition to the opportunity to file the response and brief, Petitioners were also provided with the opportunity to present oral arguments on the legal issues on May 16, 2017. Given this, the Tribunal finds that Petitioners were provided with several months to conduct discovery and prepare their case. Petitioners provided a written response to the Motion for Summary Disposition, a Brief in Response to the Motion for Summary Disposition, as well as, presented oral arguments on the issues. The record does not reflect that Petitioners were deprived of an opportunity to present their legal arguments in support of their claims.

Unitary Business Group and Small Business Alternate Credit

Petitioner sets forth several arguments regarding the applicability and tax consequences of the *LaBelle Management Inc v Dep't of Treasury*[1] case. On this point, the Tribunal finds many of the issues presented here were previously addressed in *Total Armored Car Service Inc v Dep't of Treasury*, MTT Docket No. 16-003017.

The first problem the Tribunal finds with Petitioner's contentions under *LaBelle*, is that this issue was never properly pled in the Petition nor did Petitioner, at any time, file a motion to amend to include its claims under *LaBelle*. Thus, this applicability of *LaBelle* and whether those in the unitary group as filed should have filed standalone returns is truly not properly pending before the Tribunal as it was never properly pled. Like *Total Armored Car*, Petitioner has not presented any information to support that it, or any of the other parties in the unitary group, have actually filed amended, standalone returns. The Tribunal held, in that case, that:

> without the amended returns, Petitioner has failed to exhaust its administrative remedies with Respondent as filing amended returns would be. Moreover, the Tribunal finds absent this filing the facts at hand are distinguishable from the facts in *LaBelle Management, Inc v Dept of Treasury*, wherein the Court had the original separate returns to evaluate. Moreover, the tax consequences of separate filings and unitary filings was clear in *LaBelle*. In this case, Petitioner failed to properly present sufficient facts and information to demonstrate a genuine issue of material fact remained.[2]

This analysis directly applies here as Petitioners have failed to exhaust their administrative remedies and the Tribunal is unable to evaluate Petitioners' actual contentions of the tax consequences at issue. The Tribunal also finds that this case, like *Total Armored Car*, is

---

[1] *LaBelle Management Inc v Dep't of Treasury*, 315 Mich App 23; 888 NW2d 260 (2016).
[2] *Total Armored Car Service Inc v Dep't of Treasury*, MTT Docket No. 16-003017, September 18, 2017 Order Denying Reconsideration at 2.

distinguishable from *LaBelle* in that there is no evidence of standalone returns or what the actual tax consequences would be for Petitioners or other members (i.e., nonparties to this case). Overall, Petitioners failed to present sufficient documentary evidence to establish that the Tribunal should address Petitioners' contentions under the unitary theory or *LaBelle*.

Genuine Issue of Material Fact

Petitioners also make numerous contentions regarding not being allowed to offer testimony and additional evidence in support of their contentions as justification to show good cause to modify the POJ. However, the Tribunal finds that Petitioners' representative misunderstands the standard of granting summary disposition under MCR 2.116(C)(10). More specifically, the Michigan Supreme Court has held that when faced with a Motion for Summary Disposition under MCR 2.116(C)(10), after the movant has met its burden, the nonmovant may not rely on mere allegations or denials to establish that a genuine issue of material fact remains, and if the nonmovant fails to present documentary evidence to establish the material dispute, the court can properly grant summary disposition.[3] The Supreme Court continued in stating:

> This Court reaffirmed *Quinto* and the proper application of MCR 2.116(C)(10) in *Maiden,* 461 Mich at 121, 597 NW2d 817, stating that "[a] litigant's mere pledge to establish an issue of fact at trial cannot survive summary disposition under MCR 2.116(C)(10). The court rule plainly requires the adverse party to set forth specific facts at the time of the motion showing a genuine issue for trial."[4]

Here, the Tribunal finds that Respondent, movant, presented various documentation including deposition transcripts and tax returns to support its Motion demonstrating that no genuine issue of fact remains. Petitioners had ample opportunity in this case to obtain affidavits from the individuals they contend would have presented testimony at hearing on this matter and present all the documentary evidence (i.e., five banker boxes) with their response. Petitioners' failure to present the affidavits and/or documentary evidence it contends would support them at trial is not an error by the Administrative Law Judge in granting summary. Rather, Petitioners have failed to submit any affidavits or the again, alleged five bankers boxes, with their response to the Motion for Summary Disposition and their "mere pledge to establish an issue of fact at trial" was not sufficient. In the Motion for Reconsideration, Petitioners' counsel cites to its Response and Brief in Support to contend that " 'clearly and without doubt establish that there are genuine issues of material fact . . .' " remaining.[5] However, the Tribunal finds these statements are mere allegations and are insufficient to set forth specific facts to survive the summary disposition. Petitioners have, therefore, generally failed to meet their burden to establish a genuine issue of material fact remains.

---

[3] *Lowrey v LMPS & LMPJ, Inc*, 500 Mich 1, 7; 890 NW2d 344 (2016) (quoting *Quinto v Cross & Peters Co,* 451 Mich 358; 547 NW2d 314 (1996)).
[4] *Id.* at 7-8.
[5] Petitioners' Motion for Reconsideration at 8.

The Tribunal further finds that with regard to the Small Business Alternative Credit ("SBAC"), the Tribunal properly held that Petitioners' position was not supported. In this regard, the Tribunal finds that Petitioners have devoted a substantial amount of their exceptions regarding this issue. Petitioners rely, primarily, on statutory construction and the premise that Respondent's Frequently Asked Questions are not binding on the Tribunal. The Michigan Supreme Court has held "agency interpretations are entitled to respectful consideration, but they are not binding on courts and cannot conflict with the plain meaning of the statute."[6] Here, Petitioners have not provided sufficient support to demonstrate that Respondent's position is contrary to the statutory language and the Tribunal does not find cogent reasons to overturn or disregard Respondent's interpretation on this issue.[7] Moreover, Petitioners acknowledge the statutorily based disqualifier, yet fail to explain how the disqualifier does not apply merely because the taxes were filed on a unitary basis. Overall, the Tribunal finds Petitioners have not demonstrated any error on this issue.

Petitioners have also specifically addressed individual issues such as inventory, interest, and payroll allocations. The Tribunal finds that the Administrative Law Judge properly considered the evidence submitted in the rendering of the POJ. More specifically, Petitioners are primarily relying upon the fact that testimony could have been set forth, at a hearing, to further explain the actual documents and allocations. Petitioners, in part, rely upon a "narrative" labeled as Exhibit D to their response; however, this is not a sworn statement and is a mere allegation. Overall, it does not provide sufficient support for Petitioners' contention that genuine issues of material fact remain. The documentation was properly reviewed by the ALJ and he properly found that the majority of the documents were not source documents and that they, in total, are insufficient to demonstrate that the ALJ erred.

The Tribunal also finds that the ALJ properly denied Respondent's Motion for Costs.

Given the above, Petitioner has failed to show good cause to justify the modifying of the POJ or the granting of a rehearing.[8] As such, the Tribunal adopts the POJ as the Tribunal's final decision in this case.[9] The Tribunal also incorporates by reference the Findings of Fact and Conclusions of Law contained in the POJ in this Final Opinion and Judgment. As a result:

a. The taxes, interest, and penalties, as levied by Respondent, are as follows:

**Assessment Number**: UI64360

| Taxes | Interest | Penalties |
|---|---|---|
| $72,255.00 | $15,359.83[10] | $0.00 |

[6] *In re Rovas Complaint*, 482 Mich 90, 117-118; 754 NW2d 259 (2008).
7 *See id.* See also *Andersons Albion Ethanol, LLC v Dep't of Treasury*, 317 Mich App 208; 893 NW2d 642 (2016).
[8] See MCL 205.762.
[9] See MCL 205.726.
[10] Interest continues to accrue per 1941 PA 122. Interest shown above is current as of the date of the assessment.

**Assessment Number**: UJ42338

| Taxes | Interest | Penalties |
|---|---|---|
| $55,601.00 | $9,258.41[11] | $0.00 |

b. The final taxes, interest, and penalties are as follows:

**Assessment Number**: UI64360

| Taxes | Interest | Penalties |
|---|---|---|
| $72,255.00 | $15,359.83[12] | $0.00 |

**Assessment Number**: UJ42338

| Taxes | Interest | Penalties |
|---|---|---|
| $55,601.00 | $9,258.41[13] | $0.00 |

IT IS SO ORDERED.

IT IS FURTHER ORDERED that Respondent shall cause its records to be corrected to reflect the taxes, interest, and penalties, as finally shown in this Final Opinion and Judgment within 20 days of entry of this Final Opinion and Judgment.

IT IS FURTHER ORDERED that Respondent shall collect the affected taxes, interest, and penalties or issue a refund as required by this Order within 28 days of entry of this Final Opinion and Judgment.

