Michigan Department of
TREASURY UPDATE

May 2024

Published by the Tax Policy Division of the Michigan Department of Treasury

CANNARBOR: TREASURY PREVAILS IN MARIHUANA TAX CASE

The Department of Treasury prevailed in two challenges relating to the taxation of medical marihuana in the consolidated case *Cannarbor v Treasury*. Both challenges were brought in the Court of Claims by Cannarbor, an Ann Arbor–based company that sells marihuana. One challenge involved whether sales tax applied to sales Cannarbor made while it lacked a license under the Medical Marihuana Facilities Licensing Act (MMFLA). The other challenge addressed whether Cannarbor was entitled to a business-expense deduction from income tax under the Michigan Regulation and Taxation of Marihuana Act (MRTMA) for its medical-marihuana sales.

On November 16, 2023, the Court of Claims Judge Swartzle resolved nearly all issues for the Department of Treasury, in separate opinions. The sales-tax issue was resolved entirely in Treasury's favor. The deduction issue was also resolved in Treasury's favor; the court left unresolved an issue relating to an "add-back" to Cannarbor's tax base.

Sales Tax Matter

The Michigan Medical Marihuana Act (MMMA), which became law in 2008, lets patients with certain medical conditions cultivate, possess, and use marihuana. It also lets a patient get marihuana from a so-called "caregiver" (aka "primary caregiver" and, if registered, "registered primary caregiver"), an individual (not a corporate entity) who may cultivate marihuana and give it to up to five patients. Caregivers may "receive compensation for costs associated with assisting" a patient, but under the MMMA that compensation does not make a caregiver patient exchange a "sale." For that reason, Treasury has not considered those exchanges subject to sales tax. As Treasury expressed in a 2011 letter offering informal advice, the MMMA "re-characterizes what might otherwise be a taxable sale of tangible personal property as a non-taxable caregiver service."

In 2016, with the passage of the MMFLA, "provisioning centers" joined caregivers as sources of medical marihuana for patients. A "provisioning center" includes a medical-marihuana retailer that holds a license under the act, but the act does not stop a retailer from operating without a license. In other words, the act doesn't consider an unlicensed retailer to be a "provisioning center," but, like a provisioning center, it would make retail sales to patients.

During 2017, Cannarbor sold marihuana at retail without a license; in 2018, it acquired a license and became a "provisioning center." Treasury audited Cannarbor for tax years 2017–2020, a period straddling Cannarbor's licensure and thus including both unlicensed and licensed operation. The audit determined that Cannarbor owed sales tax on unlicensed sales.

Cannarbor fought its liability for unlicensed sales, arguing that it did not make sales; instead, pointing to Treasury's 2011 letter, it characterized itself as performing a "non-taxable caregiver service." In the alternative, Cannarbor argued that it engaged in bundled transactions that should be considered

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services under *Catalina Marketing Sales v Treasury*. In support, Cannarbor asserted that its customers pay not only for marihuana products but also for advice and recommendations.

After an informal conference yielded no relief, Cannarbor sued Treasury, arguing that its right to equal protection was violated when the state treated its conduct differently from caregivers' conduct and that its conduct should be considered the provision of a service under *Catalina*. The parties cross-moved for summary disposition. Treasury argued that the Legislature had a rational basis to distinguish between a caregiver and a provisioning center and that *Catalina's* test for bundled transactions does not apply. Treasury prevailed across the board.

To begin, the court explained that the General Sales Tax Act applies generally to tangible personal property; as the parties agreed, marihuana is tangible personal property and thus taxable without a lawful exemption. The MMMA exempts caregivers insofar as they accept compensation for costs from no more than five patients. In contrast, the MMFLA permits profits and doesn't limit business volume. The parties agreed that Cannarbor is not a caregiver, yet Cannarbor urged the court to consider that it offers "assistance" services similar to a caregiver's. The court declined, explaining that the MMFLA contemplated "commercial entities where marijuana would be sold at retail," which accurately described Cannarbor's operation, regardless of whether Cannarbor had a license.

