Michigan Department of TREASURY UPDATE

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Archives of Treasury Update can be found on the website at **Michigan.gov/Treasury** *under the* ***Reports and Legal Resources*** *tab.*

Treasury Works to Streamline Power of Attorney Process

The Revenue Act prescribes Treasury's powers and governs the manner and methods by which it exercises those powers in administering taxes. An important part of the administrative framework provided by the Revenue Act are stringent requirements that Treasury safeguard taxpayer information and not disclose or divulge such information obtained in connection with the administration of a tax to persons other than the taxpayer, unless otherwise permitted by law. MCL 205.28(1)(f). The protection of a taxpayer's confidential tax information, however, invariably bumps into the interactions between Treasury and taxpayers. A tension can thus occur between Treasury's duty to ensure taxpayers' confidential tax information is not improperly disclosed and the communication necessary for Treasury, taxpayers, and taxpayers' representatives to efficiently address taxpayer issues.

When working with Treasury, a taxpayer may authorize someone to represent the taxpayer before Treasury and receive confidential tax information relating to the taxpayer. That authorization is generally communicated to Treasury through Form 151, Authorized Representative Declaration (Power of Attorney) ("POA"). Because various units within Treasury may interact with a taxpayer on different issues, with each unit ensuring its interaction with any purported representative has been properly authorized, and with taxpayers often revoking the authority of previously designated representatives, confusion often occurred as to whether a particular representative in fact had the requisite authority to communicate with Treasury. The confusion caused taxpayer frustration and impaired Treasury's ability to efficiently administer taxpayers' issues with Treasury. This prompted Treasury to review its POA processes and to revise the POA form to simplify and better address these matters.

In consultation with tax practitioners, Treasury revised and simplified Form 151, distilling onto one page the information necessary to properly designate a representative to communicate with Treasury and act on the taxpayer's behalf. Added to Form

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Form 151 can be accessed and filled out on Treasury's webpage at ***www.michigan.gov/taxes*** *(Power of Attorney Form 151 under Popular Forms) or on Michigan Treasury Online at* ***mto.treasury.michigan.gov***

Please follow the form and instructions carefully to be sure Form 151 is filled out ***accurately*** *and* ***completely****.*

Note: An informational video about POA Form 151 is also available on Treasury's website.

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151 is a section that directs Treasury to send copies of all future notices and letters involving a particular tax dispute to a designated representative. This section was added to comply with section 8 of the Revenue Act. Designating a representative to receive such notices and letters under this section, however, does not give that representative authority to act on the taxpayer's behalf. That authority must be granted in other parts of the form, or through other written documentation that clearly establishes that authority and provides all the information required by Treasury's rules.

In conjunction with Treasury's revamp of the POA/Form 151, Treasury is also currently revising the Taxpayer Bill of Rights administrative rules that govern the appropriate conduct of Treasury employees, the implied and express authorization for disclosure of taxpayer's confidential information (including the proper use of POA/Form 151), the scope and manner in which Treasury may discuss tax return information with the preparer of the return and the informal conference process. Preliminary drafts of the rules have been reviewed by tax practitioner groups, with Treasury making various revisions to those draft rules based on their input. Treasury anticipates that it will finalize those drafts shortly, and request the commencement of formal rulemaking proceedings for the ultimate promulgation of revised rules.

Taxpayer Advocate Announces Changes

Effective January 20, 2017, the Office of the Taxpayer Advocate implemented changes to Treasury's tax practitioner services after seeking input from the Michigan Association of Certified Public Accountants (MICPA) on how to improve customer service and how Treasury interfaces with the practitioner community. Recent improvements include:

Tax Practitioner (only) Hotline 517-373-0616:
The Hotline service was changed to allow callers to select three options.

1. Web Services instructions are now offered as a punch off under option #1 (to accommodate those practitioners who do not want to listen to those instructions on every call).

2. General and specific questions about Individual Income Tax can now be left under option #2.

3. General and specific questions about business taxes (CIT/MBT/SBT and SUW) can now be left under option #3.

Practitioners calling about business tax questions will no longer be transferred to the Business Tax Call Center, which had resulted in delays and confusion for some practitioners.

