

Michigan Department of TREASURY UPDATE

September 2023

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

REVISIONS TO MICHIGAN'S SALES AND USE TAX RULES TAKE EFFECT

On August 11, 2023, substantial revisions to Michigan's sales and use tax rules took effect. Before these changes were made, Michigan's sales and use tax rules contained over 80 rules, many of which were promulgated in 1979 and had not been amended since. Due to significant changes to Michigan's sales and use tax laws since then, due to both legislation and litigation, many of those rules became obsolete in whole or in part. Because promulgated rules generally have the force and effect of law in Michigan, these outdated rules often led to confusion among taxpayers that attempted to rely on them and created administrative burdens for Treasury. The revised rule set addresses these issues by modernizing the rules so that they align with both the current statutory language in the sales and use tax laws and relevant case law.

The revisions to the rules resulted in the amendment of 29 rules, the addition of 2 new rules, and the rescission of 43 rules. To determine whether to recommend a rule for rescission, Treasury utilized the following general framework: If a rule merely restated a statutory provision, had been superseded by statute or case law, was adequately covered by another rule, or was not unique to warrant its continuation because it merely applied settled principles or clear statutory direction to a specific category of transactions or business, Treasury recommended that the rule be rescinded.

Below is a list of the rules which have been amended, added, or rescinded in the Michigan Administrative Code:

Amended: R 205.1, R 205.13, R 205.15, R 205.16, R 205.20, R 205.22, R 205.26, R 205.54, R 205.55, R 205.62, R 205.67, R 205.68, R 205.70, R 205.71, R 205.76, R 205.77, R 205.79, R 205.80, R 205.88, R 205.93, R 205.94, R 205.98, R 205.104, R 205.108, R 205.109, R 205.111, R 205.112, R 205.132, and R 205.137.

Added: R 205.29 and R 205.142.

Rescinded: R 205.8, R 205.52, R 205.56, R 205.57, R 205.58, R 205.60, R 205.63, R 205.64, R 205.66, R 205.72, R 205.73, R 205.75, R 205.78, R 205.81, R 205.83, R 205.84, R 205.89, R 205.90, R 205.91, R 205.92, R 205.97, R 205.99, R 205.100, R 205.101, R 205.102, R 205.106, R 205.107, R 205.110, R 205.113, R 205.114, R 205.115, R 205.116, R 205.117, R 205.118, R 205.119, R 205.124, R 205.126, R 205.130, R 205.131, R 205.133, R 205.134, R 205.135, and R 205.139.

The amended Sales and Use Tax Rules can be found by selecting Treasury's Bureau of Tax and Economic Policy under the administrative code search tool at: <https://www.michigan.gov/lara/bureau-list/moahr/admin-rules>.

IN THIS ISSUE

Pages 1

Revisions to Michigan's Sales and Use Tax Rules Take Effect

Page 2-3

Michigan Supreme Court Affirms Treasury and the Constitutionality of the Single Sales Factor Formula as Applied to the Gain on the Sale of an Outstate Business

Page 3

Taxpayer Refund Request Must be Explicit and in Writing to Trigger Interest Accrual

Page 3

Recently Issued Guidance from Treasury

Page 4

To Register or Not to Register

Page 4

About Treasury Update

Page 4

All Things Advocate: Pension Subtraction Guidance for the 2023 Tax Year

Page 5

Update on Partnership Audit Adjustment Reporting

MICHIGAN SUPREME COURT AFFIRMS TREASURY AND THE CONSTITUTIONALITY OF THE SINGLE SALES FACTOR FORMULA AS APPLIED TO THE GAIN ON THE SALE OF AN OUTSTATE BUSINESS