The court then turned to Cannarbor's claim that the state's different treatment of caregivers and provisioning centers lacks a rational basis and thus violates its right to equal protection. Here, the differences are manifest. Caregivers assist up to five patients each and may accept compensation for costs but not profit; they don't make sales. Provisioning centers are "for-profit operations that sell marijuana at retail"; they have no legally prescribed "assistance" role. Because caregivers and provisioning centers are not similar, they are not entitled to similar treatment under the law.

Nor did *Catalina* get any traction. In *Catalina*, the court developed a test to resolve the nature—service or retail sale—of a "bundled transaction," a single transaction involving both the provision of a nontaxable service and the transfer of tangible personal property. Identifying a transaction's nature is important because, in general, services are not taxable and retail sales are. So if *Catalina's* test characterizes Cannarbor's bundled transactions as nontaxable services, then sales tax doesn't apply. But here, the statutes already characterize the transactions at issue: the MMMA contemplates services, and the MMFLA contemplates retail sales. It follows that *Catalina* has no role to play.

The court also addressed Cannarbor's assertion that it reasonably relied on Treasury's 2011 letter in believing that an exchange of marihuana for money is a service, not a sale. Under the Revenue Act, taxpayers may rely on Treasury's statements in "letter rulings" and "revenue administrative bulletins." The 2011 letter is neither of those. But more important, the letter's content doesn't support Cannarbor's belief that exchange of marihuana for money is a service. Instead, "all that can be gleaned from the letter is that registered primary caregivers are not subject to sales tax." The letter said nothing on which Cannarbor "could have reasonably relied to formulate its interpretation of its sales-tax obligations."

CIT Business Expense Deduction Matter

The primary issue in the second matter ruled on by the court was whether the state income tax deduction for ordinary and necessary business expenses available to "marihuana establishments" under the MRTMA is also available to medical-marihuana provisioning centers licensed under the MMFLA. Cannarbor took the expense deduction on its CIT returns for all of the income from its retail marihuana sales, both medical and adult-use, for the years 2018, 2019, and 2020. The deduction with respect to income from the provisioning center, which sold medical marihuana, was disallowed at audit, because Treasury maintained that the deduction was available only to adult-use marihuana establishments licensed under the MRTMA. Cannarbor appealed the resulting assessments to the court, arguing that the business-expense deduction also applies to medical-marihuana provisioning centers, because provisioning centers fall within the literal definition of "marihuana establishment" set forth in the MRTMA. Cannarbor also alleged that Treasury violated its equal-protection rights by treating medical-marihuana facilities differently than adult-use facilities. Cannarbor further challenged an unrelated add-back to income adjustment made at audit.

Cannarbor moved for summary disposition on both issues, and Treasury responded by moving for partial summary disposition on the statutory-interpretation issue only. Cannarbor argued that the MRTMA defines "marihuana establishment" to mean, among other things, "any other type of marihuana related business licensed" by the Cannabis Regulatory Agency (CRA), and because the provisioning center operated by Cannarbor is licensed by the CRA, it falls within this definition. Treasury argued that the MRTMA and the MMFLA regulate different marihuana-related entities, impose different requirements, and contemplate separate tax schemes. If provisioning centers were also "marihuana establishments" under the MRTMA, Treasury reasoned, they would be entitled to the business expense deduction, but they would also be subject to all of the other requirements and regulations applicable to "marihuana establishments" under the MRTMA. This would lead to absurd results, such as subjecting medical-marihuana establishments to the MRTMA's security requirements as well as the MRTMA's 10% excise tax on retail marihuana sales. Treasury further argued that provisioning centers and adult-use facilities are not similarly situated, and there is a rational basis for treating the two entities differently. Finally, Treasury maintained that summary disposition was inappropriate on the add-back issue, because questions of fact remained.

The court granted Treasury's motion for partial summary disposition, and denied Cannarbor's summary-disposition motion.