This Final Opinion and Judgment resolves the last pending claim and closes this case.

APPEAL RIGHTS

If you disagree with the final decision in this case, you may file a motion for reconsideration with the Tribunal or a claim of appeal with the Michigan Court of Appeals.

A Motion for reconsideration must be filed with the required filing fee within 21 days from the date of entry of the final decision.[14] Because the final decision closes the case, the motion cannot be filed through the Tribunal's web-based e-filing system; it must be filed by mail or personal service. The fee for the filing of such motions is $50.00 in the Entire Tribunal and $25.00 in the Small Claims Division, unless the Small Claims decision relates to the valuation of property and the property had a principal residence exemption of at least 50% at the time the petition was filed or the decision relates to the grant or denial of a poverty exemption and, if so,

[11] Interest continues to accrue per 1941 PA 122. Interest shown above is current as of the date of the assessment.
[12] Interest continues to accrue per 1941 PA 122. Interest shown above is current as of the date of the assessment.
[13] Interest continues to accrue per 1941 PA 122. Interest shown above is current as of the date of the assessment.
[14] See TTR 261 and 257.

there is no filing fee.[15] A copy of the motion must be served on the opposing party by mail or personal service or by email if the opposing party agrees to electronic service, and proof demonstrating that service must be submitted with the motion.[16] Responses to motions for reconsideration are prohibited and there are no oral arguments unless otherwise ordered by the Tribunal.[17]

A claim of appeal must be filed with the appropriate filing fee. If the claim is filed within 21 days of the entry of the final decision, it is an "appeal by right." If the claim is filed more than 21 days after the entry of the final decision, it is an "appeal by leave."[18] A copy of the claim must be filed with the Tribunal with the filing fee required for certification of the record on appeal.[19] The fee for certification is $100.00 in both the Entire Tribunal and the Small Claims Division, unless no Small Claims fee is required.[20]

By Steven H. Lasher

Entered: October 25, 2017
krb

[15] See TTR 217 and 267.
[16] See TTR 261 and 225.
[17] See TTR 261 and 257.
[18] See MCL 205.753 and MCR 7.204.
[19] See TTR 213.
[20] See TTR 217 and 267.

STATE OF MICHIGAN
DEPARTMENT OF LICENSING AND REGULATORY AFFAIRS
MICHIGAN ADMINISTRATIVE HEARING SYSTEM
MICHIGAN TAX TRIBUNAL

James A. Koester & Randi M. Koester,
Petitioners,

v

MTT Docket No. 16-003317

Michigan Department of Treasury,
Respondent.

Administrative Law Judge Presiding
Peter M. Kopke

PROPOSED ORDER GRANTING
RESPONDENT'S MOTION FOR SUMMARY DISPOSITION

PROPOSED OPINION AND JUDGMENT

PROPOSED ORDER DENYING RESPONDENT'S REQUEST FOR COSTS

On January 31, 2017, Respondent filed a Motion in the above-captioned case requesting that the Tribunal grant summary judgment in its favor "pursuant to MCR 2.116(C)(10)" and enter an Order dismissing the case and granting "it such other relief, including attorney's fees and costs, as the Tribunal deems appropriate." In support of its Motion, Respondent contends that:

1. "In this tax appeal, Petitioners seek to amend their Michigan Business Tax (MBT) returns in order to reallocate certain business expenses from one member entity of their unitary business group to another.[1] For the tax years at issue, Treasury denied or reduced Petitioners' Small Business Alternative Credit (SBAC) claimed in their originally filed returns based on one member's share of business income, which was attributable to its 100% shareholder and exceeded the SBAC business income disqualifier threshold. Petitioner restructured their expenses between the two members – i.e., allocated more expenses to one member to reduce its shareholder's business income beneath the SBAC income threshold – but did not later modify either entity's financial statements to reflect the returns."

2. "Boiled down to its essence, this case involves tax evasion. It is undisputed that Petitioners provided no documentation to support the proposed expense reallocations (instead only self-serving anecdotal testimony).[2] Petitioners also did not correct their

[1] Respondent also stated:

> "Treasury denied the amended returns because they were incomplete, i.e., Petitioners did not provide Form 4580, which would support an amended return by providing information for each UBG member. ([Am Returns, Ex 14; Ex 12] . . . 7/3/15 Notice, Ex 15.)"

[2] Although Respondent indicates that "Petitioners provided no documentation," Respondent also states:

financial statements. Additionally, Petitioners' rationale and methodology have no basis in fact. Finally, Petitioners misinterpret federal law concerning authority to make expense reallocations."

3. "Petitioners filed the Petition on behalf of a unitary business group (UBG), comprised of two separate entities, Gibraltar Trade Center, Inc. (GTC) and Gibraltar Trade Center North (North). GTC is the parent company, and 100% shareholder, of North. (Koester Dep Tr, Ex 1 at 6.) GTC is owned 50% by Petitioner James Koester, and 50% by Robert Koester, who is also the President of North. (Ex 1, at 7; 2010-11 MBT Returns, Ex 2.)"

4. "During the tax years at issue, **GTC and North were distinct entities**, with separate locations, corporate filings, and federal employee identification numbers. (Articles of Incorporation, Ex 3; Ex 1, at 9, 14.) GTC was located in Taylor, Michigan; North was located in Mount Clemens, Michigan. (Ex 1, at 8, 12.) The business at both locates involves space rental to individual vendors, retail sales, admissions, food sales, storage services, and space leasing for various shows. (*Id.* at 9-10.) For retail sales, GTC obtains inventory from surplus closeouts (in bulk), and then sells such items for retail to the public. (*Id.* at 11-12.)" [Emphasis added.]

5. "GTC has a wholesale division, which is responsible for purchasing and distribution of inventory to the retail floors for both GTC and North. (*Id.* at 12: Fleming Dep Tr, Ex 4, at 26.) The wholesale division purchases items from third-party vendors, which invoices GTC. (Ex 4, at 10; Invoice, Ex 5.) **These items were then transferred to North for retail sale.** (Ex 4, at 11; Transfer Sheet, Ex 6.) North does not pay GTC for its services in purchasing and distributing inventory to North. (Danville Dep Tr, Ex 7, at 17.)" [Emphasis added.]

6. "GTC also has revenues from wholesale sales. (EX 1, at 17-18.) Wholesale goods sold are overstock items that were initially placed for retail sale, but did not sell. (*Id.*) North, therefore, sends such items back to GTC for wholesale sale to third parties. (*Id.* at 12-13.)"

7. "Here, Petitioners fail to show they are entitled to a 100% SBAC credit under their original returns because one shareholder member exceeded the business income threshold.[3] Furthermore, Petitioners provide no factual support, for the expense reallocations, and misinterpret federal law concerning authority to make such reallocations."[4]

---

"Following an informal conference on December 15, 2015, Treasury upheld the assessments on the basis that Petitioners had not provided source documents in support of the purported reallocations, but instead merely self-prepared summaries, and did not support its 50/50 reallocations between GTC and North. (Ex 12.)"

[3] See MCL 208.1417(4) and 208.1417(1)(a) and (b).

[4] Respondent cites *Andrie Inc v Dep't of Treasury*, 496 Mich 161, 165; 853 NW2d 310 (2014) in support of the proposition that Petitioners have "[t]he burden of proving entitlement to the exemption," as Petitioners "are asserting the right to the exemption."

8. "Petitioners did not correct the financial statements for GTC and North to match their MBT returns and thus reflect the reallocations. (*Id.* at 42.) Petitioner's CPA, Dennis Danville admitted that a business's financial statements and tax returns should reflect its business activity. (*Id.* at 45-46.) He explained that the tax implications do not change because GTC and North file on a combined basis. (Id.) But he also admitted that businesses that file on a combined basis must account for the business activity of each member entity within the UBG. (Id. at 46.)"

9. "Petitioners' failure to ensure accurate financial statements in light of the reallocations further shows their intent to evade taxation, and not to file returns in accordance with their true business activity."

