

Treasury Update

Appellate Court Redefines “Unitary Business Group”

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Good news!

Current and past editions of “Treasury Update” are now located on their own page on Treasury’s website. The new page can be found under the [Reports and Legal Resources](#)

tab.

In *LaBelle Management, Inc. v Dep’t of Treasury*, ___ Mich App ___ (2016), the Michigan Court of Appeals rejected the Department of Treasury’s published guidance defining indirect ownership for purposes of the definition of a unitary business group under the Michigan Business Tax (MBT). Reversing the Court of Claims, the Court of Appeals found in favor of LaBelle, holding that indirect ownership means ownership through an intermediary, not constructive ownership or ownership through attribution.

Under the MBT and the Corporate Income Tax (CIT), a unitary business group (UBG) is a group of related United States persons, other than a foreign operating entity, whose business activities or operations are interdependent. Specifically, a UBG exists when two or more persons satisfy both a control test and one of two relationship tests. The control test is satisfied when one person owns or controls, directly or indirectly, more than 50% of the ownership interest with voting or comparable rights of the other person or persons.

Since no one person directly owned or controlled more than 50% of the other persons in *LaBelle*, the case focused on what constitutes “indirect” ownership, a term not defined in the MBT. Treasury asserted that the word “indirect” should be assigned the same meaning for MBT purposes as the word had when used in a comparable context in the laws relating to federal income taxes. In Revenue Administrative Bulletin (RAB) 2010-1, its primary guidance on the application of the control test, Treasury had interpreted indirect ownership to include ownership through attribution (also known as constructive ownership). In that RAB, Treasury modeled its definition of indirect ownership for purposes of application of the control test on the attribution rules contained in Internal Revenue Code (IRC) Sec. 318. Under these attribution rules, the *LaBelle* entities constituted a UBG.

The lower court agreed that it was appropriate for Treasury to rely on contextually analogous federal income tax law, finding that IRC Sec. 957, which incorporates the attribution rules of IRC Sec. 318, was contextually analogous. The Court of Claims therefore held in favor of Treasury. LaBelle had agreed that it was appropriate to rely on contextually analogous federal law, but argued that IRC Sec. 482, a section which does not incorporate the attribution rules of IRC Sec. 318, was the most analogous IRC provision.

The Court of Appeals, however, determined that there was no comparable federal context to the UBG definition of the MBT. The court therefore looked to various dictionary definitions of the word “indirect,” ultimately defining the word for UBG purposes to mean ownership through an intermediary.

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The *LaBelle* decision is published. Published Court of Appeals decisions are normally binding on Treasury and have full retroactive effect (*i.e.*, the *LaBelle* holding would apply to all open tax years). On May 5, 2016, however, the Court of Appeals entered an order staying the effect of its earlier decision until Treasury's appeal rights have been exhausted. Consequently, until the stay is lifted, the *LaBelle* decision is not considered binding precedent. Treasury anticipates publishing further guidance for taxpayers on this issue after appeal of the *LaBelle* decision or a decision not to appeal.

Expansion of Vehicle Trade-In Deduction or “Sales Tax on the Difference”

The General Sales Tax and Use Tax Acts were amended in December 2013 to exclude from the sales and use tax base the value of a motor vehicle or recreational vehicle, up to \$2,000 (increasing \$500 annually beginning on January 1, 2015), used as part payment for the purchase of a new or used motor vehicle or recreational vehicle from a dealer. The acts were also amended to exclude from the sales and use tax base beginning November 15, 2013, the full value of titled watercraft used as part payment for the purchase of new or used titled watercraft. In other words, the value attributed to a vehicle or watercraft that is traded in for a new/used vehicle or watercraft is not subject to sales and use tax. These deductions from the sales and use tax base are commonly referred to as a “trade-in deduction” or “sales tax on the difference.”

Until recently, the deduction for motor vehicles and recreational vehicles was limited to only trade-ins with dealers licensed in Michigan. However, the Acts were recently amended to provide that the deduction is available even if the vehicle or recreational vehicle is used as part payment with dealers in other states. The acts were also amended to require that the trade-in deduction for titled watercraft is limited to transactions with a dealer (*i.e.*, excludes private party sales). These amendments are retroactive back to December 15, 2013.

