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Treasury Update

In this issue:

Taxability of "Cloud Computing" Clarified by Appellate Court

As noted in the November issue of Treasury Update, the Department of Treasury had been litigating the taxability of certain forms of "cloud computing." On October 27, 2015, the Michigan Court of Appeals issued a published decision in *Auto-Owners Insurance Co v Dep't of Treasury*, ___ Mich App ___ (2015), 2015 WL 6473592. At issue in *Auto-Owners* was whether certain products were subject to the imposition of use tax on prewritten computer software delivered in any manner under MCL 205.92b(o). Treasury had determined during audit that the taxpayer's purchase of remote access to third party vendors' computer networks, servers, data storage, and software applications amounted to the taxpayer's "use" of tangible personal property—specifically prewritten computer software—in Michigan. The taxpayer objected, and filed a claim in court. On appeal, the Court of Appeals found that the taxpayer's transactions amounted to the purchase of nontaxable services, not the purchase of prewritten computer software.

The decision by the Court of Appeals in *Auto-Owners* provides guidance to Treasury on the parameters involved in taxing certain "cloud computing" products. Essentially, the court separated the products into two different categories.

The first category consisted of products that did not include the delivery of "code that enabled" the vendor's system to operate. That is, the software was entirely accessed remotely. The court found these products did not satisfy the requirement that prewritten computer software was delivered, in any manner, because there was no proof that code was electronically delivered to Auto-Owners, or that Auto-Owners exercised any incidence of ownership over the vendor's code. The second category consisted of products where the court found that some prewritten computer software was electronically delivered to Auto-Owners. The court found that the electronic delivery of a "local client" or "desktop agent" was sufficient to constitute an "ownership-type right" over the product.

Under Auto-Owners, the taxability of "cloud computing" products depends upon whether the software at issue is downloaded in its entirety; if the software is downloaded only in part, the "incidental to service" test must be applied. If merely accessed remotely, the software is exempt.

However, even though the court found that some prewritten software had been delivered, the court determined that – under the "incidental to service" test developed in *Catalina Marketing Sales Corp v Dep't of Treasury*, 470 Mich 13 (2004) – the software was merely incidental to the vendor's "rendering of professional services." Consequently, if a software program is electronically downloaded in its entirety, it will be taxable. If only a portion of a software program is electronically delivered to a customer, the "incidental to service" test under *Catalina* will be applied to determine whether the transaction constitutes the rendition of a nontaxable service rather than the sale of tangible personal property.

Treasury will apply the holding in *Auto-Owners* to all open tax years. Treasury has issued a Notice providing further guidance for taxpayers seeking a refund of taxes paid on products falling within the *Auto-Owners* opinion. The [Notice regarding *Auto-Owners*] is available on Treasury's website.

Motor Fuel Inventory "Floor Stock" Tax Set to Spring into Effect in 2017

With the enactment of 2015 PA 176, the tax rates imposed under the Motor Fuel Tax Act (MFTA) on gasoline and diesel fuel will increase to 26.3 cents/gallon beginning on January 1, 2017. This increase in the tax rates will cause a dormant provision in the MFTA to spring to life. That provision is the inventory (floor stock) tax found in section 10 of the MFTA, MCL 207.1010. Under that provision, whenever the tax imposed on gasoline or diesel fuel is increased, a specific amount of previously taxed fuel held in storage is subject to the tax increase, and tax must be reported and paid to the Department of Treasury based on the increase. This inventory tax applies as follows:

- For end users, the tax applies to motor fuel held in storage in excess of 3,000 gallons.
- For those holding fuel for sale (e.g., retail stations), the tax applies to motor fuel in excess of "dead storage." Dead storage equals either 200 gallons (for a tank with a capacity less than 10,000 gallons), or 400 gallons (for a tank with a capacity of 10,000 gallons or more).

A person in possession of motor fuel subject to this inventory tax must do all of the following:

- Take an inventory at the close of business on the last day before the effective date of the tax increase (i.e., December 31) to determine the gallons of motor fuel in storage.
- Complete a report to be filed with Treasury (on a form or in the format required by Treasury) for the following gallons held in storage: (i) total gallons of motor fuel; (ii) gallons in "dead storage," and; (iii) gallons of dyed diesel fuel.
- File the report and pay the tax due within 20 days after the last day of the month that the increase in the tax rates took effect (i.e., February 20). Tax due is calculated by multiplying the increase in the tax rates by the taxable gallons held in storage.

