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TREASURY EMPOWERED TO ENTER INTO QUALIFIED FUEL TAX RECIPROCITY AGREEMENTS WITH BORDERING IFTA JURISDICTIONS

With the enactment of Public Acts 24, 25, and 26 of 2022, Treasury is authorized to enter into reciprocal agreements with one or more International Fuel Tax Agreement ("IFTA") jurisdictions (that share a common border with Michigan) to provide exemption from IFTA tax payment, credentialing, and reporting obligations for certain motor carriers of raw forest products traveling no more than 30 air miles into the other jurisdiction. Without such an agreement, interstate operations would subject these motor carriers to these obligations. These public acts amend the Motor Carrier Fuel Tax Act ("MCFTA"), 1960 PA 124 ("PA 124"), and the Streamlined Sales and Use Tax Revenue Equalization Act, 2004 PA 175 ("PA 175"), as explained below.

2022 PA 25 amended PA 124 to grant sole authority to Treasury to enter into a "qualified fuel tax reciprocity agreement" that Treasury considers proper or expedient and in the interests of the people of the State of Michigan. Such an agreement would be limited to certain motor carriers operating qualified commercial motor vehicles carrying "raw forest products" to a sawmill or factory within 30 air miles of the Michigan border. The agreement would exempt those motor carriers from paying, reporting, or filing returns for taxes imposed by or subject to the IFTA, the MCFTA, or section 5 of PA 175, as well as exempting them from IFTA/MCFTA licensing, decal, permit, and credentialing requirements. "Raw forest products" are defined as logs, pilings, posts, poles, cordwood products, wood chips, sawdust, pulpwood, intermediary lumber, fuel wood, and Christmas trees, that are not altered by a manufacturing process off the land, sawmill, or factory from which they are taken and are not finished products suitable for sale at retail.

2022 PA 24 and 2022 PA 26 create exclusions from the use tax imposed under section 5 of PA 175, MCL 205.175, and the requirements under the MCFTA and IFTA, respectively, for motor carriers covered by a qualified fuel tax reciprocity agreement. The tax rate generally applicable to motor carriers under IFTA is a component of the use tax imposed under MCL 205.175 and the fuel tax rate prescribed under the MCFTA.

Notably, the exemptions provided for under these Public Acts are not self-executing, as they rely on the execution of a qualified fuel tax reciprocity agreement between Treasury and the other IFTA jurisdiction to bring those exemptions into effect.

IN THIS ISSUE

TAXPAYER THAT ELECTED TO FILE UNDER THE MBT ACT CANNOT CLAIM MBT BUSINESS LOSS CARRYFORWARDS ON CIT RETURNS

On February 18, 2022, the Court of Claims granted summary disposition in favor of Treasury in *International Automotive Components Group North America, Inc., v Dep't of Treasury*, Docket No. 21-000189-MT, holding the taxpayer could not deduct business losses on its 2019 Corporate Income Tax (CIT) return that were generated when it elected to file under the Michigan Business Tax Act (MBTA).

The taxpayer was awarded Michigan Economic Growth Authority (MEGA) credits under the MBTA beginning in the 2008 tax year. After the CIT was enacted in 2011, for tax years beginning after December 31, 2011, the taxpayer elected to continue to file under the MBT to claim its MEGA credit. This election, authorized by statute, allowed the taxpayer to file under the MBTA to "claim a certificated credit or any unused carryforward for that tax year . . . for each tax year thereafter until that certificated credit and any carryforward from that credit is used up." See MCL 208.1500(1) and MCL 206.680(1). This election required the taxpayer to calculate its MBT liability as the "greater of" MBT or CIT tax computed until the 2018 tax year, at which time the MEGA credits were exhausted. The taxpayer filed its first CIT return for the 2019 tax year and claimed a CIT business-loss carryforward.

Treasury issued a Notice of Refund Adjustment in December 2020 denying the taxpayer's claimed business-loss carryforward reported on its first CIT return. Treasury contended there was no business loss from a previous CIT return that could be carried forward since the taxpayer was filing under the MBTA and had not filed a CIT return for the previous year. After an informal conference before Treasury, the hearing referee recommended that the refund adjustment be upheld, because the taxpayer "could not generate CIT losses until it was filing CIT returns." Treasury accepted the informal conference recommendation in a July 9, 2021, decision and order. The taxpayer appealed Treasury's decision and order to the Court of Claims.