On July 31, 2023, in *Vectren Infrastructure Services v Dep't of Treasury*, the Michigan Supreme Court, in a 4-3 decision, issued an opinion in favor of Treasury, holding that "Treasury properly included the income from the . . . asset sale in the tax base apportionment formula under the MBTA[]" and "[n]either the Due Process Clause nor the Commerce Clause [were] violated in this matter." The Court noted that a party challenging a business tax as disproportionate has a heavy burden of showing by clear and cogent evidence the apportionment formula attributes income "out of all appropriate proportion" to the business activity in Michigan or it "grossly distorted" the result. The Court further ruled that the sale of business assets constituted "business activity" under the statute and was subject to apportionment using the statutory single sales factor formula. Sales, generally defined as "stock in trade" or property that can be inventoried, as used in the apportionment formula do not include the sale of a company. The Court clarified the proper legal test for the sale of business assets is not the location of the assets or domicile of the company but whether the assets were part of the unitary business operations.

The taxpayer is the successor to Minnesota Ltd, (MLI), a Minnesota based S-Corp. In 2010, it secured a large contract to clean up an oil spill in the Kalamazoo River after a pipeline leak. MLI had previously performed limited services in Michigan, averaging about 7% of sales historically; however, the contract to provide remediation services on the Kalamazoo River substantially increased its Michigan sales.

The Michigan Business Tax Act calculates taxable business income for companies operating in more than one state by apportioning income using a single sales formula: (Michigan sales / total sales) multiplied by the tax base. In March of 2011, the shareholders sold their shares to Plaintiff electing to treat the sale as an asset sale under IRC 338(h)(10). When the required 2011 short year MBT return was filed, MLI reported the gain in business income for the tax base, but also included the gain in the sales factor apportionment denominator. While Treasury agreed the gain was properly included in business income but removed the gain from the apportionment formula because it failed to meet the statutory definition of sales.

In the Michigan Supreme Court decision, the majority relied on well settled precedent that the income from the sale of a business generated by interstate as well as intrastate activities are part of the net income of a corporation that may be fairly apportioned if related to business activity. A taxpayer's contention the income source is from out of state is insufficient, rather a taxpayer must prove "the income was earned in the course of activities unrelated to" the business activities carried on in Michigan. Here, the evidence disclosed that the taxpayer had a business presence and business activity in Michigan for several years before the sale and Michigan was a target state based on existing customers and planned market growth. These factors also played a role in the opportunity for growth in Michigan and the valuation of the entity for the buyer.

The Court noted a recent Maine Supreme Judicial Court ruling in *State Tax Assessor v Kraft Foods Grp, Inc*, 235 A3d 837 (2020), that held the income from the sale of business lines could be fairly apportioned using the single sales formula determined from the sales of its day-to-day food products. The Court did not see any meaningful distinction between these cases and agreed with that court's ruling that the fact that net income was much greater in the year of sale than in prior years does not support a conclusion that the sales factor does not fairly represent the taxpayer's business activity in the state. The Court held that the company must prove that the income was earned in the course of activities unrelated to the unitary business engaged within the state to justify alternative apportionment. Here, the Court found since the business assets that generated the large gain were related to the business conducted in Michigan, the statutory formula was applicable.

The Michigan Supreme Court next found the sales factor appropriately captured the sales activity in the short year. The formula met both the internal and external consistency tests. Removing the gain from the reported sales denomination that increased the apportionment percentage from 15% to 70% was not a distortion of true tax liability. The Court stated the taxpayer "was never entitled to add the asset-sale income to the denominator of the sales factor without first obtaining permission from treasury to pursue an alternative apportionment." Recognizing that the sales formula should reasonably reflect the business activity in each specific tax period, the Court noted the taxpayer inappropriately relied on historical tax liability and apportionment percentages without explaining why historical taxes paid or percentages are relevant to a different year's tax liability. Internal business decisions and the timing of the sale do not dictate a different tax treatment, the relevant question remains whether the sales factor fairly represents the business activity in Michigan during that tax period.