The following chart summarizes the calculation of the tax due for rates effective January 1, 2017:

	END USER	**RETAILER**
	(a) Total Gallons of Motor Fuel*	(a) Total Gallons of Motor Fuel*
	(b) 3,000 gallons	(b) Dead Storage
	(c) Exempt Gallons (e.g., Dyed Diesel Fuel)	(c) Exempt Gallons (e.g., Dyed Diesel Fuel)
Taxable Gallons (TG)	**(a)-(b)-(c) = TG**	**(a)-(b)-(c) = TG**
Tax Due by Feb 20, 2017	**TG x $0.073**	**TG x $0.073**

* As of December 31, 2016

Treasury will publish more guidance regarding the inventory (floor stock) tax in the future.

Tax Implications of the "Sharing Economy"

The "sharing economy" is a phrase given to a new and emerging sector of the business market that seeks to match demand with what many may think of as unconventional sources of supply. Examples of the "sharing economy" are cropping up in a variety of industries, including housing, transportation and leasing of tangible personal property. Have you booked housing accommodations through Airbnb or HomeAway, or caught a ride using Uber or Lyft's platform? If so, you have participated in the "sharing economy." In addition to various public safety and public policy issues, states have an interest in applying their tax laws consistently to these new business models. This article will focus on the use tax implications of the "sharing economy" in the housing sector.*

Homeowners who rent out their homes, or rooms in their homes, to the public for temporary lodging must remit use tax on those accommodations. Michigan's 6% use tax applies to any stay of 30 days or less. This includes the rental of a vacation home, cabin, lodge, condominium, townhouse, room in a private residence, or any other structure. The tax applies whether the provider is a hotel chain, a bed and breakfast establishment, or a private homeowner.

Those providing goods or services in the "sharing economy" should keep proper records in order to substantiate whether, and in what amount, they may owe sales or use tax. If a person owes sales or use tax, he or she also needs to register with the Department of Treasury. Please follow the application process outlined on Form 518, Michigan Business Taxes Registration Booklet, for further information.

If after reading this article you think you may be responsible for remitting sales or use tax, please consult a tax advisor knowledgeable in state tax laws.

* The leasing of tangible personal property, such as through SnapGoods, may create a tax liability in Michigan depending on the facts. The general rule is that lessors of tangible personal property can elect to either (1) pay sales or use tax on the full cost of the property at the time it is acquired, or (2) pay use tax on total rental receipts. MCL 205.95(4); Mich Admin Code, R 205.132(1). This means that if an individual pays sales tax when he purchases a lawnmower, he will not owe use tax if he later decides to lease the lawnmower.

Tax Exemption for Data Center Equipment

Effective January 1, 2016, 2015 PA 251 and 252 (the Acts), provide a new sales/use tax exemption for certain data center equipment sold to a qualified data center or colocated business for use in the operations of the qualified data center. The exemption also extends to data center equipment sold to a contractor if the equipment is affixed to or made a structural part of a qualified data center.

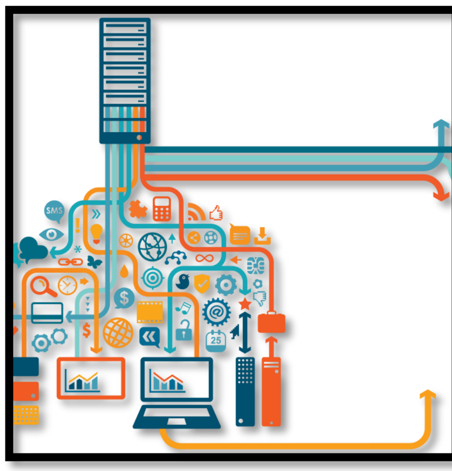
For example, an entity that sells or buys a server to be located in a qualified data center under a contract with the qualified data center will not be subject to sales or use tax on that server as long as the server is located in the data center. Similarly, a qualified data center is exempt from sales and use tax on servers it purchases for use in new data centers. The Acts are set to expire on December 31, 2035; however, they will expire sooner if certain job creation goals are not met by 2022 and 2026.

The Acts provide the following definitions of "data center equipment," "qualified data center," and "colocated business":

- "Data center equipment" is limited to computers, servers, routers, switches, peripheral computer devices, racks, shelving, cabling, wiring, storage batteries, back-up generators, uninterrupted power supply units, environmental control equipment, other redundant power supply equipment, prewritten computer software used in operating, managing, or maintaining the qualified data center or the business of the qualified data center or a colocated business, and construction materials used or assembled under the qualified data center's proprietary method for the construction or modification of a qualified data center.