10. "The United States Tax Court has applied [26 USCS] § 482 and its regulation counterpart according to its plain terms: '[s]ection 482 may not be used by taxpayers as a sword; rather, it may be invoked only by the Commissioner . . . . Moreover, Petitioners overlook the fact that section 482 is operative to prevent the avoidance of taxes as well as to clearly reflect the income of commonly owned or commonly controlled taxpayers.' *Foster v Comm'r*, 80 TC 34, 191-92 (1983)."[5]

11. "Here, it is anticipated that Petitioners will rely on IRS Regulation 1.482-1 to support the expense reallocations in this case. (Ex 4, at 28.) However, Petitioners misunderstand this regulation and its applicability, and attempt to use Reg. 1.482 in a way that is expressly forbidden – i.e., as a sword in avoidance of taxes. Petitioners are not free to utilize IRS Reg. 1.482 at their own will by making whatever reallocations they see as advantageous to their tax liability. 26 CFR 1.482-1A(3). Furthermore, without the reallocations, Petitioners' tax liability (and its SBAC disqualification) are clear. Petitioners attempt to use the reallocations in order to reduce GTC's share of business income, and, thereby, take advantage of the SBAC to reduce their tax liability. Such actions are taken in order to avoid taxes, and thus contravene the IRS Code and regulations. *Foster*, 80 TC at 191-92."[6]

---

[5] 26 USCS § 482 provides, in pertinent part:

> In any case of two or more organizations, trades, or businesses (whether or not incorporated, whether or not organized in the United States, and whether or not affiliated) owned or controlled directly or indirectly by the same interests, the Secretary may distribute, apportion, or allocate gross income, deductions, credits, or allowances between or among such organizations, trades, or businesses, if he determines that such distribution, apportionment, or allocation is necessary in order to prevent evasion of taxes or clearly to reflect the income of any of such organizations, trades, or businesses.

[6] 26 CFR 1.482-1A provides, in pertinent part:

> (1) The purpose of section is to place a controlled taxpayer on a tax parity with an uncontrolled taxpayer, by determining, according to the standard of an uncontrolled taxpayer, the true taxable income from the property and business of a controlled taxpayer . . . .

12. "Here, Petitioners admit that GTC obtained the line of credit from Fifth Third Bank in order to purchase inventory. (Loan Agreement, Ex 19; Ex 1, at 26; Ex 4, at 24.) **GTC is the only signatory to the loan**, and North has no obligation to repay the loan. (Id.; Ex 1, at 71.) Additionally, Petitioners admit that GTC has title to the items purchased through the line of credit loan (i.e., GTC's inventory for retail and wholesale sales). (Ex 1, at 30-31.) Therefore, the loan obligation is not enforceable as to North, for which reason North has no 'indebtedness' for the loan."[7] [Emphasis added.]

13. "Similarly, GTC and North are both parties to a forbearance agreement relating to the line of credit. (Forbearance Agreement, Ex 20.) GTC is listed as the borrower, while North is listed as a guarantor. (Id.) However, **federal law is clear that a guarantor of a loan is not entitled to an interest deduction** . . . . Accordingly, whether as a non-party to the loan, or a guarantor to the forbearance agreement, it is clear that North cannot take interest expenses relating to the loan."[8] [Emphasis added.]

14. "Respondent anticipates that Petitioners will argue that because the UBG is the 'taxpayer' for MBT purposes, the interest expenses belong to the group and may be allocated amongst its members. However, **this argument would ignore that the UBG is not a signatory to the loan and is not responsible for repaying the loan obligation** – only GTC is. Furthermore, a UBG has no income and no expenses. Instead, each member entity's expenses and income are that entity's alone, 26 CFR 1.1502-11-12, for which reason any expense/income analysis must be performed on a member-entity by member-entity basis. See, e.g., *D'Agostini v Dep't of Treasury*, Order Granting Resp's Motion for Summ Disp, issued September 28, 2016 (Ex 21.)" [Emphasis added.]

15. "Here, **it is also undisputed that each entity pays the salaries/wages of its own employees**. (Ex 1 at 21.) Petitioners also do not dispute that Tom Fleming, Chris Koester, and Maria Pagnucco are GTC employees, (Id., at 21-22; Ex 4, at 9, 14), or that GTC pays salaries/wages, and issues W2s for Fleming, Chris Koester, and Pagnucco. (EX 4, at 17-20.)[9] Petitioners' controller, Mr. Fleming, testified that Petitioners have no documentation to support reallocations of his salary – i.e., **no documentation to demonstrate services performed at each location** (e.g., time cards), but instead '[i]t's

---

(3) Section 482 grants no rights to a controlled taxpayer to apply its provisions at will, nor does in grant any right to compel the district director to apply such provisions.

[7] Respondent cites *Crouch v United States*, 509 F Supp 727, 733 (DC Kan, 1981), *cert den* 305 US 625; *Scripps v Commissioner*, 96 F2d 492 (CA6, 1938); *Nunan v Green*, 146 F2d 352 (CA8, 1945); *Golder v Commissioner*, 604 F2d 34, 35 (CA8, 1979); 2010 IRS Publication 535, Ex 18, at 12; *Commissioner v Park*, 113 F2d 352, (CA3, 1940); *Johnson v Commissioner*, 108 F2d 104 (CA8, 1939); *Autenreith v Commissioner*, 115 F2d 856 (CA3, 1940); and *Steinbach Kresge Co v Sturgess*, 33 F Supp 897 (DC NJ, 1940).

[8] Respondent cites *Crouch, supra* at p 733.

[9] Respondent also stated, as follows:

> "Petitioners also purport to reallocate wages for Penny Halsey from North to GTC. (Pet at Ex P-15.5.) However, Ms. Halsey was a North employee, and Petitioners have no documentation to support the reallocation. (Ex 4, at 21, 23.)"

just my knowledge of the amount of work and time that I had and that I was performing at the time.' (Ex 4, at 17-18.) Mr. Danville testified that the salaries/wage expense reallocations are based on the '**facts and circumstances**,' e.g., the fact that Mr. Fleming lives close to the North location. (Danville, Ex 7, at 33.) Similarly, Petitioners have no documentation to support salaries/wage reallocations for Chris Koester and Maria Pagnucco. (*Id.* at 18-20.) And when GTC employees perform services for North, North does not pay GTC for such services. (Ex 1, at 24.)" [Emphasis added.]

16. "In short: Petitioners have no documentation (e.g., time sheets) to show whether and to what extent the GTC employees performed services for North – instead they rely on after-the-fact, self-serving, anecdotal testimony (e.g., Mr. Fleming lived close to the North location). On that basis alone, Petitioners' salaries/wage expense claims must be rejected . . . . Yet, even assuming that the employees performed any services for North, it is undisputed that North did not pay for the employees' services. Therefore, North did not pay or incur salaries/wage expenses for the services provided by those employees, for which reason any such related expenses were not North's to take."[10]

17. "Here, Petitioners seek to reallocate certain direct and indirect expenses relating to GTC's wholesale operations. (Ex 17, at ¶¶ 23, 34.) GTC had title to the inventory that it purchased for retail sales by GTC and North. (Ex 1, at 30-31.) GTC records the costs for purchase and transportation of inventory. (Ex 4, at 29.) Also, it is undisputed that all direct and indirect expenses listed in the Petition, (Ex 17, P-11.5), are charged to GTC's wholesale department. (Ex 4, at 32.) And Petitioners have no documents to support the reallocation of direct/indirect wholesale costs. (*Id.* at 38-39.)"

18. "Petitioners' controller admitted that North does not pay cash to GTC for inventory it transfers to North. (Ex 4, at 27.) **Instead, the entities maintain intercompany receivable accounts, and 'cash is transferred between the facilities or companies as needed to cover payment of vendor invoices or others, bank payments**.' (Ex 4, at 60.) However, neither the cash transfers nor the recorded debts between GTC and North relate to any particular/ identified inventory transferred to North. (*Id.* at 69-70.)" [Emphasis added.]

19. "Therefore, Petitioners cannot demonstrate that any transactions took place between GTC and North (i.e., invoice-payment, debits/credits relating to specific inventory); *a fortiori* Petitioners cannot show that any such transactions took place at an arm's length . . . . Accordingly, Petitioners cannot meet their burden to support the wholesale reallocations."[11]

20. "Petitioners claim that the reallocations in this matter were necessary because of the entity-by-entity SBAC analysis that is performed under the MBTA, which Petitioners claim is different from how they prepared their SBT returns. Furthermore, Petitioners

---

[10] Respondent cites *Alacan v Comm'r*, 89 TCM (CCH) 950 (2005); *Doudney v Comm'r*, 90 TCM (CCH) 509 (2005); 26 USC 162(a); 26 CFR 31.3401(c)-(1)(a); and *Neonatology Assocs, PA*, 115 TC at [p] 88."

[11] Respondent cites *Cal- Farm Ins Co*, 647 F Supp at p 1087.

assert that the 50/50 reallocation percentage is based on retail sales only, and should not account for wholesale sales. However, neither of these assertions is credible or based in fact . . . . Specifically, their 2005-2007 Single Business Tax . . . (SBT) returns show that, instead of using consolidated expense deductions, **they allocated expenses to each entity**. (GTC 2005-07 SBT Returns, Ex 22; North 2005-07 SBT Returns, Ex 23.)" [Emphasis added.]