On appeal, the taxpayer alleged that it calculated both MBT and CIT business losses during the time it was paying the "greater of" tax and that it tracked the losses on the pertinent tax forms for the 2012-2018 tax years. The taxpayer asserted that the 2019 business loss carryforward simply reflected a loss that it had been tracking on its returns. The taxpayer argued that it effectively paid tax under both the CIT and the MBT during the years it made the "greater of" election, with the lesser tax being applied as a credit against the greater tax, and that since it paid both taxes, it could carryforward such business loss into its first CIT return.

Treasury argued the MBT and CIT are separate taxes and that taxpayers are not paying both taxes under the MBT election, rather they are merely required to compute tax liability according to the requirements of both acts and pay the greater determined amount as their liability under the MBT. Treasury argued further that the CIT does not provide for carrying forward MBT business losses into the CIT.

The Court of Claims agreed with Treasury, noting with respect to the MEGA credits that caused the taxpayer to make the election under the MBTA that the Legislature expressly provided for the preservation for tax credits while at the same time was silent on the preservation of business losses. The court said that the Legislature thus knew how to preserve the parts of the previous tax scheme upon transition to a new tax scheme it intended to keep, and that the "plain language of the acts reveals that the Legislature did not preserve preexisting losses in the transition from the MBTA to the CITA." The court also noted that the CIT's definition of "business loss" contemplated allocation and apportionment adjustments to be made under the CIT losses, and not losses under the MBT.

Finally, the court held that the taxpayer was not paying both taxes under its election. The court stated, in allowing taxpayers to make the "greater of" election, the MBTA states that the taxpayer is to calculate its liability "*as if* the taxpayer were subject" to the CIT. (Emphasis added). In other words, the MBTA confirms that a taxpayer is not actually subject to the CIT, but rather the taxpayer merely calculates its MBT tax liability as if it were subject to the CIT. The court noted that the CIT confirms this, as it provides that a taxpayer making the "greater of" election is not required to file a CIT return.

The taxpayer has appealed the Court of Claims' decision to the Michigan Court of Appeals.

COURT OF APPEALS AGREES EVIDENCE SUFFICIENT TO CLAIM HICAA DEDUCTION

In an unpublished opinion issued in *Priority Health v Dep't of Treasury* on April 14, 2022 (Docket No. 356769), the Michigan Court of Appeals affirmed the deductibility of pharmaceutical rebates received by an insurer under the Health Insurance Claims Assessment Act (HICAA).

The HICAA, repealed effective October 1, 2018, by 2018 PA 173, levied an assessment on insurance carriers and other organizations paying certain health insurance claims for Michigan residents. The annual HICAA assessment was levied on "paid claims" of these insurers, which was defined under Section 2(s) of the HICAA, in pertinent part, as:

> [A]ctual payments, *net of recoveries*, made to a health and medical services provider or reimbursed to an individual by a carrier, third party administrator, or excess loss or stop loss carrier. [Emphasis added.]

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Priority Health is a nonprofit health maintenance organization that provides insurance coverage for various healthcare services including, as relevant in this case, prescription drugs. For its prescription drug coverage during the years at issue, Priority Health contracted with third-party pharmacy benefit managers (PBMs) to administer their prescription drug benefits and manage rebates on prescription drugs. In determining its "paid claims" under the HICAA, Priority Health treated rebates received through these PBMs as a deductible "recovery" item. Upon audit, Treasury denied these deductions on the basis that a pharmacy rebate could not be a "recovery" because it did not actually reduce the underlying payment to the pharmacy dispensing the drug. This appeal followed.

In the initial proceedings on this matter, the Michigan Tax Tribunal interpreted the definition of "paid claims" under Section 2(s) of the HICAA and concluded that pharmaceutical rebates received through a PBM could, contrary to Treasury's position, constitute "recoveries" under the HICAA. However, because these pharmacy rebates were a deduction from "paid claims," the Tribunal further concluded that the claimant must prove entitlement to that deduction by establishing the rebate was linked to the claims payment. In this regard, because available deposition testimony at the time established that Priority Health did not have any such evidence, the Tribunal concluded that Priority Health had failed to provide evidence in support of its deduction and thereafter dismissed the case. The dismissal was appealed to the Michigan Court of Appeals which, although acknowledging that the evidence may not have been overwhelming, found there to be a sufficient factual basis for the matter to proceed to an evidentiary hearing. In an unpublished opinion entered on October 30, 2018 (Docket No. 341120), the Court of Appeals remanded the case back to the Tribunal to determine the extent by which, if any, Priority Health could link the pharmacy rebates to its claims payments.