- "Qualified data center" means a Michigan facility (only) that is owned and operated by an entity engaged in operating, managing, or maintaining networked computers/facilities for the purpose of centralizing the storage, processing, management, or dissemination of data of at least one person that is not an affiliate of the owner or operator of the qualified data center. The qualified data center must receive 75% or more of its revenue from unaffiliated colocated businesses to qualify for the exemption. An "affiliate" is a person that directly, or indirectly through one or more intermediaries, controls, is controlled by, or is under common control with a specified person.

- A "colocated business" is a person that has entered into a contract with the owner or operator of a qualified data center to use or deploy data center equipment physically located within the qualified data center for a period of 1 or more years.



Qualifying persons may claim the exemption when purchasing eligible data center equipment by providing a completed Michigan Sales and Use Tax Certificate of Exemption (Form 3372) to its seller. The purchaser, including contractors, must mark the box "Other" (Section 3, Line 11 of Form 3372) and fill in "Data Center" on the explanation line. Or, in lieu of an exemption certificate, the seller may obtain and retain other identifying information of the purchaser and the reason for claiming the exemption, in paper or electronic format.

To read the new laws, please refer to [2015 PA 251] and [2015 PA 252], which will be codified at MCL 205.54ee and MCL 205.95cc.

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

The Chicken or the Egg: *Ashley Capital* Determines Order of MBT Credits

"No, *you* back off! I was here before you!"

The Michigan Court of Appeals recently addressed an issue that, while facially technical, may significantly impact a taxpayer's ultimate liability under the Michigan Business Tax (MBT). In its November 10, 2015 decision in *Ashley Capital v Dep't of Treasury*, ___ Mich App ___ (2015), 2015 WL 6955187, the Court of Appeals held that in calculating tax liability under the MBT, the Department of Treasury was required to first apply the compensation and investment tax credits to the taxpayer's liability before applying unused carryforward amounts from the former Single Business Tax (SBT). The ruling was contrary to Treasury's interpretation of the order in which these MBT credits and SBT carryforwards were to be taken and the manner in which those items were to be claimed on MBT returns developed by Treasury.

Section 401 of the MBT Act permitted a taxpayer to claim against its MBT liability unused amounts carried forward from certain credits provided under the SBT. The opportunity to claim these carryforward amounts was limited to a taxpayer's 2008 and 2009 tax years; unused carryforwards after 2009 were extinguished.

In addition, section 403 of the MBT Act provided for a credit against MBT liability equal to a percentage of a taxpayer's compensation in Michigan for the tax year 2008 and each year thereafter. Section 403 also provided that a taxpayer may claim an investment tax credit (ITC) against MBT liability equal to a percentage of the cost of depreciable assets paid for the tax year 2008, net of recapture, and each year thereafter. The total combined credit that could be claimed under section 403 was limited to 50% of the taxpayer's tax liability for 2008 and 52% for 2009 and each year thereafter. Section 403 required that the credits provided under that section (i.e. the compensation credit and the ITC) be taken "before any other credit under this act." This key phrase was the focus of the Court of Appeals' decision in *Ashley Capital*.

Treasury had determined that the SBT carryforward amounts that could be claimed under section 401 were not "credits under this act," since they were created and claimed under the SBT, a different act. Consequently, Treasury argued that an MBT taxpayer was required to apply the SBT carryforwards against tax liability before claiming the compensation credit and ITC provided under section 403.

The order in which these carryforwards and credits are taken affects the amount of compensation credit and ITC a taxpayer is able to claim, and typically impacts a taxpayer's resulting ultimate MBT tax liability. Because the combined section 403 credit is capped as a percentage of tax liability calculated at the time the credit is taken, application of the SBT carryforwards prior to the application of the combined credit could reduce the amount of the compensation credit and/or ITC that the taxpayer could claim and, thus, result in a higher tax MBT tax liability than would otherwise result when that order is switched.

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The Court of Appeals concluded that the statutory language placed the combined compensation credit and ITC credit in a "super priority" position relative to all other credits that a taxpayer could take under the MBT. The Court ruled that the statute's requirement in section 403 that that credit be taken "before any other credit under this act" means that it must be taken before the SBT carryforwards as well as other MBT credits. The Court reasoned that while the carryforwards may have originated under the SBT, as of the effective date of the MBT, the SBT no longer existed and therefore, the carryforwards were governed by the MBT. The Court ruled that the carryforwards were credits "under" the MBT Act and, thus, would fall within that statutory prescription as to the ordering priority.