Based on these changes in the law, consumers who purchased a vehicle from a dealer in another state may have a refund opportunity. Additionally, any vehicle or watercraft dealer that erroneously remitted sales or use tax on trade-in values that were eligible for the deduction may request a refund.

Refund requests may be sent to:

Michigan Department of Treasury, Attn: Technical Services, P.O. Box 30698, Lansing, MI 48909-8198.

The new laws can be read in their entirety here: [MCL 205.92 \(2016 PA 7\)](#) and [MCL 205.51 \(2016 PA 8\)](#). For more information regarding the trade-in deduction please see [Letter Ruling 2014-2](#). Please direct any questions to Treasury's Sales and Use Tax Technical Services Division at (517) 636-4357.



Don't Lose Your Michigan Net Operating Loss! — Calculating the Deduction Correctly

Under the Michigan Income Tax Act (MITA), a Michigan net operating loss (NOL) is created when business losses exceed gains in a particular tax year. An individual, a trust, or an estate can sustain an NOL, which may be carried to certain other years to offset positive income in those years. The resulting offset to income in those other tax years is referred to as the “NOL deduction.”¹ The Michigan NOL is calculated using the same general formula as the federal NOL, but it is computed independently of the federal NOL and starts with modified federal adjusted gross income rather than federal taxable income.

Like its federal tax counterpart, the Michigan NOL deduction is a legislatively-created mechanism which allows taxpayers to “smooth” fluctuating income from year to year for tax purposes. Once a Michigan NOL has been computed for a given tax year, the MITA permits a taxpayer to carry the loss back two years and then forward 20 years, chronologically, until the entire amount of the NOL is consumed.² A taxpayer may also elect to forgo the carryback and apply the NOL in the 20 succeeding years only.³ To establish a Michigan NOL and claim an NOL deduction and a refund in the carryback or carryforward years, a taxpayer must file Form MI-1045, *Application for Michigan Net Operating Loss Refund*.

Form MI-1045 is required because the Michigan NOL deduction is subject to miscalculation by taxpayers. The form provides step-by-step instructions to help taxpayers make the correct calculation, thereby avoiding processing delays and refund adjustments. When miscalculations do occur, the cause can frequently be traced to confusion of computation of the Michigan NOL with computation of the taxpayer’s Michigan taxable income. Some taxpayers erroneously understand their Michigan NOL to simply equal their loss year’s negative taxable income. However, while a taxpayer is permitted to subtract items such as interest from federal bonds and state tax refunds to compute and reduce their Michigan taxable income, the taxpayer may not also include these adjustments to adjusted gross income when computing their Michigan NOL.

While the Michigan NOL permits a taxpayer to smooth income from year to year, it is also a product of legislative grace, and may only be used only as statutorily prescribed. The statute specifically limits adjustments to adjusted gross income in the calculation of the Michigan NOL to only those adjustments related to allocation and apportionment of income attributed to other states.

The disallowance of MI-1040 Schedule 1 adjustments in the calculation of a Michigan NOL does not result in a “backdoor” tax of these items. Bearing in mind that no tax is incurred on income in the loss year because reported income was less than zero, excluding items from the NOL calculation in the loss year merely reduces the size of the deduction available for use in another tax year. When that NOL is carried to another tax year with positive income, the taxpayer is still permitted to use all Schedule 1 adjustments for that year to reduce taxable income before applying the Michigan NOL deduction.



¹ See MCL 206.30(1)(m) and (n).

² The MITA adopts the carryback and carryforward provisions in Internal Revenue Code § 172, which are subject to change.

³ These carryback and carryforward years apply for all tax years after August 5, 1997.

Application of Sales Tax to “Core Charges”

Similar to a bottle deposit, the retail sale of certain automotive parts may include an additional charge to encourage the return of those parts when they are worn out or depleted so that the parts can be recycled or remanufactured. In the automotive parts industry, the used part being returned (typically as a trade-in toward the purchase of a new part) is commonly referred to as a “core.” Therefore, this additional charge is commonly referred to as a “core charge” (although it may also be described as a “core fee” or “core price”). Typical items with a “core charge” include vehicle batteries, brake master cylinders, water pumps, alternators, and starters.

The following examples (using a car battery as the “core”) illustrate how core charges are applied:

Example 1 (original purchase of battery with no core trade-in): On February 5, 2008, customer purchased a new battery from retailer at a total cost of \$100 (\$70 battery list price + \$30 core charge). The sales invoice separately itemized the battery list price and the core charge.