Under options #2 and 3, the Taxpayer Advocate staff will respond to the messages.

Web Services: All business tax inquiries that come through practitioner web services will be handled by Taxpayer Advocate staff to ensure acknowledgment and response times meet the established 5 business day turnaround. For a link to Treasury's web services, click here.

“Check the Box” Authorization on Returns

When a taxpayer (individual or entity) signs the Certification at the end of a return (for example, the MI-1040), it may check the box authorizing Treasury to discuss that return with its preparer. Have you wondered what information the Department may discuss with the preparer when that box has been checked?

When a taxpayer checks the box, it provides the Department with the authority to communicate with the preparer about issues that may arise concerning the contents of that particular return; the Department is given the authority to contact the preparer concerning any information on the return he or she prepared. The preparer has the authority to provide the Department with information that was missing from the return. The preparer may contact the Department to obtain information about the processing status or the status of refunds and payments that are related to that return. In addition, the preparer may request copies of notices related to the return. Finally, the preparer may respond to notices related to matters on the return, including math errors, return preparation, and any adjustments made to the return. The authorization is applicable only to the individual named as the preparer on the return and does not extend to others in the preparer’s office or firm.

Checking the box does not authorize the Department to discuss any other return with the preparer or provide any information regarding audit, assessment, or collection activities on the taxpayer’s account. The preparer is not authorized to take any definitive action on behalf of the taxpayer, such as requesting an informal conference. The preparer may not receive a refund check, bind the taxpayer to an agreement, or otherwise represent the taxpayer before the Department.

The check-the-box authorization does not take the place of a form designating power of attorney or designating a representative under MCL 205.8. To grant that level of authority, the taxpayer should file a completed Form 151, Authorized Representative Declaration.

Recently Issued Guidance from Treasury

Revenue Administrative Bulletins

RAB 2016-24

Use Tax Base of Tangible Personal Property Affixed to Real Estate by a Manufacturer/Contractor or Other Contractor

RAB 2017-2

Notice of Prepaid Sales Tax Rates on Fuel in Effect for the Month of March 2017

Other Guidance

Notice to Taxpayers Regarding the Increase in the Health Insurance Claims Assessment (HICA) Tax Rate and the Suspension of the HMO Use Tax

Notice to Taxpayers Regarding 2016 PA 515 and 516 (Core Charges)

Notice Regarding Documentation Required for Real Estate Transfer Tax Refunds

Revenue Administrative Bulletins (RAB) can be found on the website at **Michigan.gov/Treasury** *under the* ***Reports and Legal Resources*** *tab.*

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, please contact your tax professional.

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Timing is Everything: Tax Statutes of Limitations Explained

A statute of limitations sets forth the period of time within which a party must assert a claim and after which a party's claim is barred. For Michigan state taxes, the statute of limitations is the time frame within which Treasury may assess a tax or the taxpayer may claim a refund for a particular period. The Revenue Act sets the tax statute of limitations at four years for both assessments by Treasury and refund claims by taxpayers. More specifically, Treasury has four years within which to issue an assessment, from either the date set for the filing of the required return or the date the return was filed, whichever is later. The required return is the original return including any granted extensions, but not including amended returns. Likewise, a taxpayer has four years from the date set for filing of the original return to claim a refund or a homestead property tax credit. Home heating credit claims must be filed by September 30th of the year following the year of the claim.

The statute of limitations can be extended by written agreement of the taxpayer and Treasury and under certain other circumstances, including informal conferences, litigation, and – most notably – when a taxpayer undergoes an audit (see RAB 2015-26). Public Act 3 of 2014 substantially changed the manner in which the statute of limitations can be extended. Under PA 3, the statute of limitations can be extended for the period of an audit for federal income tax and for one year after that period. For state audits, PA 3 extends the statute of limitations for the length of time beyond the limitations period that it takes to issue a preliminary audit determination (PAD) but no longer than one year. An additional extension of nine months is permitted for issuance of the assessment if the PAD is issued timely.