In the remand hearing, Priority Health produced new information received from its PBMs which allowed for the production of spreadsheets and other information that purported to trace the pharmacy rebates to Priority Health's paid claims. Priority Health supported these spreadsheets by testimony from employees who explained how the new rebate data, filtering methodology, and other relevant information on the spreadsheets detailed the relationship between the pharmacy rebates and the underlying claims. While Treasury maintained Priority Health had not met its burden of proof because the spreadsheet information had been produced after-the-fact, had been previously filtered, and did not otherwise match up each rebate to each individual claim, the Tribunal rejected those arguments based on the totality of Priority Health's documentary and testimonial support.

On appeal, the Court of Appeals affirmed the Tribunal, rejecting Treasury's arguments and agreeing that the testimony and other evidence satisfied Priority Health's burden of demonstrating that the rebates were linked to the claims. As such, the Court of Appeals upheld the Tribunal's conclusion that the pharmacy rebates received by Priority Health were properly regarded as deductible "recoveries" under HICAA.

As of the time of publication of this article, Treasury has filed a motion for reconsideration with the Court of Appeals.

RECENTLY ISSUED GUIDANCE FROM TREASURY

Revenue Administrative Bulletins

RAB 2022-4 Sales and Use Tax – Food for Human Consumption (published 3/31/22)

Notices

- Reminder Notice: Flow-Through Entity Tax Payments Due by March 15, 2022, to Create a Member Income Tax Credit for the Tax Year 2021 (Issued March 2,2022)
- Notice: Flow-through Entity Tax Payments Delayed Due to MTO Registration Will Be Treated as Timely for Taxpayers Registered as of March 15, 2022 (Issued March 14, 2022)
- Notice to Taxpayers Regarding Income Tax Deduction for Income Attributed to Cancellation or Discharge of a Student Loan for Disabled Veteran (Issued March 14, 2022)
- Notice: First Time Home Buyer Savings Account Program (Issued May 19, 2022)

Statement of Acquiescence/Non-Acquiescence Regarding Certain Court Decisions

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

ACQUIESCENCE: No cases this quarter.

NON-ACQUIESCENCE: No cases this quarter.

MICHIGAN SUPREME COURT ASKS FOR ADDITIONAL BRIEFS IN AGRICULTURE EXEMPTION CASE

At issue in the matter of *TruGreen Limited Partnership v Dep't of Treasury* is whether certain personal property, such as fertilizers, herbicides, and insecticides, used by the taxpayer in the provision of lawn and plant care services qualifies for the "agricultural production" exemption in section 94(1)(f) of the Use Tax Act. The taxpayer is engaged in the business of caring for commercial and residential grass and plants. The taxpayer requested a refund of use tax paid on property used in its business asserting that it was entitled to the agricultural production exemption. In supporting its claim under the exemption, the taxpayer focused on the words "caring for… things of the soil" in the exemption. Treasury denied taxpayer's request based on reading the context within which those words resided in the statute, specifically noting that the remainder of the exemption language and its history indicate that it is only intended to apply to those persons producing agricultural or horticultural products.

The taxpayer appealed Treasury's refund denial, the appeal of which went through a series of remands to lower courts and subsequent appellate reviews, the history of which is discussed in the June 2020 and August 2021 issues of *Treasury Update*, which ultimately resulted in the Court of Appeals' July 29, 2021 decision reaffirming its earlier decision that the taxpayer was not entitled to the agricultural production exemption, based on the plain and contextual language of the statute.

On September 8, 2021, the taxpayer again sought leave to appeal to the Supreme Court. On April 1, 2022, the Supreme Court issued an order to schedule oral argument on the application for leave to appeal and directed the parties to file supplemental briefs addressing whether the taxpayer qualifies for the use tax exemption because its consumption or use of fertilizers, herbicides, and insecticides constitutes "caring for … things of the soil" under the exemption. Briefing has commenced and, as of this publication, oral argument has not yet been scheduled.