Example 2 (customer purchases another new battery and returns core as trade-in): On May 12, 2014, customer returned the used battery (purchased on February 5, 2008) to retailer as a trade-in toward the purchase of a new battery with a list price of \$80 and a core charge of \$30 for a total selling price of \$110. Because the customer returned the used battery (core) to the retailer, the customer received a credit of \$30 to be applied to the purchase of the new battery. This credit covered the core charge for the new battery, so the remaining balance due from the customer was \$80. Customer paid the retailer \$80 cash, so the \$80 cash plus the returned core (valued at \$30) constituted the full consideration for the retail sale of the new battery. The sales invoice separately itemized the battery list price, the core charge, and the credit based on the value of the returned core.

In each of the above examples, the retailer was required to remit sales tax on the total sales price of the new battery, regardless whether there was a core trade-in or whether the list price of the battery, the core charge, or the credit was separately itemized on the sales invoice. In *Example 1*, sales tax in the amount of \$6.00 was due on the total sales price of \$100. In *Example 2*, \$6.60 in sales tax was due on the total sales price of \$110. No refund or reduction of sales tax due is permitted based on any payment or credit given to the customer for the return of the core, regardless whether the core is returned at the time the new battery is purchased or is returned at a later date for refund or credit. The sales tax treatment of core charges is explained further in [Rule 205.15](#) and Letter Ruling 1988-34 (see p. 930, 2014-2015 *Michigan Tax Guide for Sales and Use Tax*).

An exception to this tax treatment of core charges is provided in Section 14a of the Streamlined Sales and Use Tax Revenue Equalization Act, [MCL 205.184a](#), which was added by 2010 PA 333 and states that a person who paid sales tax on a core charge “attributable to a recycling fee, deposit, or disposal fee for a component, part, or battery for heavy earthmoving equipment may calculate a credit and seek a refund from the department ... in an amount equal to the sales tax paid” on the core charge.

For questions, ideas for future newsletter or Revenue Administrative Bulletin topics, or suggestions for improving Treasury Update, please contact:

Mike Eschelbach, Director, Tax Policy Bureau: (517) 373-3210

Lance Wilkinson, Administrator, Tax Policy Division: (517) 373-9600

Email address: Treas_Tax_Policy@michigan.gov

Update on Multistate Tax Compact Apportionment Litigation

The apportionment election provision in the Multistate Tax Compact (Compact) continues to be an item of jurisprudential significance to Michigan taxpayers, both on the Michigan Business Tax (MBT) front and most recently regarding the Single Business Tax (SBT). The Compact's election provision permits a taxpayer subject to an "income tax" to elect to apportion and allocate income according to the Compact's equally-weighted three-factor method or in the manner provided by a Compact member state's law.

The Michigan Supreme Court previously held – in *IBM v Dep't of Treasury* (2014) – that the election provision under the Compact, adopted into Michigan statute in 1970, was not repealed by the enactment of the MBT, which took effect January 1, 2008. In response to the Court's decision in *IBM*, the Legislature enacted 2014 PA 282 (PA 282), retroactively repealing the Compact entirely, effective January 1, 2008, and indicating that the retroactive repeal expressed the Legislature's original intent for the application of the MBT's mandatory single sales factor method for apportionment. In *Gillette Commercial Operations N.A. v Dep't of Treasury* (2015), the Michigan Court of Appeals rejected taxpayers' constitutional challenges to PA 282 and held that the statute applied retroactively, precluding the use of the three-factor apportionment formula previously available under the Compact, effective January 1, 2008.

However, the legislative repeal of the Compact did not extend to the years in which the SBT was in effect. In February 2016, the Michigan Court of Appeals issued a published decision in *AK Steel Holding Corp v Dep't of Treasury*, holding that the SBT did not impliedly repeal the Compact's election provision. *AK Steel Holdings* also held that the SBT was an "income tax" as defined under the Compact, which was a necessary condition for a taxpayer under the SBT to claim entitlement to the Compact's election provision. The Compact broadly defines an "income tax" as "a tax imposed on or measured by net income, including any tax imposed on or measured by an amount arrived at by deducting expenses from gross income, 1 or more forms of which expenses are not specifically and directly related to particular transactions." MCL 205.581, Art II(4). The Court of Appeals concluded that the SBT fit this definition. Although both the U.S. Supreme Court and the Michigan Supreme Court in the *Trinova Corp v Dep't of Treasury* cases had previously determined the SBT to be a value-added tax rather than an income tax, the Court of Appeals distinguished those cases since the issue before the court in *AK Steel Holdings* was limited to the application of the Compact's definition to the SBT. Treasury has declined to appeal *AK Steel Holdings*, or any of the other SBT three-factor cases consolidated with that case.