In its Opinion and Order, the court noted first that the focus of the MRTMA is on the regulation of recreational marihuana use, while the focus of the MMFLA is on regulating medical-marihuana facilities. It then agreed that, read in isolation, the definition of "marihuana establishment" set forth in the MRTMA supports Cannarbor's position because, as a medical-marihuana provisioning center, Cannarbor falls within the catchall clause, "any

other type of marihuana-related business" licensed by the CRA. Citing case law holding that a statute must be interpreted in light of the overall statutory scheme, the court determined, however, that the definition of "marihuana establishment" must be read in context and "viewed through the lens of the entire MRTMA." The court explained that the stated purposes of the MRTMA do not include regulation of medical marihuana, and the other types of entities included in the statutory definition of "marihuana establishment" are defined in the same section of the statute, suggesting that the definition is meant to apply only to entities regulated by the MRTMA. Moreover, the MRTMA's drafters explicitly referenced the MMFLA elsewhere in the statute, and the fact that they did not do so here supported Treasury's position that medical-marihuana facilities were also not intended to be included in the definitional catchall. Finally, the court observed that other provisions of the MRTMA reveal that it was not intended that provisioning centers would be subject to that statute's requirements and restrictions, including the MRTMA's transfer restrictions, security requirements, and taxing scheme. The court concluded that, based on the plain language of the MRTMA as a whole, "the expense deduction permitted under the MRTMA does not apply to provisioning centers licensed under the MMFLA."

Additionally, the court found that Cannarbor's equal protection claim lacked merit because adult-use and medical-marihuana facilities are not in the same tax position, and Treasury therefore had a rational basis for treating the two types of entities differently. The court further concluded that questions of fact precluded summary disposition on the unrelated add-back issue.

Current Status

As explained above, the Court of Claims' two opinions do not resolve all the issues in this case because the add-back adjustment issue has not yet been resolved. Accordingly, on December 18, 2023, the Court of Appeals denied Cannarbor's claim of appeal as of right for lack of jurisdiction. The appellate court noted that its dismissal was without prejudice to the timely filing of an application for leave to appeal, or the timely filing of a claim of appeal after a final order has been entered in the consolidated case.

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RECENTLY ISSUED GUIDANCE FROM TREASURY

Revenue Administrative Bulletins

RAB 2023-24 Sales and Use Tax Refund Procedure, Approved December 19, 2023

RAB 2023-25 Taxation of Adult-Use (Recreational) Marihuana Under the Michigan Regulation and Taxation of Marihuana Act, Approved December 19, 2023

RAB 2023-26 Sales and Use Tax Sourcing, Approved December 26, 2023

Notices

- **Notice Regarding Changes to the Tax Treatment of "Prepared Food",** Issued January 25, 2024
- **Sales and Use Tax Exemption for Firearm Safety Devices to Take Effect May 13, 2024,** Issued February 14, 2024
- **4.25% Income Tax Rate for Individuals and Fiduciaries in 2024 Tax Year,** Issued February 28, 2024
- **Court of Appeals Concludes Reduction to Income Tax Rate for Tax Year 2023 Was Temporary,** Issued March 7, 2024
- **4.25% Tax Rate for Flow-Through Entity Tax Years Beginning in 2024,** Issued March 20, 2024
- **Extensions for Income Tax Returns and Payments Due to Federal Disaster Declaration in Certain Michigan Counties,** Issued March 5, 2024
- **Notice Regarding Forms Submission Deadline Beginning in 2024 for Bottle Deposit Dealer Disbursements**, Issued April 1, 2024
- **Homestead Property Tax Credit and Adjacent and Contiguous Property**, Issued April 17, 2024

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 nonacquiescence 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: None this quarter.

NON-ACQUIESCENCE: None this quarter

CARD SURCHARGE SUBJECT TO SALES TAX

When a seller accepts payment by credit card, it pays a small fee, a percentage of the payment, to a payment processor like Visa or Mastercard. So, for example, if a restaurant charge of $50 is paid by credit card, after the payment processor takes its fee, say $1, the restaurant gets the balance of $49. In an isolated transaction, the processor's fee lowers the seller's receipts; but sellers may nonetheless benefit when they accept convenient payment methods. In other words, the fees can be viewed as a cost of doing business.

But more and more sellers are passing that cost on to purchasers. Thus, if the restaurant above passed along the fee, the $50 charge turns into a $51 charge as the $1 payment-processing fee, also called a "surcharge," is added to the bill. (To be clear, a purchaser paying with cash would pay only $50.)