The applicability of PA 3 to state audits that began before its enactment is currently under review in the courts. That litigation will determine how the statute of limitations for certain state audits is tolled or extended and for what period. (For more information on the Department's interpretation of the effect of PA 3 of 2014 on the statute of limitations period for state audits, see Letter Ruling 2015-2.)

Manufacturer/Contractor Liability for Use Tax

In our August 2016 Treasury Update, we discussed the use tax consequences that arise when a contractor affixes tangible personal property to the real estate of a customer. "Contractor Liability for Use Tax," Volume 1, Issue 4, August 2016, pgs. 3-4.

A recent decision of the Michigan Court of Appeals addressed this very situation. In *Brunt Associates, Inc. v. Department of Treasury*, the taxpayer produced and installed custom office furnishings and interior finishes such as cabinetry, decorative panels, and freestanding furniture for its customers. In a published opinion, the Court of Appeals upheld the Department's determination that the taxpayer was liable for use tax as a manufacturer/contractor engaged in the business of constructing, altering, repairing, or improving real estate for others. Mich. Ct. App., Dkt. No. 328253, 01/03/2017.

As noted in the August article, property purchased or manufactured by a person engaged in the business of constructing, altering, repairing, or improving real estate for others (i.e., a contractor) is subject to the use tax when affixed to (and made a structural part of) a customer's real estate.

In *Brunt*, the taxpayer argued that it was not liable for use tax because it was not a contractor but rather was an industrial processor that made sales of tangible personal property at retail to tax-exempt customers.

In determining whether the taxpayer was a contractor affixing tangible property to the realty of others, the court applied the "3-part fixture test," and concluded that the products taxpayer installed were affixed to the real estate of its customers. While the taxpayer admitted that it used bolts, clips, fasteners, or screws to attach furnishings and finishes to customers' buildings, it argued that those products, as well as the freestanding furniture, could easily be removed without damaging the product or diminishing the value of the customer's realty.

The court, however, ruled that whether an item is removable is not the only factor to consider.

It found that the taxpayer's products were intended to be permanent accessions to realty by looking at the nature of the products (wall paneling, lecture hall desks, large nurses stations, etc.), and the functions they fulfilled in the buildings.

The court pointed out that taxpayer had even testified that its products are rarely removed, and then only for repair, after which they are reinstalled.

The court also found that the taxpayer was not eligible for the industrial processing exemption because the tangible personal property was permanently affixed to and became a structural part of customer's real estate in Michigan and was not manufactured for "ultimate sale at retail."

For more information regarding whether property remains tangible personal property or becomes a fixture through its affixation to real estate for purposes of the General Sales Tax Act and the Use Tax Act, please refer to Revenue Administrative Bulletin 2016-4.

For a more detailed discussion of the tax liability of manufacturer/contractors under the General Sales Tax Act and the Use Tax Act, please refer to Revenue Administrative Bulletin 2016-24.

Statement of Acquiescence/ Non-Acquiescence Regarding Certain Court Decisions

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

ACQUIESCENCE:
No cases this quarter

NON-ACQUIESCENCE:
No cases this quarter

Breaking Up is Hard to Do: Unwinding Unitary Business Groups after *LaBelle Management*

The August 2016 issue of Treasury Update provided an update on *LaBelle Management, Inc. v Department of Treasury* (315 Mich App 23 (2016)). In that case, the Michigan Court of Appeals previously rejected the Department of Treasury's published guidance defining indirect ownership for purposes of defining a unitary business group under the Michigan Business Tax (MBT). Treasury applied for leave to appeal that decision to the Michigan Supreme Court, and the Court of Appeals granted a stay of its decision until all appeal rights were exhausted. On January 24, 2017, the Michigan Supreme Court denied Treasury's leave to appeal. The stay dissolves automatically on February 14, 2017, when the deadline for any further appellate remedies expires.