Service Fee Housing: List of Properties

The November 2015 edition of *Treasury Update* reported on 2015 PA 10, which allows Treasury to publish a list of service fee housing properties to assist taxpayers and preparers in calculating the homestead property tax credit for income tax returns. (Prior to this change in the law, service fee housing information obtained by Treasury was confidential and could not be disclosed.) At the time of that report, the list was not available. As of January 2016, however, a list of service fee housing addresses is now available on Treasury's website in spreadsheet form. The list may be accessed through the [Tax Professionals](#) link. Please refer to the [Guidelines](#) when using the spreadsheet.

A few words of caution. The published list of service fee housing properties was compiled from information reported on tax returns and or by certain local government units. However, not all local government units have reported this information to Treasury. While Treasury will continue to update this list as new information is provided, taxpayers and practitioners should know that the list is not complete and may contain addresses that are no longer service fee housing. Before calculating the homestead property tax credit, taxpayers or preparers should consider confirming the status of an address by contacting the local government unit.

Appeals Court Rules SBT Brownfield Credit Carryforwards Refundable Under MBT

The Michigan Court of Appeals recently issued two decisions ruling that taxpayers were able to claim remaining carryforward amounts of brownfield redevelopment credits originally issued and claimed under the Single Business Tax (SBT) as refundable credits under the Michigan Business Tax (MBT).

In *Hudsonville Creamery and Ice Cream Co, LLC v Dep't of Treasury*, ___ Mich App ___ (2016), Hudsonville Creamery was issued a brownfield redevelopment credit in 2005. It did not have sufficient tax liability to fully consume the credit. Hudsonville Creamery carried forward its unused SBT credit into the MBT in 2008, claimed the SBT credit carryforward amount against its MBT liability, and sought 85% of the remainder as a refund under subsection 437(18) of the MBT. Treasury honored the claimed application of the SBT carryforward against Hudsonville Creamery's MBT 2008 liability, but denied the claimed refund on the grounds that a SBT brownfield redevelopment credit carryforward is not "the credit under this section [437]" that is eligible to be claimed as a refund at 85% under subsection 437(18). Hudsonville Creamery contested Treasury's denial before the Michigan Tax Tribunal. Treasury's position was that the MBT statute explicitly differentiates between a credit and a carryforward from a credit, particularly carryforwards from SBT brownfield redevelopment credits. Treasury further asserted that subsection 437(18) explicitly prescribed the manner in which an MBT taxpayer with an unused SBT brownfield redevelopment credit carryforward was able to claim the carryforward amount against its MBT liability, with that treatment differing from a brownfield redevelopment credit issued under the MBT. The Tax Tribunal affirmed Treasury's denial of the claim for refund.

In a 2-1 published opinion, the Court of Appeals overturned the Tax Tribunal's ruling, finding in favor of Hudsonville Creamery. The court held that Hudsonville Creamery's SBT carryforward amount from a previously claimed brownfield credit was also a "credit" under the MBT Act with respect to the refund election under subsection 437(18) of the MBT Act. The court thus held that Hudsonville Creamery was permitted under subsection 437(18) to elect to have its SBT brownfield redevelopment credit carryforward amount refunded at 85% and forgo the remainder of the credit carryforward amount.

The dissenting opinion in *Hudsonville Creamery* found that while a credit carryforward is a type of credit and not wholly distinct from a credit, the specific language in subsection 437(18) indicates that the Legislature did not intend to provide a refund for credit carryforwards. The dissent found that interpreting the refund portion of subsection 437(18) as applying to all credits, including credit carryforwards, would render portions of the statute nugatory, contrary to well-established rules courts must follow for construing the meaning of statutes. Thus, the dissent would have affirmed Treasury's denial of the claimed refund.