This isn't just a case study in business decision-making; it also leads to a question about the sales-tax treatment of the credit-card surcharge—that is, whether a credit-card surcharge is subject to sales tax. As explained below, Treasury answers "yes."

The General Sales Tax Act imposes on sellers a 6% tax on "gross proceeds" aka "sales price." See MCL 205.51(1)(c); MCL 205.52(1). The tax base on a transaction thus is the "sales price," defined broadly to include "the total amount of consideration ... for which tangible personal property or services are sold ... valued in money." MCL 205.51(1)(d). To clarify, the statute adds that the sales price includes "service cost[s] ... and any other expense of the seller." MCL 205.51(1)(d)(ii).

Under that definition of "sales price," whether the surcharge is taxable depends on whether it is a "service cost" or "any other expense of the seller." A payment processor provides a financial service for the seller for which it imposes a fee on the seller. Since that fee represents a cost or expense for which the seller is responsible, the fee is fairly characterized as a "service cost" or an "expense of the seller." Thus, the fee is part of the sales price and thus part of the tax base. For these reasons, Treasury concludes that the credit-card surcharge is part of the sales price as a "service cost" or "any other expense of the seller."

Sellers employing credit-card surcharges on purchasers should make sure that they remit tax on the surcharges.

COURT OF CLAIMS FINDS TAXPAYER FAILED TO SATISFY ESCROW REQUIREMENTS OF THE REVENUE ACT AND FAILED TO SHOW THAT THE FAIR MARKET VALUE OF THE ACQUIRED ASSETS WAS SUBSTANTIALLY LESS THAN THE AGREED UPON PRICE

In *Beacon Park Finishing, LLC v Michigan Department of Treasury,* Case No. 22-000022-MT (December 12, 2023), the Court of Claims decided a successor liability case in favor of Treasury, holding that the purchaser failed to meet the escrow requirements of MCL 205.27a(1) and that it had also failed to present evidence that the fair market value of the assets it acquired was substantially less than the price set forth in its agreement with the seller.

Howard Finishing, LLC, (HF) agreed to sell approximately 40% of its assets to Beacon Park Finishing, LLC, (BPF) for $464,000. BPF held $250,000 of the purchase price in escrow to satisfy any indemnification issues. BPF's principal alleged that at the time of the sale, HF's principal represented that all outstanding tax liabilities had been satisfied. This assertion, if made, was untrue. HF owed Treasury outstanding taxes. Moreover, the existence of the liability had been disclosed on an attachment to the purchase agreement.

Immediately following the sale, BPF allegedly discovered that HF had misrepresented the condition of the assets it sold and that it (BPF) had lost substantial sums of money as a result. BPF refused to pay HF the $250,000 holdback amount, and HF sued BPF in Macomb County Circuit Court. The case settled with BPF retaining the $250,000 holdback.

Neither HF nor BPF sought a tax clearance from Treasury before proceeding with their agreement.

Treasury assessed BPF, as successor to HF, the price set forth in the purchase agreement, $464,000. BPF filed suit in the Court of Claims, arguing that it had met its obligation to escrow funds, that it was not liable for HF's unpaid taxes, that Treasury was required to collect the liability from HF and its principals, and that the assessment was excessive because it exceeded the fair market value of the business. Following discovery, Treasury moved for summary disposition on liability and valuation.

BPF defended the motion on the grounds that it had substantially complied with the statute and that it had been victimized by the misrepresentations of HF. The Court observed that compliance meant meeting the requirements of the statute, that there was no legitimate defense of "substantial compliance," and that the only way to comply under the circumstances was to escrow the purchase price until HF or Treasury produced a tax clearance certificate. Despite the amount of the unpaid taxes having been included as an exhibit to the purchase agreement, BPF had proceeded with the purchase without demanding to see a clearance certificate. The Court also rejected BPF's contention that Treasury was required to collect from HF or its principals pursuant to MCL 205.27a(5), because now, BPF, having failed to meet the escrow requirements, was the "business liable for taxes."

Regarding the "fair market value" limitation on the amount Treasury may assess a successor per MCL 205.27a(1), the Court ultimately held that BPF had failed to offer any evidence to prove a fair market value lower than the $464,000 price set forth in the purchase agreement. However, the Court agreed with Treasury that the assessment should be reduced by an amount due to a secured interest superior to Treasury's lien.