21. "Petitioners claim that the expense allocations should be determined by examining costs of retail goods only, and should not consider all the expenses associated with wholesale sales. Petitioners explained that their methodology is necessary to avoid having all costs in one entity, and all revenue in another entity . . . . Petitioners' method purports to split the expenses 50/50 between GTC and North. (Ex4, at 64.) This methodology is based on costs associated with retail sales only, and does not consider wholesale sales. (Id., at 55-56; Methodology Attach to Pet's Disc Resps., Ex 24.) **This is despite the fact that all items sold at wholesale were at one time distributed and placed for retail sale, and that all wholesale related costs were charged to GTC**. (Ex 1, at 19; Ex 4, at 57; Ex 7, at 16.) . . . But Petitioners' explanation has no basis in fact or law – Petitioners acknowledge that all items sold at wholesale were at one time for retail sale, and that all costs were charged to GTC. Additionally, **Petitioners admit that GTC had title to all inventory/merchandise**, which makes sense because all the costs associated with those items are charged to GTC. Furthermore, Petitioners cannot point to any transactions between GTC and North – i.e., invoicing, payment, etc. – that would afford North the opportunity to take any of the reallocated expenses relating to the inventory/merchandise. Indeed, had North purchased and paid for any of the inventory, it would have had expenses relating thereto. But there were no purchases between GTC and North – instead, by their controller's admission, **Petitioners casually shifted money between entities as necessary to pay bills**." [Emphasis added.]

22. ". . . if wholesale sales are considered, the reallocation percentage is significantly lower (about 36% to North instead of 50%) **because all of the wholesale sales are attributable to GTC**, not North." [Emphasis added.]

23. "Petitioners' reallocation methodology serves to highlight that the true rationale behind the reallocations was not to reflect an arm's length transaction or otherwise, but instead to bring GTC's business income below the SBAC threshold and thus qualify for the SBAC. Thus, Petitioners are seeking to evade taxes through use of reallocations, in contravention of 26 CFR 1.482-1A(3)."

On February 16, 2017, Petitioners filed a response to the Motion. In the Response, Petitioners contend that there are genuine issues of material fact and that:

1. Respondent's Brief "included 42 separately identifiable statements that are blatantly false, misleading, irrelevant or misplaced conjecture. **The Brief reveals a basic failure to understand basic accounting concepts contained in Generally Accepted Accounting Principles (GAAP) including the proper and effective use of the accrual method of accounting, double entry accounting and the matching concept**. (Exhibit

A) Respondent has **grossly misinterpreted** relevant provisions of the Internal Revenue Code (IRC) (Exhibit B) and fails to recognize Petitioner's right in law to correct errors and mistakes in tax returns by filing an amended federal income tax return and an amended Michigan Business Tax return to report income and expenses for federal income tax purposes and the Michigan Business Tax." [Emphasis added.]

2. "Respondent alleges 'tax evasion' . . . but fails to document the essential elements of 'tax evasion.'[12] Petitioner provided documentation in the form of schedules and made available contemporaneous source documents."

3. "Petitioner did not restructure their expenses. Petitioner allocated certain common costs included in the expenses of GTC to North **in accordance with** GAAP (Exhibit A-2) and the Internal Revenue Code (IRC) (Exhibit B-1) to achieve a matching (Exhibit A-2) of income and expenses between the two entities." [Emphasis added.]

4. "Financial statements are not prepared to reflect tax returns. Financial statements and tax returns are independently prepared documents. Federal income tax returns are prepared in accordance with the provisions of the . . . IRC . . . . Financial statements are prepared in accordance with the provisions of . . . GAAP . . . . Federal income tax returns reconcile the difference between income reported for federal income tax purposes and income reported for financial statement purposes. (Federal Income Tax Schedule M). Petitioner reports on the consolidated basis for financial statement purposes. **Petitioner does not report on a single entity basis**. (Exhibit G: Dennis Danville Deposition). Therefore, any and all intercompany transactions between the entities, including all allocations of costs, would be eliminated thereby having [no] financial statement effect." [Emphasis added.]

5. "Tax evasion is a serious charge and should be made only and if the preponderance of the evidence supports the conclusion that Petitioner willfully intended to purposefully avoid the payment of tax legally determined to be due. In this case, it has not been determined that tax is due. Petitioner asserts that it is not due."

6. "Petitioner provided documentation in the form of schedules which accompanied both the amended federal income tax returns (Exhibit D-10) and the amended Michigan Business Tax return. In addition, Petitioner provided Respondent with the opportunity to review the contemporaneous source documents which corroborate and support the allocations made including the transfer of inventory documents. (Exhibit C)"

7. "Petitioner prepared a document titled 'Methodology for the Reallocation of Expenses' (Exhibit D, Pages 1- 4) which provides in a narrative description and in great detail the methodology used **which was based on the facts and circumstance of Petitioner's business** and **allocated on a fair and equitable basis as if the separate entities were standalone filers for both federal income tax and Michigan Business Tax purposes**.

---

[12] Petitioners cite the Tax Crimes Handbook from the U.S. Internal Revenue Services' Criminal Tax Division Office of Chief Counsel dated 2009 and indicates that "[t]here are three elements for Tax Evasion[:] (a) An attempt to defeat a tax or the payment of a tax; (b) An additional tax due and owning; and (c) Willfulness."

The narrative description was supported and corroborated by accounting schedules and workpapers. (Exhibit D-1 through D-11.)" [Emphasis added.]

8. "The . . . [IRC] in Section 482 (Exhibit B-1) and in the Income Tax Regulations at 1.482 (Exhibit B-2) provide authority for Petitioner to allocate expenses. Guidance is provided by the Internal Revenue Service to both taxpayers and their examining officers. (Exhibit B-3)"

9. "Petitioner maintains its books and records on the accrual basis utilizing the double entry method where every transaction affects two different accounts. The term 'pay' does not have a definable meaning. A business entity, in this case North, accrues a liability when it benefits from the services provided by GTC for its services in purchasing and distributing inventory. The costs for such services can be paid in a variety of ways, but ultimately is 'paid for.' Cash or money is a fungible commodity. (Exhibit A-2: Matching Concept in Accounting Explained)"

10. "The term 'denied the amended return' is not an accurate explanation of what transpired. The . . . . MBTA . . . (MCL 208.1507) requires the taxpayer to amend their Michigan Business Tax return when the federal income tax return is amended. The federal income tax returns were amended pursuant to the Internal Revenue Service instructions on a form provided by the IRS. (Exhibit D-10 for FYE 9/2011 and D-11 for FTE 9/2010). Petitioner provided the information which would normally be included on a Form 4580 in the form of schedules and resubmitted actual forms upon Treasury's request. The amended returns and the resubmitted forms were accepted by Treasury."

11. "Petitioner did provide at the Informal Conference schedules and contemporaneous source documents which did support the allocation of costs between GTC and North. After the filing of a Petition in the Tax Tribunal, as part of discovery, Petitioner provided to Respondent access to all requested source documents which supported the allocations made."

12. "While the original MBT return reflected one shareholder member exceeding the business income threshold, such a calculation of business income was made before the allocation of expenses between GTC and North."

13. "Petitioner was not required by either GAAP or the IRC to correct financial statements because they were accurate as originally prepared and the allocation of costs, which were ultimately eliminated, did not affect the financial statements. Petitioner's financial statements reported on a combined basis are accurate both before the reallocations as well as after the reallocations. (Exhibit G: Dennis Danville Deposition)"

14. "Respondent's citing of IRC Section 482 . . . inaccurately implies that Petitioner applied its allocations at will when in fact the allocations were based on the facts and circumstance of Petitioner's business applied on a fair and equitable basis. (Exhibit C: Methodology for the Reallocation of Expenses)"

15. "IRC Section 482 (Exhibit A-1) does have a dual purpose. In this case[,] it is necessary to employ Section 482 to reflect the income of commonly owned and controlled taxpayers. This is exactly what Petitioner did as authorized by Section 482. Without the allocations, North's books and records would not reflect the costs incurred in order to generate the income it recorded in direct conflict with the matching concept of GAAP."

16. "Respondent's citing of IRC Section 482 . . . inaccurately implies that Petitioner applied its allocations at will when in fact the allocations were based on the facts and circumstance of the Petitioner's business applied on a fair and equitable basis in order to clearly reflect income. (IRC 482) (Exhibit D)"

17. "The allocations of costs were necessary to clearly reflect income pursuant to Section 482 (Exhibit B-1) and to achieve a matching of sales to the costs which produced the sales in accordance with GAAP. (Exhibit A-2)"

18. "Petitioner was required by the MBTA to amend its Michigan Business Tax return because of the amendment to the federal income tax return which has an effect on the Michigan Business Tax liability. (MCL 208.1507)"

19. "Respondent references 'courts" but did not cite 'courts.' Petitioner suspects the reference is misplaced but applies to the deduction of interest for individual income taxes. It should be noted that GTC paid the interest for which it was liable and from which it was able to acquire and maintain inventory for sale, a portion of which was provided to North for sale. After the allocation of costs, which included interest, North was not the payer of interest. GTC paid the interest and merely allocated a portion of its costs to North. Interest, or any other expense, can be allocated among [members] of a controlled group to clearly reflect income. The question of deduction is not an issue here, it is the proper allocation between a controlled group to clearly reflect income."