Taxpayers and Treasury must now begin the difficult task of implementing the Court of Appeals decision. Unitary business groups whose membership is based on the form of indirect control prohibited by the Court of Appeals decision will need to begin the separation process. Treasury is committed to assisting taxpayers through this transition and will provide guidance as soon as it becomes available. Please keep your eyes on our website for an updated Notice to Taxpayers Regarding *LaBelle Management, Inc. v Department of Treasury.*

Challenges to *Quill's* Physical Presence Standard

The Commerce Clause of the United States Constitution limits a state from imposing sales or use tax collection responsibilities on sellers that lack substantial nexus with the state. As first set forth by the 1967 ruling in *Nat'l Bellas Hess, Inc v Department of Revenue of Ill,* 386 US 753 (1967), and later reaffirmed in 1992 in *Quill Corp v North Dakota,* 504 US 298 (1992), the United States Supreme Court has historically interpreted substantial nexus for sales and use tax purposes to be a bright-line test requiring physical presence within the state. That is, *Quill* has traditionally limited a state from imposing sales or use tax – or collection duties – on online retailers and other out-of-state sellers without nexus in that state. In an increasingly digital economy that favors e-commerce over brick-and-mortar sellers, such a limit has obvious implications on state tax revenues. Believing the decades-old test to now be outdated, and emboldened by a recent statement of Supreme Court Justice Kennedy, many states have aggressively begun to implement policies designed to "find an appropriate case for [the Supreme] Court to reexamine *Quill* and *Bellas Hess*."

Not surprisingly, legal challenges regarding the continued viability of *Quill* have quickly moved to the forefront of tax litigation across the country. Most recently, in *Direct Marketing Association (DMA) v Brohl*, 814 F3d 1129 (10th Cir. 2016), remote sellers challenged a Colorado reporting statute requiring those sellers to either voluntarily collect use tax or notify customers and the Department of Revenue of the tax that is due on sales within the state. While *DMA* sought an appeal to the Supreme Court primarily on the issue of interstate discrimination, the Colorado Department of Revenue used that appeal to ask that the Court address *Quill.* On December 12, 2016, however, the Court declined to hear the case.

With the Supreme Court passing on *DMA,* battle lines between states and remote sellers continue to be drawn across the country. For example, Alabama (*Newegg Inc v Alabama Department of Revenue,* No. S. 16-613 (Ala. Tax Tribunal June 8, 2016)), and South Dakota (*South Dakota v Wayfair Inc*, Docket No. 32 Civ. 16-92), are already embroiled in litigation defending regulations or statutes that require out-of-state retailers with in-state sales to collect and remit sales and use tax. While the cases in both states are likely to remain at the trial court level throughout this year, other states may attract similar litigation during that time. Indeed, Vermont (32 VSA 9701(9)(F)), Tennessee (Tennessee Rule 1320-05-01-.129), and Louisiana (RS 47:309.1) have all enacted laws set to take effect later this year which openly flout *Quill's* physical presence standard. As the disputes regarding the vitality of *Quill* approach a critical groundswell across the country, it appears all but certain that the U.S. Supreme Court will need to revisit the physical presence standard at some point in the coming years.

Michigan's nexus statutes for sales and use tax are found in Section 2b of the Sales Tax Act, MCL 205.52b, and Section 5a of the Use Tax Act, MCL 205.95a. RAB 2015-22 provides detail regarding the limited scenarios where the activities of out-of-state sellers may create nexus with Michigan. There are no direct challenges involving *Quill* and the physical presence standard within Michigan. Even so, the Michigan Department of Treasury continues to monitor the ongoing litigation and legal developments on this issue across the country. Treasury remains committed to modernizing and simplifying its sales and use tax administration consistent with the latest developments in the law.

Court Reaffirms and Explains the Preclusive Effect of MCL 205.22

Thumb Motorsports, LLC v Treasury

The Michigan Court of Appeals in its November 17, 2016, unpublished opinion in *Thumb Motorsports, LLC v Department of Treasury* (Docket No. 329121) reaffirmed the preclusive effect of Section 22 of the Revenue Act, MCL 205.22, on challenges to final assessments that were not timely appealed.