AUDITS OF SINGLE ENTITY TAXPAYERS THAT SHOULD HAVE FILED A COMBINED RETURN DOES NOT EXTEND STATUTE OF LIMITATIONS FOR THE LATE UNITARY FILING

In this MBT case, *Anthony L. Soave and Unitary Affiliates v Department of Treasury,* the central question was whether an audit of the tax returns of single entity taxpayers who are later included in an untimely unitary business group (UBG) return filing extends the statute of limitations for the UBG to request a refund. Anthony Soave ("taxpayer") owned a number of affiliated companies during the MBT audit years but did not treat those companies as members of a UBG when filing tax returns. When some of the entities that the taxpayer owned, which had originally filed returns as separate entities, were selected for a desk audit and found to owe additional tax due to the denial of the small business alternative credit, the taxpayer and his tax director concluded that he should have been filing as the designated member of a UBG on behalf of his many companies.

Thereafter, the taxpayer filed UBG combined returns for the 2008 and 2009 tax years for the first time in October 2014 and for the 2010 and 2011 tax years for the first time in November 2014. The Department rejected the UBG's 2008 and 2009 returns as untimely, and he appealed those tax years to the Court of Claims.

The taxpayer on behalf of the UBG asserted that because a UBG is the sum of all its members, an audit of one member extends the statute of limitations for the UBG. The Court of Claims disagreed. Reasoning that resolution of the issue depended on whether a UBG and its member entities were one and the same under the MBT, the Court determined that the MBT's definition of taxpayer as a person or a unitary business group distinguishes the UBG as a separate taxpayer from its constituent members for purposes of tax filing. Therefore, an audit of single entity taxpayers could not extend the statute of limitations as to the UBG. The Court denied reconsideration and the UBG appealed.

In a November 30, 2023, opinion, approved for publication on January 4, 2024, and therefore binding, the Court of Appeals affirmed the Court of Claims. The Court of Appeals concluded that under the MBT a UBG is a separate taxpayer from its constituent members and that a UBG return filing is mandatory, not elective, a conclusion the Court noted was uncontested by the taxpayer. Given the taxpayer's concession that a UBG return should have been filed, the Court rejected the paradoxical argument that the audit of the single entity returns which should never have been filed should toll the statute of limitations for the filing of UBG returns that should have been filed but were not. The Court concluded that there was no legal basis for the claim that a pending audit for a single member of a UBG extends the statute of limitations for the entire UBG.

Taking the analysis one step further, the Court held that even if the filing of both the individual and UBG returns were proper, tolling of one set of returns could not support a basis to extend or toll the statute for the other taxpayer's returns. And even if an extension were applicable, it would only apply as to those items that were the subject of the audit. With respect to this holding, the taxpayer had argued that the subject of the audit was in part to determine whether the single member entities should have filed as a UBG.

The Court rejected this argument, reasoning that the UBG returns, which did not even exist when the audit began, could not have been the subject of the audit of the individual entities; nor were the individual entities being audited to determine whether a UBG return should have been filed instead. The Court concluded that "at best, information revealed during the audit may have led to the discovery that the individual entities were part of a larger UBG that should have been the taxpayer filing a return, but that does not . . . somehow bring the UBG within the scope of the audit. . . . Rather, it merely revealed a case of a failure to file a tax return."

The taxpayer also argued that purported extensions of the filing deadlines for some of the entities that comprised the UBG extended the statute of limitations for not only those entities but also for the UBG. The Court of Appeals rejected this argument and concluded, as did the Court of Claims, that: 1) the taxpayer failed to provide evidence that the member entities received federal income tax extensions or that they complied with the requirements for a Michigan extension and 2) even if an extension of the federal filing deadline for the individual entities was established, there is no legal basis for extending that to a different taxpayer's (the UBG's) state tax return.

Lastly, the Court rejected as unpersuasive and irrelevant the taxpayer's assertion that the Department's policies as applied to its voluntary disclosure program should somehow control the issue presented in this case. Instead, the Court held that it was the taxpayer's obligation to determine whether a UBG return should have been filed and to timely file it, and any refund lost was not the result of the Department's actions, but of the UBG's failure to recognize its obligation to file a UBG return and to do so in a timely manner.