20. "Respondent's statement is . . . suggest[s] that GTC is barred from allocating costs to North, which is not true. GTC is not allocating interest, it is allocating costs to acquire and maintain inventory. (Exhibit B-3; IRS Examining Officers Guide – Allocation of Income and Deductions)"

21. "When GTC allocated its cost to acquire and maintain inventory, it is not making North the payor of interest. Petitioner did an allocation of costs, not a transfer of deduction. (Exhibit D-1 through D-9)"

22. ". . . the cite to *D'Agostini v Dep't of Treasury* is misplaced . . . [as] it involved a brother-sister group of entities. The *D'Agostini v Dep't of Treasury* case is currently under appeal at the Court of Appeals."

23. "GTC has the legal right in GAAP and the IRC to allocate costs to North. GTC did not allocate salaries and wages to North, it allocated certain costs incurred to provide certain services to North. The actual calculation of costs were determined from documented records based on a reasonable and fair formula. (Exhibit D-3 for 2010 and D-7 for 2011)"

24. "Respondent's statement is confusing in that it references the statutory authority for GTC to deduct salaries and wages with North's authority to deduct the allocated costs. The allocation of costs from GTC to North to achieve a matching of expenses to the sales produced from those expenses constitutes an ordinary and reasonable expense of North to generate its sales; fully deductible for federal income tax purposes. (Exhibit B-3: IRS Examining Officers Guide – Allocation of Income and Deductions)"

25. "All of the costs allocated by GTC to North were substantiated in the books and records of GTC. The methodology of the allocation was also documented in the form of schedules and worksheets supported by contemporaneous source documents and memorialized in narrative form. (Exhibit D)"

26. "While the allocation of costs relating to the salaries and wages of four salaried individuals was not documented with time cards, the salaried individuals do not punch a time card, they were documented on a reasonable and fair basis based on the facts and circumstances . . . . Respondent rejected the allocation in whole which is arbitrary and unfair as it is an uncontroverted fact that GTC does provide substantial services for North to enable North to operate and generate a profit. (D-3 for 2010 and D-7 for 2011)"

27. "There is no dispute that GTC paid the salaries and wages for the four individuals performing services that benefited North. The issue is the reasonable and fair allocation of those costs which benefited both GTC and North. (Exhibit D-3 for 2010 and D-7 for 2011)"

28. "Without the allocation of common costs, North would not be placed in the same position as uncontrolled taxpayers dealing at arm's length. This is precisely why Section 482 was needed to justify the allocation of costs incurred by one entity but benefitting another entity. The matching of sales to the cost to produce those sales can only be achieved with the reasonable and fair allocation of costs. (Exhibit A-2)"

29. "Neither GAAP nor the IRC requires a cash payment of the inventory. A taxpayer on the accrual basis of accounting accrues a liability when it acquires, not pays for, the inventory. Cash is a fungible commodity which does not bear specific identification. (Exhibit A-2)"

30. "It should be noted that every transfer of inventory is recorded in the books and records of the two companies and documented in the form of a contemporaneous transfer document. (Exhibit C)"

31. "GTC documents in its books and records the purchase and acquisition of inventory. (Exhibit C-1 and C-2) Every transfer of inventory, to North or from North, is recorded in the recorded in the books and records of the two companies and documented in the form of a contemporaneous transfer document. (Exhibit C-3 through C-7)"

32. "Respondent's [statement] is false and untrue in that the rational for the allocation of common cost is deep-rooted in the matching concept requiring a matching of the expenses to the sales generated from those expenses. (Exhibit A-2)"

33. "Respondent's accusation of a tax motivated purpose to the allocation of costs is misplaced. Petitioner made an error (2010) in not allocating certain common costs from GTC to North in accordance with GAAP and the IRC because of the misinformed belief that the allocation was not necessary because for financial purposes, federal income tax purposes and Michigan Business Tax purposes; all reported and filed on the combined, consolidated and unitary basis, that such allocation of costs would be eliminated and have no effect on the tax. It was not until Respondent notified Petitioner that it did have an effect on the MBT Small Business Alternative Credit that Petitioner corrected its mistake and filed amended returns for both federal income tax and the Michigan Business Tax."

34. ". . . the wholesale division benefits both GTC and North. Therefore its costs should be allocated based on the retail sales that the inventory provided by and returned to wholesale produced."

35. ". . . the books and records of GTC clearly identify all costs associated with its sales as well as with North's sales from which a reasonable and fair allocation was made. (Exhibit C)"

36. "Neither GAAP nor the IRC require an accrual basis business to actually pay cash for inventory before a deduction can be taken . . . . in fact, for an accrual basis business, purchases are paid for in the normal business cycle. (Exhibit A-2)"

37. ". . . given the extent of documentation provided in the original Petition and during discovery [Petitioner has provided factual support for the proposed expenses reallocations]. Federal law, specifically IRC Section 482, specifically requires the allocation of common costs to fairly reflect income (Exhibit B) and GAAP requires the allocation of common costs to achieve a reasonable and fair matching of income and expenses. (Exhibit A-2) The actual allocations of the common costs were documented in the form of schedules and documents provided to Respondent which accompanied both the amended federal income tax returns as well as the amended Michigan Business Tax returns. (Exhibit D-10 for 2011 and D-11 for 2010) in addition, Respondent was provided access to contemporaneous source documents which supported the common cost ultimately allocated to the entities."

38. The above "clearly and without doubt establish that there are genuine issues of material fact which impact the final resolution of this case."

39. "Petitioner denies that it had engaged in 'tax evasion' and will make its arguments at a Hearing scheduled on this matter . . . ."

40. "Respondent, in its Motion and also in its Brief has requested attorney's fees and costs. Such relief can only be granted with a finding the Petitioner acted in a frivolous manner.

> Petitioner denies that it acted in a frivolous manner and will make its arguments at a Hearing scheduled in this matter . . . ."

The Tribunal has reviewed the Motion, the Response, and the case file and finds that oral argument on the Motion was conducted on May 16, 2017. Although there were subsequent discussions (i.e., telephonic status conferences) regarding the conducting of a limited evidentiary hearing, the conducting of said hearing was determined to be unnecessary.[13] As for the Motion, there is no specific Tribunal rule governing motions for summary disposition and, as such, the Tribunal is bound to follow the Michigan Rules of Court in rendering a decision on such motions.[14] In the instant case, Respondent indicates that its Motion is being filed under MCR 2.116(C)(10), which tests the factual support for Petitioners' claim based upon the Tribunal's consideration of all pleadings, affidavits, depositions, admissions, and any other documentary evidence submitted by the parties "in the light most favorable to the party opposing the motion."[15] Further, the Tribunal may only grant such motions if the parties' submissions show that there is no genuine issue of material fact and that the moving party is entitled to judgment as a matter of law.[16] If it is, however, determined that an asserted claim can be supported by evidence at trial, the motion under (C)(10) must be denied.[17] Additionally, the moving party bears the initial burden of supporting its position by presenting its documentary evidence for the court to consider. The burden then shifts to the opposing party to establish that a genuine issue of disputed fact exists.[18] Where the burden of proof at trial on a dispositive issue rests on a non-moving party, the non-moving party may not rely on mere allegations or denials in pleadings but must go beyond the pleadings to set forth specific facts showing that a genuine issue of material fact exists.[19] If the opposing party fails to present documentary evidence establishing the existence of a material factual dispute, the motion is properly granted.[20]

---

[13] As indicated above, two telephonic status conferences were conducted after the oral argument to discuss the possible scheduling of a limited evidentiary hearing to clarify certain statements made by Petitioners' agent during the oral argument that were improperly characterized by the Tribunal. See Oral Argument Transcript ("OTR") 20. In that regard, Petitioners' agent indicated, during the first of the two telephonic conferences, that the statements at issue were the result of him being "badgered" and "rushed." A review of the transcript does not, however, support that contention. Rather, the statements were misleading or non-responsive and, as such, unfortunately, required repeated unsuccessful questioning. Nevertheless, said statements were, in fact, clarified by Petitioners' agent during the first telephonic conference when he admitted that the statements reflected Petitioners' intent and not Petitioners actual activities and said admission is supported by the deposition testimony. In that regard, a further review of the submitted depositions in a light most favorable to Petitioners also clarified or supplemented the agent's statements and demonstrated that no hearing was necessary, particularly with respect to the "independent professional judgment" utilized in the preparation of the written methodology offered by Petitioners in support of their proposed allocation. See TR. 62. See also the deposition testimony of Thomas Fleming ("FTR") and Dennis Danville ("DTR"), as discussed herein. As a result, the second telephonic conference was conducted to inform the parties that the holding of the proposed limited hearing was unnecessary based on the oral argument and the deposition testimony provided.