COURT OF CLAIMS AFFIRMS REFUND CLAIM REQUIREMENTS

The Revenue Act requires Treasury to pay interest on refund claims starting the later of 45 days after the refund claim is filed or 45 days after the date established by law for the filing of the return. In a recent Court of Claims case, *U.S. Steel Corp v Dep't of Treasury*, (Docket No. 21-000129-MT), the court held it was required to apply the criteria prescribed by the Michigan Supreme Court in *Ford Motor Co v Dep't of Treasury*, 496 Mich 382 (2014), to determine when the taxpayer made a proper claim for refund triggering the 45-day interest accrual period.

In *Ford*, the Michigan Supreme Court set forth three requirements a taxpayer must meet to trigger the accrual of interest on a refund claim: 1) pay the disputed tax, 2) make a "claim" or "petition" for a refund, and 3) "file" the claim or petition. The Court held that a refund claim need not take a specific form or even use the words "refund" or "claim" but must clearly and explicitly demand, request, or assert a right to a refund of tax payments to provide Treasury with adequate notice of the taxpayer's claim for refund.

In *U.S. Steel*, the taxpayer asserted that it had made a claim for refund of taxes paid under the Corporate Income Tax in an e-mail submitted to Treasury during an audit. The e-mail explained the taxpayer's legal position on whether a subsidiary was a foreign operating entity and implied that the subsidiary should be included in the taxpayer's unitary business group. The alleged implication from inclusion of the subsidiary in the unitary business group was a lower tax liability for the taxpayer. However, e-mail failed to assert that a lower tax liability would result or that it would result in an overpayment and failed to request any refund at all.

The Court of Claims held that the e-mail's implications were insufficient where the writing submitted to Treasury lacked a clear expression of a demand for refund or any expression of what that refund should be. Further, the court held that a demand for refund must be in writing, and rejected as insufficient the taxpayer's assertion that it had also requested a refund in a telephone call with Treasury's auditor. The court found that the taxpayer's letter requesting an informal conference before Treasury was the first time that the taxpayer stated that the inclusion of the subsidiary in the unitary business group meant that the taxpayer was entitled to a refund of tax previously paid to be an express demand for a refund to trigger the 45-day interest accrual period.

The court's opinion in *U.S. Steel* further elucidates the *Ford* requirements that to make a claim for refund and to file it means that a taxpayer may not merely imply that a refund is owed but must expressly in writing request one.

On April 18, 2022, the taxpayer appealed the Court of Claims decision to the Michigan Court of Appeals.

MICHIGAN SUPREME COURT ASKS FOR ADDITIONAL BRIEFS ON ALTERNATIVE APPORTIONMENT CASE

The Michigan Supreme Court announced in a March 23, 2022, order in *Vectren Infrastructure Svs Corp v Dep't of Treasury* (SC Docket No. 163742) that it will hold oral argument to decide whether to grant Treasury leave to appeal the Court of Appeals' September 30, 2021, decision, which held that using the statutory apportionment formula in the Michigan Business Tax Act (MBTA) – which the lower court and the Court of Appeals both held were properly applied by Treasury – violated the Due Process and Commerce Clauses in the U.S. Constitution. Background on this case and its extensive procedural history to this point can be found in the June 2020, August 2021 and November 2021 issues of the *Treasury Update*.

In its order, the Michigan Supreme Court directed the parties to brief three specific issues that it considers important on whether to grant leave to appeal: (1) whether the taxpayer established by clear and cogent evidence that "the business activity attributed to it in this state 'is out of all appropriate proportion to the actual business activity transacted in this state and leads to a grossly distorted result'" under section 309(3) of the MBTA; (2) whether application of the statutory formula in this case runs afoul of the Due Process and Commerce Clauses because it does not fairly determine the portion of income from the sale of a business attributed to in-state activities; and (3) whether remand for the parties to determine an alternate method of apportionment conflicts with section 309(2) of the MBTA, which vests exclusive authority to approve an alternate method of apportionment with Treasury.

Briefing is ongoing and, as of this publication, oral argument has not yet been scheduled.

COURT OF APPEALS AFFIRMS FREIGHT CHARGES MUST BE INCLUDED IN CONTRACT PRICE TO QUALIFY FOR MBT "PURCHASES FROM OTHER FIRMS" DEDUCTION

On April 14, 2022, the Michigan Court of Appeals issued a published decision in *Zug Island Fuels Company LLC V Dep't of Treasury* (Docket No. 356419) upholding the lower court's decision in favor of Treasury.