The main focus of the case was the taxpayer's sales tax liability for the tax periods covering January 2011 through December 2012. For each of the 15 tax periods covering October 2011 through December 2012, Treasury issued final assessments to the taxpayer. The taxpayer did not contest those final assessments within the 90-day limit set forth in MCL 205.22(1). No final assessments were issued by the Department, however, for the nine tax periods covering January 2011 through September 2011.

Though the taxpayer failed to timely appeal the 15 final assessments covering tax periods October 2011 through December 2012, the taxpayer attempted to challenge the sales tax liability established under those final assessments by filing amended returns that stated a reduced sales tax liability. The taxpayer argued when MCL 205.22, MCL 205.27a(2) (statute of limitations), and MCL 205.30 (refund claims) are read together, these statutes afford a taxpayer a second avenue of relief by allowing the taxpayer to assert a different tax liability through filing an amended return, despite the taxpayer's failure to timely appeal a final assessment covering that tax period and notwithstanding the "final" and "conclusive" nature of untimely appealed final assessments under MCL 205.22. Applying established principles of statutory construction, the court rejected that argument because MCL 205.22 is "clear and unambiguous" and sets forth the more specific rule which controls over the general time frame and process by which a taxpayer may seek a refund under MCL 205.27a(2) and MCL 205.30. Moreover, the court explained that reading those statutes as permitting an "end-run around" MCL 205.22 would render MCL 205.22's explicit prohibition against collateral attacks on untimely appealed final assessments nugatory. Accordingly, the court held the Michigan Tax Tribunal did not err when it ruled these final assessments could not be collaterally attacked by the filing of amended returns and related refund requests.

Concerning the remaining nine tax periods (January 2011 through September 2011), the court determined the preclusive effect of MCL 205.22 was not invoked because Treasury did not issue final assessments for those tax periods. As a result, the court held that there was nothing to prevent the taxpayer from seeking to amend its returns and claim refunds for alleged overpayments for those months under MCL 205.27a(2) and MCL 205.30. The court returned the case to the Michigan Tax Tribunal for determination of what, if any, credit the taxpayer is entitled to for those nine tax periods.

The court also concluded the taxpayer's efforts to have a 2010 credit applied to its 2012 sales tax liability was not a collateral attack on the 2012 final assessment, and directed the Tax Tribunal to determine whether the 2010 credit should be applied to the taxpayer's 2012 or 2014 tax liability since the Tax Tribunal had not made a substantive ruling on this issue.

Treasury Weighs Response to Decisions Regarding Materials and Supplies Deduction

In determining its modified gross receipts tax base under the Michigan Business Tax ("MBT"), a taxpayer deducts amounts for "purchases from other firms" made during the tax year. The more common items included in the definition of "purchases from other firms" are: inventory acquired during the tax year; assets that are eligible under the IRC for depreciation, amortization or accelerated capital cost recovery; and "to the extent not included in inventory or depreciable property, materials and supplies, including repair parts and fuel." MCL 208.1113(6)(a)-(c). While the MBT Act expressly defines the term "inventory" and the IRC prescribes whether an asset is eligible for depreciation, amortization or accelerated capital cost recovery, the phrase "materials and supplies" is not defined.

In its published guidance issued in the early months of the MBT, Treasury looked to the express language "to the extent not included in inventory or depreciable property" in the statute and interpreted "materials and supplies" to mean "tangible personal property acquired during the tax year to be used or consumed in – and directly connected to – the production or management of inventory under MCL 208.1113(6)(a) or the operation or maintenance of assets under MCL 208.1113(6)(b)." Some taxpayers contested Treasury's definition of "materials and supplies" in the Tax Tribunal and the Court of Claims, claiming that Treasury's definition reads a limitation into the statute unsupported by the statutory language. These taxpayers argued for a broader interpretation – that "materials and supplies" generally includes items of tangible personal property other than inventory or depreciable property.