[14] See TTR 215.

[15] See *Maiden v Rozwood*, 461 Mich 109, 120; 597 NW2d 187 (1999) and *Quinto v Cross and Peters Co*, 451 Mich 358, 362; 547 NW2d 314 (1996).

[16] See *Smith v Globe Life Insurance Co*, 460 Mich 446, 454-5; 597 NW2d 28 (1999) and *Quinto*, *supra* at 362.

[17] See *Arbelius v Poletti*, 188 Mich App 14, 18; 469 NW2d 436 (1991).

[18] See *Neubacher v Globe Furniture Rentals, Inc*, 205 Mich App 418, 420; 522 NW2d 335 (1994).

[19] See *McCart v J Walter Thompson USA, Inc*, 437 Mich 109, 115; 469 NW2d 284 (1991).

[20] See *McCormic v Auto Club Ins Ass'n*, 202 Mich App 233, 237; 507 NW2d 741 (1993).

Here, the Tribunal has considered the parties' pleadings and documentary evidence in a light most favorable to Petitioners and finds that there is no genuine issue of material fact and that the granting of the Motion in favor of Respondent under MCL 2.116(C)(10) is warranted. More specifically, Petitioners claim that an "error" was made in the allocation of certain common expenses between GTC and North and that without the allocation North would not be placed in the same position as an uncontrolled taxpayer dealing at arm's length with another taxpayer. Said claim is erroneous. Although Petitioners attempt to support the proposed allocations by reliance on "basic accounting principles," the standard to be applied by the IRS in determining the true taxable income of GTC and North relative to their amended U.S. return and, ultimately, their amended Michigan return "is that of a taxpayer dealing at arm's length with an uncontrolled taxpayer."[21] GTC and North were, however, operated as a single-family business and said operation renders the dealings between the two controlled, albeit "separate" and "distinct," entities as non-arm's length in nature.[22] In that regard, North is a "wholly owned subsidiary" of GTC;[23] both entities had the same president for the tax years at issue;[24] the entities made "joint" decisions;[25] the entities shared common employees paid by one entity and "expensed" by the other;[26] the entities had a single GTC wholesale division or person that (i) bought, warehoused, and distributed the purchased wholesale merchandise "for both retail locations" or, more appropriately, both entities, (ii) distributed the purchased wholesale merchandise to both entities

---

[21] See 26 CFR §1.482-1(b)(1).

[22] See Transcript of Robert Koester's Deposition ("KTR") 16-7 (i.e., "they're **separate** organizations, but **it was still a family business**). [Emphasis added.] See also KTR 9 (i.e., distinct entities) and FTR 6 (separate entities that "report as one entity"). [Emphasis added.] Although GTC and North may have been organized as separate entities, GTC is the "parent company" of North. See FTR 8.

[23] See FTR 6. The Taylor location no longer exists. Nevertheless, GTC still exists and is housed at the Mt. Clemens location. See FTR 8.

[24] See KTR 5 (i.e., president and "52 percent owner of Gibraltar Trade Center as a whole"), 6 (i.e., "52 percent ownership of the corporate"), 7 (i.e., as president of North, he ran the "operation . . . and manage[d] everybody"), and 8 (i.e., he was also the president of GTC "[f]rom probably 2010 and on" and prior to becoming president, he was the vice president with 25 percent ownership). As for the president's salary, the Mt. Clemens property was owned by Robson LLC and he is a member of that LLC. See KTR 5 and 19. He did not, however, have any ownership interest in the GTC property. See KTR 8. Rather, that property was owned by his father, Petitioner James Koester. See KTR 19. Although GTC and North paid and expensed rent for use of the property, they did not pay market rent (i.e., "[n]ot that I'm aware of"). Instead, they paid "enough" to cover bank payments, taxes, and for the president to make a living, as the president "took no salary out of Gibraltar Trade Center itself." See KTR 20-1. In that regard, said non-market rent payments raise questions with respect to the appropriate expensing of those payments.

[25] See KTR 17 (i.e., "**everything we did was, in fact, jointly** - - as far as decisions were made and the likes and advertising, promotion, you name it, **it was all done as a whole** . . . . **[w]e always treat Gibraltar as a whole** . . . . we did it for purpose of separation, you know, the real estate up here and everything else as far as starting Gibraltar Trade Center North, Inc . . . . [b]ut it was always - - you know, **we always viewed it as family**"). [Emphasis added.]

[26] See KTR 21-4 (i.e., Tom Fleming, Chris Koester, and Maria Pagnucco were GTC employees, Penny Halsey was a North employee; Ms. Halsey was the "only one" doing accounting work on the payroll for the North Mt. Clemens location; and no consideration was paid by North to GTC if a GTC employee performed work for North). See FTR 7-9 (i.e., controller "for all entities" (GTC and North); and "paid on the payroll of [GTC]," 14-5 (i.e., GTC employee and paid by GTC; and North "pays" for his services to North '[t]hrough an allocation of . . . expenses" and not cash), 16-8 and 62-3 (i.e., the allocation of expense was reasonable and supported; and no documentation to support allocation of expense "just my knowledge of the amount of work and time I had and that I was performing at the time"), 18-23 and 62-3 (i.e., Chris Koester and Maria Pagnucco were GTC employees and paid by GTC with no documentation to support their allocated expense to North; and Penny Halsey was a North employee with no documentation to support her allocated expense to GTC).

at "landed cost" with no markup relative to merchandise distributed to North to reflect GTC distribution costs (i.e., warehousing and transportation from GTC to North, etc.) or GTC profit,[27] and (iii) GTC sold purchased wholesale merchandise returned by both entities due to the failure of that merchandise to sell at retail;[28] both entities maintained intercompany accounts for the transfer of monies from one entity to the other on an as-needed basis to pay vendors or make bank payments (i.e., "not tied" to payments relating to services rendered or inventory transferred, which are handled through an allocation of cost or expense only); and the loan was "collateralized by the inventories and assets at both locations."[29]

As for the claimed tax evasion, the parties admit that Petitioners or, more appropriately, the controlled entities, GTC and North, had the right to file amended returns, which at the Federal level had no tax consequences and, as a result, no "sword" impact.[30] Rather, the "sword" impact

---

[27] Further, North does not pay for the transferred merchandise. Rather, accounting entities are made to reflect the transfer of the merchandise, which are purportedly reconciled through the exchange of money from one intercompany account to the other even though the exchanges are not related to the transfers.

[28] See KTR 11-5 (i.e., "primarily where we get our merchandise"; "our buyers, our warehouse"; "[t]hey distributed the goods to the retail floors in Taylor as well as in Mt. Clemens"; and the "goods" were housed in Taylor), 17-9 (i.e., "**transfers** from Mt. Clemens **back** also to Taylor **if** things didn't sell"; and sold by wholesale division "sometimes at cost, sometimes at a loss, **sometimes at a minimal amount of profit per se** . . . it is the outlet that we used to get rid of our excess product"). [Emphasis added.] See FTR 10-2 (i.e., GTC purchases retail inventory), 27-9 (i.e., "[l]anded cost is the cost of the item plus the transportation cost of getting the item from the vendor to wholesale"), 28 (i.e., when North sells an item at retail, North "recognizes" the revenue even though the transfer of the item from GTC to North was a "no cash transaction"), 29 (i.e., "Gibraltar Trade Center - - **all** assets secured the loan . . . . [a]ll assets, including inventory, equipment . . . . [**a**]**nd** North"), and 31 (i.e., wholesale department is part of GTC and not North). [Emphasis added.] Finally, see Petitioner's Exhibit D (i.e., "transferred at cost to both Taylor and MC retail public markets").