ABOUT TREASURY UPDATE

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COURT OF APPEALS AFFIRMS — 4.05% INDIVIDUAL INCOME TAX RATE FOR TAX YEAR 2023 IS TEMPORARY

Associated Builders and Contractors of Michigan v Eubanks involves the determination of the income tax rate under Section 51 of the Income Tax Act, MCL 206.51. Section 51(1)(b) imposes a 4.25% income tax rate effective beginning October 1, 2012. Beginning with the 2023 tax year, that rate may be subject to a special formulary reduction under Section 51(1)(c) if certain economic conditions are triggered. The formulary reduction under subsection (1)(c) was triggered for tax year 2023, resulting in a reduction to the income tax rate from 4.25% to 4.05%. An opinion of the Attorney General concluded the rate reduction was temporary (No. 7320) and therefore Treasury announced that the 4.05% rate would be effective only for the 2023 tax year. This announcement prompted a group of plaintiffs — state legislators, business advocacy groups, and individual taxpayers — to file a lawsuit seeking to compel the Treasurer to apply the 4.05% rate permanently. In a pair of recent opinions, the Michigan Court of Claims and Michigan Court of Appeals agreed that the 4.05% income tax rate as adjusted under subsection (1)(c) is temporary.

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SCOPE OF SALES AND USE TAX EXEMPTION FOR SALES OF FEMININE HYGIENE PRODUCTS

In February 2022, legislation took effect that exempted sales of "feminine hygiene products" from Michigan's sales and use taxes. The legislation defines the exempted products as "tampons, panty liners, menstrual cups, sanitary napkins, and other similar tangible personal property designed for feminine hygiene in connection with the human menstrual cycle." Since the exemption took effect, certain so-called "period-proof" clothing items have become popular in the marketplace. Retailers have indicated uncertainty whether these items – specifically, period underwear, period swimwear, and similar products – are covered by the statutory exemption. To address any uncertainty, this article will provide information on the overall scope of the sales and use tax exemption for "feminine hygiene products," as well as explain why period underwear, period swimwear, and similar products are exempt from Michigan's sales and use taxes as "feminine hygiene products."

Although Michigan's statutory definition of exempted "feminine hygiene products" includes, in addition to the listed items, "other similar tangible personal property," there is no indication in the statute what is meant by "similar" products, and no mention of products or types of products that are specifically excluded from the definition. Treasury has previously provided guidance to taxpayers (see Notice to Taxpayers dated December 14, 2021) regarding the phrase "similar tangible personal property," interpreting that language to include products that are sold at retail and designed specifically to catch menstrual flow, either internally or externally.

Period-proof clothing items, including period underwear and period swimwear, are described as relatively new menstrual blood absorption products; they are garments that eliminate the need for a sanitary pad. Period underwear looks like regular underwear but is designed to absorb menstrual blood and keep moisture away from the wearer's skin. Period swimwear is similar to period underwear, but with an additional waterproof layer that keeps the wearer dry. Period underwear and period swimwear are made by numerous companies and are sold at retail (i.e., they are not prescribed by a physician or dispensed by a pharmacy). While they function as clothing, these products are specifically designed to catch and absorb menstrual flow externally, eliminating the need for a sanitary pad. Additionally, these products are different from the types of grooming and cleansing products that Treasury has stated are excluded from "similar tangible personal property," such as feminine sprays, powders, creams and ointments, as well as douches and cleansing wipes. Accordingly, period-proof clothing items such as period underwear and period swimwear fall within Michigan's statutory definition of "feminine hygiene products," and these products are therefore exempt from Michigan's sales and use taxes.