Zug Island addressed whether Treasury properly denied the taxpayer's claimed "purchases from other firms" deduction for freight costs associated with its coal purchases in determining its Michigan Business Tax (MBT) liability. The taxpayer purchased coal from its suppliers and contracted with third-party transportation companies for delivery. The auditor applied the following provision from the MBT definition of "purchases from other firms" in denying the deduction:

> MCL 208.1113(6) "Purchases from other firms" means all of the following:
>
> (a) Inventory acquired during the tax year, including freight, shipping, delivery, or engineering charges *included in the original contract price for that inventory*. [Italics added]

After an informal conference, Treasury issued final assessments reflecting the denial of the deduction as adjusted.

The taxpayer appealed the assessments to the Court of Claims based on the following grounds. First, construing the operative statutory language under the statutory construction canon of the "last antecedent rule," the taxpayer argued that the phrase "included in the original contract price for that inventory" applied only to "engineering charges" and not to the terms "freight," "shipping," or "delivery." The taxpayer thus argued that only "engineering charges" are required to be included in the contract price, and freight, shipping, and delivery charges automatically qualify for the deduction, even if paid to a third party. Second, the taxpayer asserted that the freight charges at issue were included in the taxpayer's coal contracts. Finally, the taxpayer contended that the taxpayer and a related company were similarly situated and should have received the same treatment (i.e., a deduction) pursuant to the equal protection clause.

The court found for Treasury on all three claims. First, the court disagreed that the last antecedent rule applied in this case, reasoning that when construed as a whole and in context, the statutory language clearly requires eligible freight charges to be included in the contract price. In reaching this conclusion, the court found it significant that the provision at subsection 113(6)(a) of the MBT, MCL 208.1113(6)(a), is both an "inventory" deduction and a "purchases from other firms" deduction. Thus, the court held, "[r]equiring that freight, shipping, delivery, or engineering charges be 'included in the original contract price' ensures that the freight, shipping, delivery, or engineering charges are in fact part of the taxpayer's 'purchase' of inventory from another firm, as opposed to separate charges apart from the purchase of inventory from another firm."

Second, the court found the taxpayer's contracts did not include freight charges in the contract price as required by the statutory language. While the contracts mentioned freight and indicated that the taxpayer "made its coal purchases with freight costs in mind," the court noted, "it is not enough for plaintiff to merely be aware of freight

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costs or for its purchase agreements to mention, as an ancillary matter, the concept of freight. MCL 208.1113(6)(a) demands that the freight charges be 'included in the original contract price' for the inventory."

Finally, the court found that there was no equal protection violation.

The taxpayer appealed the decision to the Court of Appeals based on arguments one and two above but dropped its equal protection challenge.

The Court of Appeals rejected the taxpayer's claims. First, it held the taxpayer's argument that the delivery charges were included by reference in the original contract price of the coal lacked merit:

> We find that the language of MCL 208.1113(6)(a) is plain and unambiguous and must be applied as written without the need to resort to common canons of construction to aid in the interpretation. We conclude that for delivery charges on inventory to be encompassed by the inventory deduction, (1) the charges had to have been included in the same contract covering the acquisition of the inventory and (2) the price paid under that contract had to have been for the inventory itself and for the cost of delivering that inventory to the purchaser or acquirer.
>
> … Simply put, the price paid by [the taxpayer] pursuant to the contracts with coal suppliers had to have covered the delivery of the coal being purchased under the contracts. And the coal contracts presented to the trial court did not fit within that framework for purposes of MCL 208.1113(6)(a).

Second, the Court of Appeals found that it was not necessary to resort to canons of construction such as the "last antecedent rule" because the applicable statutory language was not ambiguous. The Court of Appeals stated:

> The terms "freight," "shipping," "delivery," and "engineering" are quite clearly used as separate adjectives modifying or describing the plural noun "charges"; they cannot logically stand on their own and make sense in the context of the statutory definition. And the phrase, "included in the original contract price," plainly modifies the term "charges" and all that it entails. Accordingly, the phrase, "included in the original contract price," applies to or modifies each and every one of the four types of charges described in MCL 208.1113(6)(a). No further construction is necessary or allowed.

The taxpayer has filed an application for leave to appeal the Court of Appeals decision to the Michigan Supreme Court.

ABOUT TREASURY UPDATE

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