The three dissenting justices believed apportioning on a single factor, based on a short period was a "grossly disproportionate money grab" which taxed economic values unrelated to the activity in the state. They would have ruled in favor of the taxpayer and invalidated what they believed was a unique case that illustrates the potential unconstitutionality of a single factor sales formula, especially one that considers only sales of inventory and other sales in the ordinary course of business while including all income in the tax base. They noted that a single factor sales formula can be constitutional, as the U.S. Supreme Court concluded in its landmark 1978 decision in *Moorman v Bair*, 437 US 267, but that decision does not hold that such a single factor formula is constitutional in all cases. They also noted that the taxpayer's sales in Michigan after the sale were significantly lower and believed it showed a clear case of distortion. The majority however, noted that business activity commonly changes from one tax period to the next and the sales factor formula must reasonably reflect the business activity during that year. In response to the dissent's suggestion that a three-factor formula is a

continued on page 3

“helpful benchmark” for reviewing distortion, the majority responded that the factors used to apportion the tax base in Michigan is a policy matter for the Legislature.

This is an important case regarding the constitutionality of a single factor sales formula that does not factor the location of a taxpayer or its property and payroll. The opinion confirms the relevant question remains whether the sales factor fairly represents the business activity conducted in Michigan. Taxpayers have a high burden of proof when requesting alternative apportionment. The MBTA (and the Corporate Income Tax) provides that the apportionment provisions are “presumed to fairly represent

the business activity attributed to the taxpayer in this state” unless the taxpayer can demonstrate that “the business activity attributed to the taxpayer 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 or would operate unconstitutionally to tax the extraterritorial activity of the taxpayer.” The Court confirmed that the taxpayer must make this showing by “clear and cogent” evidence.

For questions about petitioning Treasury for alternative apportionment relief, please see RAB 2018-28.

TAXPAYER REFUND REQUEST MUST BE EXPLICIT AND IN WRITING TO TRIGGER INTEREST ACCRUAL

In its recent decision in *United States Steel Corp v Dep't of Treasury*, approved for publication on August 22, 2023, the Court of Appeals affirmed the Court of Claims' decision in favor of Treasury on the narrow issue of whether a taxpayer provided sufficient notice of a refund request to trigger the running of the interest accrual clock. MCL 205.30(3) states that interest on refunds shall be added to the amount refunded starting 45 days after the claim for refund is filed.

During an audit of its unitary business group's corporate income tax filing, the taxpayer informed Treasury that it had mistakenly omitted a holding company from its unitary business group (UBG) corporate income tax return. A dispute arose over whether the entity was a foreign operating entity. In a memo emailed to Treasury on October 17, 2018, the taxpayer asserted that the entity was not a foreign operating entity and therefore should have been included as part of its UBG filing. Treasury declined to include the entity as part of the UBG and concluded the audit in May 2020.

On July 27, 2020, the taxpayer requested an informal conference contesting the issue. Unlike its earlier audit memo, the taxpayer's informal conference request not only asked for the omitted holding company to be included in the UBG filing, but asserted for the first time that losses suffered by the holding company if included in the UBG's tax return would result in a refund. The parties resolved the holding company issue and only the interest issue remained.

The Court of Claims held, and the Court of Appeals affirmed, that the October 2018 memo did not constitute a refund request. In reaching its decision, the Court of Appeals relied on the Supreme Court's decision in *Ford Motor Co v Dep't of Treasury*, 496 Mich 382, 385-386 (2014), which held that though a taxpayer need not use any magic words such as refund or claim, it must explicitly communicate a definite demand for, request for, or assertion of a right to a refund; the demand cannot be implied.

During litigation, the taxpayer asserted that its representatives verbally communicated its refund request to Treasury's auditors. Though Treasury's auditor disputed this assertion, the Court, relying on its holding in *Muldavin v Dep't of Treasury*, 184 Mich App 222, 224, 226-227 (1990), held that a claim or petition for a tax refund must be made in writing. The court buttressed its conclusion with the requirement set forth in *Ford* that a refund claim must be “filed,” which it defined to mean (1) to initiate (as a legal action) through proper formal procedure, (2) to submit documents necessary to initiate a legal proceeding, (3) to enter (a legal document, for example) on public record or official record, and (4) to apply: file for a job.