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Michigan Court of Claims

The Michigan Court of Claims issued its opinion on December 21, 2023. The opinion first addressed whether it was appropriate for the Court to consider the merits of plaintiffs' claims under the doctrines of standing (i.e., the legal capacity for someone to sue) and ripeness (i.e., the identification of an existing injury for the court to adjudicate). The Court found that state legislators and business advocacy groups lacked standing to sue the Treasurer over the interpretation of an income tax statute because neither group could identify a legally protected interest or specialized injury. Although individual taxpayers did have an interest sufficient to create standing, their claims were unripe insofar as none of these taxpayers had been assessed tax, paid tax, or had tax withheld at the 2024 tax rate. In fact, at that time the 2024 tax rate had not yet even been determined. Accordingly, the Court held that plaintiffs had collectively failed to assert justiciable claims.

Acknowledging that the claims would likely become ripe in the future, the Court nevertheless proceeded to the merits of whether the rate adjustment under subsection (1)(c) is temporary. Interpreting the plain language of Section 51, the Court noted the 4.25% rate established under subsection (1)(b) applies "[e]xcept as otherwise provided in subdivision (c)." In that regard, the formulary rate reduction in subsection (1)(c) must be considered "for each tax year," with the resulting rate reduction applicable only "if" certain triggering economic conditions are met. Reading those two subsections together, the Court found that subsection (1)(b) creates a default income tax rate that applies each tax year (i.e., 4.25%), unless the conditional provisions within subsection (1)(c) are triggered. In other words, the rate reduction under subsection (1)(c) is temporary. Such a construction is particularly compelling given the event triggering the reduction is likewise based on a temporary economic condition. Based on the plain language of Section 51, therefore, the Court of Claims found in favor of the Treasurer and concluded that the 4.05% tax rate is effective only for the 2023 tax year.

Michigan Court of Appeals

Plaintiffs appealed. In doing so, plaintiffs sought to bypass the Michigan Court of Appeals and have the appeal heard directly by the Michigan Supreme Court. The bypass application was denied; however, the Michigan Supreme Court instead ordered the Court of Appeals to consider arguments and issue a decision no later than March 11, 2024. After further briefing, the Court of Appeals issued a published opinion on March 7, 2024, affirming the Court of Claims.

Like the Court of Claims, the Court of Appeals first considered whether it could reach the merits of plaintiffs' claims. Applying the doctrine of standing, the Court found that a decision on the merits would be appropriate as long as at least one plaintiff had standing to sue the Treasurer. The Court found that the standing of individual taxpayers was not contested; therefore, standing for all plaintiffs was established without the need to address the standing arguments of the state legislators and advocacy groups. Similarly, the Court found the claims of the individual taxpayers had also become ripe during the appeal. The 2024 tax rate was announced after publication of the Court of Claims opinion so that the claims were no longer based on a future and unknown tax rate. Thus, the Court of Appeals held that it was appropriate to proceed to the merits.

On the merits, the Court generally adopted the same statutory analysis as the Court of Claims — that is, when considering Section 51 as a whole and all relevant terms in context, the default income tax rate each year is 4.25% under Subsection (1)(b), subject to the exception in Subsection (1)(c) if certain conditions are triggered. In reaching that conclusion, the Court considered the meaning of the reduction to the "current rate" in subsection (1)(c). When read in context, the Court found the "current rate" merely refers to the 4.25% default tax rate otherwise in effect under subsection (1)(b). The Court held the text did not support the claim that the reference to the "current rate" results in a new rate applicable to future tax years — not only is there no other language within subsection (1)(c) to that effect, but such a result would be inconsistent when placed in a conditional subsection that is operative only if certain conditions are triggered. More importantly, the Court found that permanent and compounding reductions to the rate could potentially reduce the rate to zero, thus rendering the statutory provisions levying an income tax as nugatory. For all of these reasons, the Court held that the plain and unambiguous language of Section 51 results in a reduction to the income tax rate under subsection (1)(c) that is temporary and effective for one tax year only.

The Court of Appeals therefore affirmed the Court of Claims and concluded that the 4.05% income tax rate as determined under subsection (1)(c) is effective for the 2023 tax year only. Under Section 51, the tax rate reverts to the 4.25% default rate under subsection (1)(b) each year, beginning with tax year 2024. Because it has been determined that a rate reduction under subsection (1)(c) has not been triggered for the 2024 tax year, the income tax rate effective under Section 51 for tax years that begin in 2024 is 4.25%.

On March 25, 2024, plaintiffs filed an application for leave to the Michigan Supreme Court.