In *Plastic Surgery Associates, PC v Department of Treasury*, Docket No. 16-000011, November 15, 2016, the Tax Tribunal held that Treasury's interpretation improperly narrowed the scope of what qualifies as "materials and supplies." Looking to the IRC, the Tax Tribunal rejected Treasury's contention that the taxpayer's interpretation effectively created a "catch all" deduction for items of personal property that are not inventory or depreciable property, concluding that an item of personal property must still be ordinary and necessary expense in order to be deductible.

In *Andrie Inc v Department of Treasury,* Case No. 15-000153-MT, January 24, 2017, the Court of Claims similarly held that Treasury's interpretation of "materials and supplies" departs from the statutory language. The court also looked to the IRC for comparable context and found that the IRC's delineation of ordinary and necessary expense as a deduction to gross income effectively mirrors the non-inventory and non-depreciable property description in the MBT Act.

The Tax Tribunal and Court of Claims decisions are not precedential and thus not binding as to other cases. In light of these recent cases, Treasury is evaluating both the cases and its interpretation of "materials and supplies" and will announce whether it intends to acquiesce by March 31, 2017.

2016 Legislative Highlights

Dozens of public acts relevant to the readers of the Treasury Update were passed in 2016 – a few of them were related to articles posted in previous Treasury Update issues. Some of the legislative highlights, along with a brief summary, are provided below. All public acts may be viewed in their entirety on the Michigan Legislature's website at **www.legislature.mi.gov.** We strongly recommend you review the public acts in their entirety for details and effective dates.

General Sales Tax Act and Use Tax Act

- **2016 PA 7, 8.** Modifies the definitions of "dealer" and "watercraft dealer" and extends the credit against the tax base for the trade-in value of certain vehicles to purchases made from out-of-state dealers.
- **2016 PA 431, 432.** Amends the agricultural exemption to clarify that agricultural land tile, subsurface irrigation pipe, portable grain bins, and grain drying equipment are exempt even if they are affixed to real estate.
- **2016 PA 372, 373.** Expands exemption to include a freestanding addition to a county long-term medical care facility (previously, additions had to be connected to an existing county long-term medical care facility).
- **2016 PA 159, 160**. Amends the sourcing provisions of direct mail to bring Michigan into compliance with the Streamlined Sales and Use Tax Agreement.
- **2016 PA 390.** Suspends the HMO use tax effective December 31, 2016.
- **2016 PA 503.** Exempts sales of tangible personal property by certain veterans' organizations for the purpose of raising funds for an active duty service member or veteran, limited to $25,000 per event.
- **2016 PA 515, 516.** Amends the definition of "sales price" and "purchase price" to exclude a core charge attributable to a motor vehicle or recreational vehicle part or battery, if the charge is separately stated on the invoice.

Corporate Income Tax (Income Tax Act, Part 2) and Michigan Business Tax Act

- **2016 PA 277, 278**. Limits the tax credit available to insurance companies for certain payments made to the Michigan Automobile Insurance Placement Facility.
- **2016 PA 426.** Allows a late election to file under MBT for farmland preservation tax credits under certain circumstances.

Flow-Through Withholding (Income Tax Act, Part 3)

- **2016 PA 158.** Repeals Flow-Through Withholding for tax years beginning after June 30, 2016.

Motor Fuel Tax Act

- **2016 PA 317.** Amends the MFTA to permit certain commercial alternative fuel users to calculate the fuel tax due on compressed natural gas based on a different gallon equivalent.

Natural Resources and Environmental Protection Act

- **2016 PA 467.** Increases the environmental protection regulatory fee imposed under MCL 324.21508 from 7/8 cent/gallon to 1 cent/gallon.

Tobacco Products Tax Act

- **2016 PA 86.** Extends the $0.50 cap on the tobacco tax for cigars through October 31, 2021, and changes the retailer sign posting requirements concerning online or catalog cigar purchases.

Tobacco Product Manufacturer's Escrow Accounts

- **2016 PA 42.** Revises the escrow deposit requirements for nonparticipating manufacturers including changes to the definition of "units sold" and increases the frequency of escrow payments from an annual to quarterly basis.