RECENTLY ISSUED GUIDANCE FROM TREASURY

Revenue Administrative Bulletins

RAB 2023-9 Sales and Use Tax Agricultural Production Exemption, Approved July 19, 2023

RAB 2023-10 Sales and Use Taxation of Computer Software and Digital Goods, Approved July 31, 2023

RAB 2023-12 Sales and Use Treatment of Interstate Motor Carriers, Approved August 10, 2023

RAB 2023-13 Sales and Use Tax – Lessors, Approved August 15, 2023

RAB 2023-14 Impact of COVID-19 Extensions and Penalty and Interest Waivers on the Statute of Limitations, Approved August 23, 2023

RAB 2023-16 Sales Tax and Use Tax - Taxability of Delivery and Installation Charges, Approved September 11, 2023

Notices

Notice Regarding Revisions to Michigan's Sales and Use Tax Rules, Issued September 13, 2023

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: None this quarter

NON-ACQUIESCENCE: None this quarter

TO REGISTER OR NOT TO REGISTER

The ever-evolving digital marketplace can make it difficult to determine when a business should be registered with the Department of Treasury to file and pay sales and use taxes. The purpose of this article is to shed some light on the different requirements and thresholds that may create nexus with the State of Michigan and require business file and pay sales and use tax.

Any company that has nexus with Michigan and is engaged in the business of making retail sales into Michigan must register with Treasury. See RAB 2021-21 for more information regarding when a seller has nexus with Michigan. The registration process is simple and involves submitting the company's pertinent information (business name, address, FEIN, shareholders, etc.) to ensure that all tax returns, payments, and correspondence are applied to the proper account. This process can be completed manually, using form 518, or electronically, by visiting [Michigan Treasury Online \(MTO\)](#). MTO is the Treasury's web portal to many business taxes that allows you to file, pay and manage your tax accounts online securely and free of charge.

However, sellers that only engage in wholesale activity and make no retail sales are not required to be registered. Wholesalers claiming an exemption should provide Form 3372 or a written statement that they are purchasing for "resale at wholesale" to their seller. If a seller only engages in wholesale activity, they are not required to obtain a sales tax license or provide a sales tax license number when claiming an exemption for purposes of resale. See MCL 205.68(1). Similarly, marketplace sellers that make

no direct sales (i.e., only engaged in sales facilitated by a marketplace facilitator) are not required to obtain a sales tax license. See RAB 2021-22 for more information regarding marketplace facilitators and sellers.

Whether a seller that is required to register for and report tax as sales or use tax depends on where the seller is located and how the seller structures its retail transactions. In state sellers making retail sales of tangible personal property will generally be liable for sales tax on those transactions and should obtain a sales tax license. However, sellers located out-of-state that have nexus with Michigan and make a taxable retail sale to a Michigan purchaser where the transfer of ownership of the property occurs outside of Michigan should register for, and report, use tax; if transfer of ownership occurs in Michigan the seller should obtain a sales tax license and report sales tax. To help you determine whether your business should be registered, a wealth of information can be found on Treasury's website: www.michigan.gov/taxes. From there you can review FAQ's, previously published RAB's, and even fill out a nexus questionnaire to help you decide. You can also locate forms and instructions and obtain access to Michigan Treasury Online (MTO); there's even a section designed specifically for Tax Professionals. Video tutorials with step-by-step instructions on registering a business as well as how to use MTO for different functions can also be viewed online. For additional information, or if you're ready to begin the registration process, [this link](#) would be your best starting point.

ABOUT TREASURY UPDATE

Treasury Update is a periodic publication of the Tax Policy Division of the Michigan Department of Treasury.