Although originally unpublished, the Court of Appeals approved the *Ashley Capital* decision for publication in January, rendering it precedential and binding on other matters. Accordingly, credits under section 403 are to be applied to MBT liability before the application of SBT carryforwards under section 401.

Treasury's New Acquiescence Policy

Not all court decisions have the effect of law. In particular, only published decisions of the Michigan Court of Appeals and all decisions of the Michigan Supreme Court become Michigan's "law of the land," and are therefore binding (have precedential effect) on both the Department of Treasury and taxpayers. Unpublished decisions of the Court of Appeals and decisions of the Court of Claims and the Michigan Tax Tribunal are binding only on the parties to the case and only with respect to the years and issues actually in litigation.

Even though a particular decision does not constitute precedent, it may nonetheless constitute persuasive authority in similar cases. Accordingly, when a court issues a decision that is adverse to Treasury, Treasury may determine to follow that decision even though it may not be required to do so. The policy of opting to follow a non-precedential court decision is generally known as "acquiescence." On the other hand, Treasury may also decline to follow an adverse, non-binding decision; this is known as "non-acquiescence."

At the federal level, the Internal Revenue Service (IRS) has a formal policy regarding acquiescence, pursuant to which it issues an "Action on Decision" announcing whether it will follow the holdings in certain non-binding, adverse cases. Treasury has determined to adopt a policy similar to that of the IRS with respect to such cases. Accordingly, beginning with the next quarterly newsletter (May 2016), Treasury will publish a list of final (unappealed), non-binding, adverse decisions, and announce its acquiescence or non-acquiescence with respect to each.

"Acquiescence" means that Treasury accepts the holding of the court in a case and will follow it in similar cases with the same controlling facts. "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.

New, Simplified Power of Attorney Form Now Available

In early November, the Department of Treasury unveiled a revised Authorized Representative Declaration (Power of Attorney) (ARD) form. The new ARD form incorporates a number of user-friendly changes and clarifications. Like older versions of the form, the new ARD form should be used by taxpayers to provide authorization to Treasury to communicate with a named individual or entity who has authority to act on the taxpayer's behalf. Unlike the previous form, however, the new ARD form can also be used by taxpayers to designate a representative to receive correspondence from Treasury regarding a particular, existing tax dispute. The form can also be used to revoke representative authority that was previously given.

The new, simplified ARD form is a single page. Taxpayers should take care to read the accompanying instructions, and to complete the new form properly. The form has a number of boxes labelled "required" – if these boxes are not completed with the required information, the form is considered invalid and will be rejected by Treasury; the taxpayer will then be notified of the rejection by letter.

A taxpayer may appoint either a specific individual or an entity (such as an accounting firm) as its representative. The differences between the two types of authority are explained in the instructions. If an entity is appointed, a "contact person" associated with that entity must also be named on the form. While the entity itself is the taxpayer's authorized representative, identifying a contact person ensures that information sent by Treasury to the entity is directed to the person overseeing the taxpayer's representation.

A taxpayer may grant its representative general or limited authority to act on its behalf. The specific actions that the representative may take on behalf of a taxpayer will depend on the boxes that are checked in Part 4 of the new ARD form. A taxpayer intending to grant its representative general authority to act on its behalf regarding any tax return and any debt should check box 5 in Part 4.

Part 5 of the form is completely new – this section permits a taxpayer to designate a representative to receive correspondence from Treasury regarding a particular existing tax dispute. Taxpayers should carefully read the instructions for completing Part 5. It is important to note that Part 5 cannot be used as a method of ensuring that a representative receives a "convenience copy" of every document or piece of correspondence that Treasury sends to the taxpayer. At this time, Treasury is not able to provide copies of all documents to a taxpayer's representative. A taxpayer completing Part 5 must therefore identify a single tax matter that is currently in dispute with Treasury. The dispute may cover more than one tax period or year (all of the years of a disputed audit, for example), but it must be a single dispute. If a taxpayer has several matters in dispute, and wants its representative to receive copies of future correspondence with respect to those additional disputes, a separate ARD form must be filled out for each dispute.

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Finally, filling out Part 5 alone does NOT give a representative authority to act on a taxpayer's behalf; one or more boxes in Part 4 must also be checked in order for that authority to be granted.

The new ARD form is available now on Treasury's website: [ARD Form]. Although the form is fillable, at this time the form cannot be submitted electronically; it must be faxed or mailed to Treasury as provided in the instructions.