[29] See KTR 15 (i.e., he "assumes" North purchases the merchandise through intercompany transfers, but doesn't know how they "handled it"). See FTR 13-4 (i.e., when retail inventory is transferred to North, "a monthly journal entry . . . is made that says that X amount of cost was transferred from Taylor, establishing an intercompany debt between . . . [North], who got the goods, and . . . [GTC] who transferred the goods to them"; and "no" consideration or cash is paid by North to GTC for the items or goods transferred), 59-60 (payments for inventory are "set up as a receivable or a debt on the intercompany books, and then - - well, each of our - - throughout the month, cash is transferred between the buildings - - or between the facilities or companies **as needed to cover payment of vendor invoices or others, bank payments**"; and the intercompany accounts represent "a liability and a receivable set up . . . . **[w]hen each company does services for the other**, like in this case if Taylor sells inventory to Mt. Clemens, a receivable to Taylor is set up with a liability on Mt. Clemens' books **for that same amount**, owed to Taylor"), 61-2 (i.e., "the journal entities to the intercompany accounts **constitute** an allocation of expenses"), 62-3 (i.e., the document titled 'Methodology for Reallocation of Expenses' describes the duties and responsibilities of three of the four shared employees and those employees are salaried employees that do not prepare time reports), 64 (i.e., they "made the determination [relative to the 50/50 allocation of [interest expense] that the 50 percent is because it was unknown to the specificity of what it was purchased for . . . . [w]e knew that the 3.4 million was for purchases that were necessary of inventory and expenses, and they were used mutually . . . . [a]nd so we - - having no other methodology to divide it, we said it was 50/50"), 65 (i.e., the sole purpose of the wholesale division was to benefit the retail operations), 67-8 (i.e., the cash payments made "indirectly" relate to inventory "in terms of the way . . . [GTC] did its practices, monies are received by both entities for whatever purpose . . . . [b]e it for the space rental business, be it for retail, be it for restaurant, monies came in . . . . [b]ills, as we stated from your exhibits, were paid by Taylor, as an example for wholesale goods . . . . [w]hen Taylor bills became due, funds had to be transferred to the Taylor entity in order to pay the bills"), and 68-71 (i.e., the debt that is recorded owed from Mt. Clemens to Taylor is not tied to or related to any identified inventory). [Emphasis added.]

[30] Petitioner's contentions regarding Respondent's purported "gross misinterpretation" of 26 USCS §482 and 26 CFR §1.482-1 are both incorrect and irrelevant, as the purpose for that code section and regulation are "to prevent the avoidance of taxes with respect to . . . [controlled] transactions" by providing authority to a district director to

was at the State level only, as Petitioners attempted to qualify for the requested SBAC exemption through an allocation of costs to North necessary to reduce GTC's business income and, ultimately, its shareholders' (i.e., Petitioners') business income beneath the SBAC's income threshold. Said proposed allocations, even though not sufficiently supported, do not, however, justify a conclusion that Petitioners' attempt to "defeat a tax or the payment of a tax" was "willful."[31] Rather, the attempt appears to be the result of a misunderstanding or misapplication of existing law by non-attorneys that were, as Petitioners' contend, relying on basis accounting principles to reflect the business actually being conducted by the single operation.

With respect to the parties' other contentions, the proposed reallocation only reflects a portion of the retail sales actually made by the two entities. In that regard, GTC was required to collect sales tax on the sales of the merchandise returned to its wholesale division and those sales should have been included in the determination of the proposed reallocation, notwithstanding the purported "distortion," as their inclusion would have reflected the entities' gross sales.[32] Further,

---

make allocations. See 26 CFR §1.482-1(a)(1) and (2). Nevertheless, "a controlled taxpayer **may** report on a timely filed U.S. income tax return (including extensions) the results of its controlled transactions based upon prices different from those actually charged." [Emphasis added.] See 26 CFR §1.482-1(a)(3). However, such filings cannot be used, as correctly argued by Respondent, to "compel" the application of the reported allocations. See 26 CFR §1.482-1(a)(3). In that regard, the amended U.S. return did not compel any IRS action (i.e., no "impact").

[31] In the unpublished opinion *per curiam* issued by the Michigan Court of Appeals in *Free Enterprises, LLC v Dep't of Treasury* on November 6, 2012 (Docket No. 306195) the Court stated, in pertinent part:

> "Tax evasion" is defined as "[t]he willful attempt to defeat or circumvent the tax law in order to *illegally* reduce 'one's tax liability." Black's Law Dictionary (9th ed, 2009) (emphasis added). "Tax avoidance," in contrast, is "taking advantage of *legally* available tax-planning opportunities in order to minimize one's tax liability." *Id.* (emphasis added).

The above-definitions remain unchanged in Black's Law Dictionary (10th ed. 2014). See also Tax Crimes Handbook, Office of Chief Counsel Criminal Tax Division, Internal Revenue Service (2009) at p 4 (i.e., "1-1.03 Evasion of Assessment [1] Elements of the Offense: [a] An attempt to evade or defeat a tax or the payment of a tax; [b] An additional tax due and owing; and, [c] **Willfulness**"). [Emphasis added.]

[32] See MCL 205.52(1) (i.e., such sales contributed to the "gross proceeds of the business"). See also KTR 12 (i.e., "[i]f things don't sell, **we send it back**"), 13 (i.e., "we **always considered** . . . [GTC] to be the driver of the business"), 17-8 (i.e., "[s]o you would see transfers from Mt. Clemens back also to Taylor if things didn't sell"), "they are sold down there, sometimes at cost, sometimes at a loss, sometimes at a minimal amount of profit per se . . . [b]ut it is the outlet that we used to get rid of our excess product," and other third parties will purchase those items from the Taylor location . . . . "[c]orrect"), 24 (i.e.," if an employee of GTC performed work for North, was there any consideration paid for those services . . . . '[n]o'" and "who signed the loan . . . . 'only James A. Koester'"), 26-7 (i.e., "the loan was used basically to purchase inventory . . . . '[c]orrect'" and "Fifth Third controlled everything at both corporations with the exception of the real estate"), 28-9 (i.e., "Fifth Third controlled, via their filings, every asset of . . . [GTC] and . . . [North], all of it "). [Emphasis added.] See FTR 23-5 (i.e., the "initial reallocation" of interest expense "was based upon beginning inventories at each location"; "the credit line was based on the ability to purchase inventory, so that's, **I guess**, why we did it . . . . [b]ut I couldn't give an absolute to that," GTC's line of credit, "**collateralized by the inventories of both locations and the assets of both locations**"; and there is **no** security agreement for the collateral, other than the Fifth Third loan statement), 26 (i.e., GTC's wholesale division was "an **arm or an extension** of the retail establishments working both for Mt. Clemens and Taylor . . . . **[s]o that's why we came to the 50 percent**"), 30-3 (i.e., all wholesale costs "initially charged" to GTC), 39-43 (i.e., the allocated wholesale costs were "charged" to the North location "[b]ecause it's part of an - - it's part of an overhead cost of inventory . . . . [b]ut again, I'm not an expert . . . I think probably our accountant would be better to ask that"), 35-8 (i.e., the 50/50 split of wholesale costs based on half of the inventory ending up at the Mt. Clemens location and that is just a "**generality**"; and "no" documentation to support 50/50 allocation "other than again the