In *VITEC, LLC v Dep't of Treasury*, the facts were similar to these at issue in *Hudsonville Creamery*. However, in *VITEC*, the taxpayer, after the repeal of the SBT, claimed the carryforward on its MBT returns for 2008 through 2010 and did not claim its SBT credit carryforward as refundable until its 2011 tax year. The Court of Appeals cited its published decision in *Hudsonville Creamery* as controlling, and held that VITEC could elect an 85% refund of the excess of its unused SBT brownfield redevelopment credit carryforward.

Treasury has filed a motion for reconsideration in each case.



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Use Tax Exemption for Vehicle Transfers



Use tax is imposed for the privilege of using, storing or consuming in Michigan a vehicle, off-road vehicle (ORV), manufactured housing, aircraft, snowmobile, or watercraft. Exceptions apply for certain transfers to licensed dealers or retailers for resale. When a used car (or certain other vehicle) is transferred or sold, the transferee or purchaser owes use tax. The tax on the transfer of a vehicle is 6 percent of the greater of the purchase price or the retail value of the vehicle at the time of purchase. Although use tax is collected by the Secretary of State before the registration of a vehicle, ORV, snowmobile, or watercraft, Treasury is responsible for the administering the use tax.

Michigan exempts from use tax the transfers of vehicles to certain relatives. 2014 PA 248 expanded the exemption to include a relative who is the father-in-law, mother-in-law, brother-in-law, sister-in-law, son-in-law, daughter-in-law, or grandparent-in-law of the transferor.

The transfer of a vehicle to any of the following relations is exempt from use tax:

- Spouse
- Parent
- Sibling
- Child
- Grandparent
- Grandchild
- Legal ward
- Legally appointed guardian with certified letter of guardianship
- Stepparent
- Stepchild
- Stepsibling
- Parent-in-law
- Sibling-in-law
- Child-in-law
- Grandparent-in-law (spouse's grandparent)

Transfers of vehicles to any of the following non-exhaustive list of relatives *are not* exempt from use tax:

- Aunt, uncle, cousin, niece, nephew
- Great-grandparent, great-grandchild
- Former spouse (unless transfer is in accordance with a final decree of divorce)
- Stepgrandparent (grandparent's spouse)
- Stepgrandchild (spouse's grandchild)
- Spouse of a sibling-in-law (spouse's sibling's spouse and sibling's spouse's sibling)

Persons claiming an exempt relationship when registering a vehicle may subsequently receive a letter from Treasury requesting proof of the exempt relationship. The types of documents accepted as proof include marriage licenses, birth certificates, and certified letters of guardianship issued by a court.

For more information, see Treasury's brochure, [Transferring a Vehicle Title to a Relative \(Form 248\)](#), and [Internal Policy Directive \(IPD\) 2015-1, Use Tax Exemption for Transfers of Certain Property to an "In-Law."](#) Both can be found on Treasury's website at www.michigan.gov/taxes.

Statement of Acquiescence/Non-Acquiescence Regarding Certain Court Decisions

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

ACQUIESCENCE:

No cases this quarter

NON-ACQUIESCENCE:

Hayes LB, Inc v Dep't of Treasury, MTT Docket Number 14-003902 (November 3, 2015)

RECENTLY ISSUED GUIDANCE FROM TREASURY

REVENUE ADMINISTRATIVE BULLETINS:

[RAB 2016-4](#) Determination of Property as Tangible Personal Property or Real Property for Sales and Use Tax

INTERNAL POLICY DIRECTIVES:

[IPD 2016-1](#) Taxability of OTC Medications Dispensed by Prescription and Paid for by Medicaid Arrangements

[IPD 2016-2](#) Appeal Extension When Taxpayer's Representative Was or Is Not Provided Copy of a Letter or Notice Pursuant to MCL 205.8

OTHER GUIDANCE:

[Notice to Taxpayers:](#) Overpayments Remaining on Michigan Business Tax Accounts

[Notice to Taxpayers:](#) *Ashley Capital, LLC v Department of Treasury*

[Notice to Taxpayers:](#) Appeal Extension When Taxpayer's Representative Not Provided Required Copy of Letter or Notice

[Notice to Taxpayers:](#) Data Center Exemption

[Notice to Taxpayers:](#) Changes to Prepaid Sales Tax Under 2015 PA 264

[Notice to Taxpayers:](#) Informational Reports Related to Taxable Retail Sales and Taxable Storage, Use, or Consumption of Aviation Fuel