It is distributed for general information purposes only and discusses topics of broad applicability. It is not intended to constitute legal, tax or other advice. For information or advice regarding your specific tax situation, contact your tax professional.

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

Lance Wilkinson

Director, Tax Policy Bureau
517-335-7477

Dave Matelski

Administrator, Tax Policy Division
517-335-7478

Email address:

Treas_Tax_Policy@michigan.gov

ALL THINGS ADVOCATE: PENSION SUBTRACTION GUIDANCE FOR THE 2023 TAX YEAR

Public Act 4 of 2023 rolled back the 3-tier system of limitations and restrictions on the Michigan retirement and pension benefits subtraction. While this law change is not scheduled to formally take effect until 90 days after the current legislative session closes, Treasury is committed to ensuring that all eligible retirees can take full advantage of this expanded subtraction for tax year 2023.

Despite the uncertainty surrounding the effective date, Michigan's 2023 tax return, forms, and instructions incorporate all retirement and pension benefit subtraction options - including those created in the new law. This offers retirees the ability to choose the best taxing situation for their retirement benefits. If the law takes effect before the 2023 tax season begins, Treasury will process these returns using normal practices. However, if the law takes effect after the 2023 tax season begins, Treasury must modify normal tax season practices by holding returns that claim a retirement and pension benefits subtraction until the law takes effect. If this course of action is necessary, retirees may experience longer than normal delays in receiving their refunds.

Once the effective date of Public Act 4 of 2023 is known, Treasury will be able to provide further information for tax year 2023 tax return processing.

UPDATE ON PARTNERSHIP AUDIT ADJUSTMENT REPORTING

In the November 2022 issue of the Treasury Update, an article explained the reporting of federal partnership-level adjustments and their state income tax to Michigan under 2022 Public Act 148. This article covers developments in Treasury's implementation of that program to date.

Under either the "Pay Up" or "Push Out" method, the *Michigan Federal Adjustments Report ("FAR") for Partnerships and Other Flow-through Entities* ("FAR for partnerships") must be used by partnerships subject to PA 148 to report information and adjustments to Treasury. The FAR for partnerships is an interactive Excel document that collects the necessary information about adjustments and partners and reports the partnership's tax due or refund. It is expected that completed reports will be uploaded through Michigan Treasury Online (MTO) beginning in 2024.

Payments or refund claims by partnerships are made differently depending on the method elected by the partnership. Under the "Pay Up" method, tax, penalty, and interest due from partnerships are paid using MTO. Under the "Push Out" method, partnerships are responsible for paying or seeking a refund on behalf of all partners that participated in a composite return (Form 807) filed for the reviewed tax year under MCL 206.315. These partnerships should use [Partnership Audit Adjustments Payment Voucher \(Form 5839\)](#) to make payments, which is available with the individual income tax forms.

Partners (or members of another flow-through entity in a tiered structure) that receive pushed-out Michigan adjustments from their partnership or other flow-through entity will have reporting obligations to Treasury. In addition, partners will pay tax, penalty and interest to Treasury or make a refund request, whichever is applicable. Information about these pushed-out adjustments comes from the partnership; there is no associated Treasury form. Partners should then fulfill their obligations to Treasury under the procedures specific to the partner's income tax. For a partner subject to the Corporate Income Tax, the partner should file an amended CIT return (Form 4892) for the reviewed tax year and pay tax or request a refund as they would for any other CIT amended return. For a partner subject to the individual income tax—including individuals, trusts, and estates and excluding anyone who participated in a composite return for the reviewed tax year—tax, penalty, and interest due should be paid using a paper check and the Form 5839 voucher.

The report, its instructions, and the voucher discussed above are available on Treasury's website at <https://www.michigan.gov/taxes/business-taxes/partnership-audit-adjustment>.



Archives of Treasury Update can be found on the website at [Michigan.gov/Treasury](https://www.michigan.gov/Treasury) under the Reports and Legal Resources tab.