---

same - - for the same reasons we've been - - I've been saying before, that, in essence, if wholesale did not exist in Taylor or if wholesale was not allocated to Mt. Clemens, Mt. Clemens would have to have the identical setup . . . . [f]or purchasing and distribution and overhead costs of phone and, you know, insurance and the like for those people . . . . [s]o instead of duplicating a cost, the reality is it's much more cost savings to have a - - **one department that's allocated to both companies**"), 44 (i.e., "the **rents**, the property taxes, the utilities and other overhead costs **that are charged to**, like in this case, our Taylor building - - our Taylor company and then uses a formula that says basically - - we used the formula basically to say wholesale is 38,000 square feet of a 539,000-square-foot facility, which represented 7.05 percent of the total cost . . . [a]nd then based on that 7.05 percent, that allocation is then charged to inventories), 55-7 (i.e., the methodology "is saying that the $1,871,951 of Mt. Clemens retail sales divided by the $3,414,540.43, which is - - represents the total of retail sales between Taylor and Mt. Clemens; the documentation indicates total sales of $5,110,000 approximately so why not include the wholesale sales "**I would** - - I did **not** draft this narrative, but it would - - **it would just support the same data that was said that the two retail establishments is sort of how we allocated the cost**"; wholesale sales are not included in the denominator figure of $3.4 million "[b]ecause we're saying retail sales is the method that we use to allocate wholesale - - the wholesale department" and **if they were going to do a ratio of total Mt. Clemens sales to total Taylor sales, they would have to include the wholesale sales figure "if the ratio was total sales and not total retail sales**"; and "the whole premise of wholesale is that the buyer and **the department costs were incurred for the support of retail sales in both locations,** and that if we didn't have a dollar's worth of sales, then in wholesale, as an example, **we would still incur these same costs that we incurred that would need to be allocated**"), and 58-9 (i.e., each item of inventory purchased is specifically identified and said identification is done manually and each item of inventory transferred is reflected by a transfer document and journal entities that are computerized). [Emphasis added.] See DTR 7 (i.e., "I've advised them and helped them formulate the proper allocations to make to get a properly filed tax return for the State of Michigan"), 8-9 (i.e., "the loan is between . . . [GTC], the Taylor location, and Fifth Third Bank . . . . '[y]es . . . . [c]orrect"), 12-3 (i.e., "the allocations are **not** an exact science . . . . [w]hat you do is **try . . . rationalize** the best method under accountings methods to allocate that . . . . [**i**]**t was done by 50 percent by the people here** . . . [t]hat number was kind of **picked by management** here, because they had the two entities and they both used inventory about equally" and "the two best methods that we could come up with to rationalize was either the transfer of inventory or the sales . . . . [a]nd each one of those came to a percentage that was higher than 50 percent, but conservative and - - you know, one of the dictates of accounting is be conservative on this, on what you do . . . . [a]nd you know, 50 percent is a conservative number"), 14 (i.e., "wholesale sales were **excluded because** if there was not one dollar in wholesale sales, **you would still have all these same costs** . . . . [t]he two locations needed a buyer, they needed a place to store their inventory, they needed all those things . . . . [a]nd the sales - - **wholesale sales are really inconsequential as far as the expenses** . . . . [t]hose sales are just an attempt to recover some of the costs when they buy a lot and, you know, they have excess inventory or they - - they can't sell as much retail as they thought they could . . . . [r]ather than throw the stuff in the trash, they try and recover the costs" and "it's going to be a very low-profit margin or a loss on that money . . . . [s]o, you know, the buyer, the trucks, all that stuff is going to be there whether there's any wholesale sales or not . . . . [s]o the **belief** was it would be split between the two operating entities"), 17 (i.e., "[d]oes . . . [North] pay for those services . . . . . '[n]o . . . . [**t**]**he only accounting for that is in these allocations that we've made**'"), 18 (i.e., "a measure of the usage of that department, where - - so the inventory is brought into this central location **and then it's transferred out** . . . . [a]nd how much of the resources that they're using, **one good indication of that would be how much of the inventory was transferred to the different locations**"), 19 (i.e., "[t]his is a summary on a monthly basis of the transfer out of the wholesale department to the Taylor and Mt. Clemens locations starting in October 2009, which is the beginning of the fiscal year in question, and subtotaled each year but going through December '11"), 20 (i.e., "[t]he inventory transfers are recorded on the books and put through that intercompany accounts receivable . . . . [s]o they are paid for, **but they're not paid for on a specific identification method**"), 31-2 (i.e., "[m]y opinion would be that the inventory transfers **would probably be the best method of the three** because of the line of credit being used to purchase inventory and that the inventory is collateralized"), 33 (i.e., "because **there weren't individual or contemporaneous time records** kept as to the locations and times and places, the best method, that was used, was to talk with management at the people involved and look at their duties and estimate the time that they spent at their different duties at the different locations and take into account the relevant facts and circumstances"), 34 (i.e., "the wholesales department . . . . really being a service department to service the two locations and that those expenses would be there regardless of any activity that the wholesales department had in the sales area" and "because this was retailed inventory, either using the sales at the two locations, the retail sales - - and I know we talked about a lot of

the inclusion of those sales would not, as indicated by Respondent, support Petitioners' claim to the requested credit. The proposed reallocation also relied on the sharing of employees paid by one entity and expensed by the other without appropriate or reliable documentation to support the purported expensing or reallocation. More specifically, Petitioners' documentation was not kept in the normal course of business, but rather was created after the fact to support the proposed reallocation based on the employees recollections (i.e., knowledge) of the amount of performed for each entity and the time it took to perform that work.[33] Additionally, no specific reimbursement was, as indicated herein, made to the paying entity to recoup said salaries and benefits paid for the performance of services to the expensing entity. The proposed reallocation further relied on expensing of interest and the amount of inventory for each entity. Although interest was expensed by North as part of the cost of the purchased inventory, North was not signatory to the loan, didn't make any loan payments, or specifically reimburse GTC for that expensed cost. As for inventory, no deposition testimony was provided or documentation offered to reflect the return of the unsold merchandise by North to the GTC wholesale division for sale and said inventory transfer would also impact the proposed reallocation (i.e., GTC's share of the inventory) and increase GTC's business income to the detriment of Petitioners' claimed requested credit.

Given the above, Respondent's rejection of the allocation, despite Petitioners' unsupported contention of five banker boxes containing purported source documentation, was appropriate, as the reallocation was inappropriate under Federal standards and not properly supported.[34]

Finally, "the granting of costs and attorney fees are within the discretion of the Tribunal" and the Tribunal, in exercising such discretion, generally looks to whether a claim or defense was frivolous or imposed for any improper purpose.[35] As for the instant case, Petitioners' claim was neither frivolous nor imposed for any improper purpose. More specifically, Petitioners did provide documentation, albeit insufficient documentation, to support the proposed reallocation, particularly given the effective operation of GTC and North as a single entity. Petitioners were also not necessarily required to correct their financial statements to reflect the allocations or, more appropriately, to reflect the cost of business when that cost was actually incurred. Further,

---

other income that's in these, **but just using the retail sales - - because that's what this inventory is** . . . . [i]t's not rentals . . . . [i]t's not any of that other stuff . . . . [i]t's retail sales . . . . [s]o using retail sales between the two locations would be a good method"), and 53 (i.e., "the **intent** of that inventory was half of it would go to Taylor and half of it would go to Mt. Clemens"). [Emphasis added.]

[33] Although there is an issue of fact relative to payments and expensing, particularly with respect to Ms. Halsey's salary, the resolution of that fact issue is unnecessary for purposes of this Order given the operation of the two entities as a single business. In that regard, Ms. Halsey is admittedly a North employee and expensed for purposes of the reallocation with no explanation or documentation indicating the services, if any, provided to the expensing entity. Nevertheless, said sharing and payment is, as indicated above, a further indication of the single business operation conducted by the entities. See also Oral Argument Transcript ("OTR") 18-20 and OTR 59-60.

[34] Although Petitioners did, in fact, submit some source documentation, the majority of the documentation submitted was not prepared contemporaneously, but rather prepared after the fact to support the proposed reallocation, raises questions with respect to its accurate reflection of the appropriate and required source documentation and reliability.

[35] See TTR 209(1). That rule, although recently amended to remove the "prevailing party" limitation, is silent as to the standards (i.e., frivolous, etc.) that are to be applied in making such determinations and, as such, the Tribunal looks to the Michigan Administrative Procedures Act ("MAPA") and the Michigan Court Rules ("MCR"). See TTR MCL 24.323, and MCR 2.114. See also *Aberdeen of Brighton, LLC v City of Brighton*, unpublished opinion *per curiam* of the Michigan Court of Appeals, issued October 16, 2012 (Docket No. 301826).

Petitioners were, in fact, authorized under both Federal and State law to file amended returns. In that regard, neither the IRS nor Treasury are required to accept said filings, particularly when said filings are neither appropriate nor properly supported. As such, the Tribunal concludes that Respondent's request for costs and attorney fees should be denied, as no good cause has been shown to justify any such award in this case. Therefore,

IT IS ORDERED that Respondent's Motion for Summary Disposition is GRANTED.

IT IS FURTHER ORDERED that Final Assessment Nos. UI64360 and UJ42338 are AFFIRMED.

IT IS FURTHER ORDERED that Respondent's Motion for Costs is DENIED.

## JUDGMENT

This is a proposed decision ("POJ") prepared by the Michigan Administrative Hearings System. It is not a final decision.[36] As such, no action should be taken based on this decision.

The Tribunal will, after the expiration of the time period for the opposing party to file a response to exceptions, will review the case file, including the POJ and all exceptions and responses, if any, and:

a. Issue a Final Opinion and Judgment (FOJ) adopting the POJ as the final decision.
b. Issue an FOJ modifying the POJ and adopting the Modified POJ as the final decision.
c. Issue an Order vacating the POJ and ordering a rehearing or such other action as is necessary and appropriate.

## EXCEPTIONS

The parties have 20 days from date of entry of this POJ to notify the Tribunal **in writing, by mail or by electronic filing**, if available, that they do not agree with the POJ and to state in writing why they do not agree with the POJ (i.e., exceptions). Exceptions are **limited** to the evidence submitted with the Motion, the Response, and any matter addressed in the POJ.

There is no fee for filing exceptions and the opposing party has 14 days from the date the exceptions were mailed to or electronically served on that party (i.e., email), **if** the parties agree to service by email, to file a written response to the exceptions.[37]

Exceptions and responses filed by *e-mail or facsimile* will **not** be considered in the rendering of the Final Opinion and Judgment.

---

[36] See MCL 205.726.
[37] See MCL 205.726 and TTR 289(1) and (2).

A copy of a party's written exceptions or response **must** be sent to the opposing party **by mail or email, if** email service is agreed upon by the parties**,** and proof **must** be submitted to the Tribunal demonstrating that the exceptions or response were served on the opposing party.

By Peter M. Kopke

Entered: September 6, 2017
pmk