Changes to Corporate Officer Liability

When a business fails to fully pay certain tax liabilities, its officers may be held personally liable for the debt. This is known as derivative liability or more commonly as "officer liability." The Revenue Act, specifically MCL 205.27a, sets forth procedures the Department of Treasury must follow when issuing an assessment for officer liability. In 2014 the Legislature passed 2014 PA 3 (PA 3) which made substantial changes to officer liability in Michigan. Treasury has replaced its former officer liability Revenue Administrative Bulletin (RAB 1989-38) with RAB 2015-23 to address these changes. RAB 2015-23 outlines the major changes made to officer liability by PA 3. Notably, the RAB discusses, among other topics, the following:

- The requirement to assess successors prior to assessing officers in certain circumstances;
- The tax types to which officer liability applies (notably, the Single Business Tax, the Michigan Business Tax and the Corporate Income Tax are no longer subject to officer liability);
- When and how an officer becomes a "responsible person" (and therefore liable for the business's tax debt), including a discussion of the new time period of default and willfulness requirements;
- The evidence that must be presented by Treasury to establish a *prima facie* case or *prima facie* evidence;
- An officer's ability to challenge the underlying assessment that was issued against the business;
- New disclosure requirements; and,
- Bankruptcy proceedings and receiverships

RAB 2015-23 is available on Treasury's website: [RAB 2015-23 Officer Liability].

Greg Gursky Appointed New Deputy State Treasurer for Tax Policy

Nick Khouri, State Treasurer, recently announced the appointment of Gregory Gursky as Deputy State Treasurer for Tax Policy. Most recently, Greg was the director of PricewaterhouseCoopers' State and Local Tax Group, where he was responsible for the management and oversight of all Michigan, state, and local tax issues. Prior to joining PricewaterhouseCoopers, Greg spent more than 30 years with General Motors, concluding his tenure there as Director of Property and Non-Income Taxes.

Greg's extensive experience with, and unique understanding of, Michigan tax policy makes him an outstanding choice for this new Deputy Treasurer position. Reporting to Greg will be the Bureau of Tax Policy, Legislative Affairs, and the Taxpayer Advocate.

Update: Repeal of the Multistate Tax Compact

Public Act 282 of 2014 (PA 282), enacted on September 10, 2014, retroactively repealed the Multistate Tax Compact (Compact) effective January 1, 2008, and, in doing so, extinguished any election that taxpayers may have had to apportion their income tax bases using the Compact's three-factor apportionment method in lieu of the method provided by state law. PA 282 was enacted in response to the Michigan Supreme Court's decision in *IBM v Dep't of Treasury* (July 14, 2014) which held that the Michigan Business Tax Act (MBTA) did not impliedly repeal the Compact's election provision. PA 282 expressly provided that it was intended to cure and clarify the original intent of the MBTA to extinguish the availability of three-factor apportionment under the Compact. In a published decision issued September 29, 2015 in *Gillette Commercial Operations N.A. v Dep't of Treasury*, a consolidated docket consisting of 50 cases involving the same issue, the Court of Appeals upheld the constitutionality and legal effect of PA 282.

The taxpayers in the consolidated *Gillette* case have sought leave to appeal the Court of Appeals' decisions to the Michigan Supreme Court. The parties are currently awaiting the Michigan Supreme Court's decision whether it will grant leave to appeal and review.

RECENTLY ISSUED GUIDANCE FROM TREASURY

REVENUE ADMINISTRATIVE BULLETINS:

Revenue Administrative Bulletin 2015-20 Corporate Income Tax — Where Benefit of Services is Received
Revenue Administrative Bulletin 2015-22 Sales and Use Tax Nexus Standards for Out-of-State Sellers
Revenue Administrative Bulletin 2015-23 Officer Liability
Revenue Administrative Bulletin 2015-25 Sales and Use Taxes — Lessors
Revenue Administrative Bulletin 2015-26 Revenue Act — Audits and the Statute of Limitations
Revenue Administrative Bulletin 2015-27 Sales and Use Tax Bad Debt Deduction
Revenue Administrative Bulletin 2016-2 Sales and Use Tax Treatment of Interstate Motor Carriers
Revenue Administrative Bulletin 2016-3 Income Tax — Treatment of Gambling Gains, Losses, and Expenses

OTHER GUIDANCE:

Notice to Taxpayers Regarding *Auto-Owners Insurance Company v Department of Treasury*
Notice: Appeal Extension When Taxpayer's Representative Was Not Provided Required Copy of Letter or Notice