

STATE OF MICHIGAN
COURT OF CLAIMS

ALLY FINANCIAL, INC.,

Plaintiff,

v

NICK A. KHOURI, STATE OF MICHIGAN,
AND DEPARTMENT OF TREASURY,

Defendants.

OPINION AND ORDER

Case No. 17-000317-MT

Hon. Colleen A. O'Brien

Pending before the Court in this matter seeking a sales tax refund under the bad-debt deduction statute, MCL 205.54i, are defendants' motions for summary disposition. Also pending before the Court is plaintiff's motion for partial summary disposition. For the reasons that follow, defendants' respective motions are GRANTED, and plaintiff's motion is DENIED.

I. BACKGROUND¹

Plaintiff Ally Financial (Ally Financial) is a financing company that financed the purchase of motor vehicles from various dealers in this state. The purchasers of the automobiles entered into retail installment contracts with automobile dealers. Thereafter, the retailers assigned all rights and interests in the retail installment contracts to Ally Financial, which

¹ The Court notes that the facts and issues presented in this case are similar, and at times identical, to the facts and issues in Docket No. 17-000300-MT, which involved a subsidiary of Ally Financial.

financed the total transaction, including the purchase price (minus any down payment) and sales tax. The automobile dealers were responsible for reporting and remitting sales tax due on the motor vehicles.

Unfortunately, many automobile purchasers defaulted on their installment contracts and did not repay the entire amount financed. Ally Financial authorized or occasioned the repossession of some of the automobiles, but even after selling the repossessed vehicles, many of the accounts still had unpaid balances. Ally Financial alleges that it determined the pertinent accounts were uncollectible and worthless, and that it wrote off the accounts as bad debts on its federal income tax returns. In December 2014, Ally Financial sought a refund under MCL 205.54i, the bad-debt deduction statute, in the amount of \$1,952,463; this amount was purportedly related to “the pro rata portion of sales tax relating to the unpaid balance of worthless accounts which have been charged off for federal income tax purposes” for the period of July 1, 2010 through December 31, 2013.

Defendant Department of Treasury (the Department) responded, consistent with MCL 205.54i(4), by requesting additional information to support the refund request. In particular, the Department sought: (1) written election forms specifying that Ally Financial, not the automobile dealers, could seek a refund under MCL 205.54i; (2) evidence, such as a validated RD-108 form, confirming that sales tax was remitted on each transaction at issue; (3) documentation establishing how Ally Financial arrived at its refund amount; (4) documentation indicating the date each account was charged off; (5) documentation, such as an IRS Form 1120, to substantiate that the accounts at issue were written off for the periods in question.

Ally Financial responded to the Department's request by providing a lengthy spreadsheet pertaining to the over 6,600 accounts making up the refund claim. The spreadsheet was compiled by a third party, which allegedly used information from what Ally Financial refers to as its "data warehouse" or "information warehouse." The spreadsheet contains a column that purports to indicate a charge-off date for each of the accounts. In addition, the spreadsheet estimates the amount of sales tax paid; this estimate was, as admitted at deposition by the individual² who prepared the spreadsheet, often different from the amount of sales tax indicated on the RD-108 forms—validated or otherwise—proffered by Ally Financial in support of the refund claim.

Having received Ally Financial's documentation, the Department issued a partial refund in September 2017 in the amount of \$24,168.16. The Department's denial letter stated that it removed from the claim any accounts for which Ally Financial lacked valid written elections. Further, the Department removed from the claim any accounts for which Ally Financial lacked proof of sales tax (e.g., a validated RD-108 form) having been remitted. This action followed, and Ally Financial now challenges the partial denial of the remainder of its refund claim (\$1,929,294.84).

During the course of discovery, Ally Financial submitted to the Department federal income tax documentation in an attempt to demonstrate that the accounts at issue had been written off as uncollectible and claimed as such for federal income tax purposes. The documentation consists of IRS Form 1120's; the forms identify "Ally Financial, Inc. and its

² The deposition testimony submitted in this case was taken in Docket No. 17-000300-MT; the parties have submitted the same testimony in this case, per agreement.

Subsidiaries” as the taxpayer. The forms list entity-wide amounts claimed as bad debts—often totaling in the hundreds of millions of dollars or greater—for the 2010-2013 tax years. The forms do not specify: (1) which entity or sub-entity incurred the bad-debt; (2) where the bad debt was incurred; (3) or the type of account, e.g., a sale, lease, or other transaction, giving rise to the bad debt. At deposition, Jason Binando,³ an employee of Ally Financial’s Sales and Use Tax division, testified that he did not obtain a breakdown of the bad-debt deduction by state, but he was “sure that number can be gotten.” Binando also testified that the bad-debt amounts listed on the Form 1120 included bad debts originating from retail sales as well as from lease agreements on which customers defaulted.

II. SUMMARY DISPOSITION

The Court will first address defendant State of Michigan’s (the State’s) motion for summary disposition pursuant to MCR 2.116(C)(8). The State argues, and Ally Financial has not responded to the same, that summary disposition is warranted under this subrule because it is not a proper party to an action seeking a tax refund, and because Ally Financial has failed to state a claim against it. On review of the complaint—which primarily recites the pertinent statute and certain bad-debt caselaw—there are no meaningful allegations against the State. Nor are there any allegations or theories alleged on which relief could be granted against the State. As a result, summary disposition in favor of the State is warranted pursuant to MCR 2.116(C)(8). See *Southfield Ed Ass’n v Southfield Pub Schs Bd of Ed*, 320 Mich App 353, 370; 909 NW2d 1 (2017) (discussing MCR 2.116(C)(8), generally).

³ The parties have submitted Binando’s deposition testimony taken in Docket No. 17-000300-MT.

As for the Department and Khouri's motion under MCR 2.116(C)(10), "[a] trial court may grant a motion for summary disposition under MCR 2.116(C)(10) when the affidavits or other documentary evidence, viewed in the light most favorable to the nonmoving party, show that there is no genuine issue as to any material fact and the moving party is therefore entitled to judgment as a matter of law." *Lowrey v LMPS & LMPJ, Inc*, 500 Mich 1, 5; 890 NW2d 344 (2016).

The refund sought in this case invokes the bad-debt statute, MCL 205.54i, which "permits retailers and lenders to seek a refund for sales tax paid on a 'bad debt' as defined by the statute." *Ally Fin Inc v State Treasurer*, 502 Mich 484, 492; 918 NW2d 662 (2018). Because taxation is the rule and refunds or deductions are the exception, the taxpayer bears the burden of demonstrating entitlement to a refund or deduction. *Andrie Inc v Dep't of Treasury*, 496 Mich 161, 171; 853 NW2d 310 (2014). Moreover, the bad-debt deduction statute expressly gives the Department discretion to determine the evidence that must be produced by a claimant. *Ally Fin*, 502 Mich at 504, citing MCL 205.54i(4) (specifying that "Any claim for a bad debt deduction under this section shall be supported by that evidence required by the department."). In *Ally Fin*, 502 Mich at 504, the Supreme Court held that the Department's exercise of its discretion under MCL 205.54i(4) "will be upheld if supported by a rational basis."

The Department argues that Ally Financial failed to provide "that evidence required by the department" with respect to documentation purporting to show that the accounts at issue in Ally Financial's claim were written off as uncollectible. In particular, the Department demanded all or a portion of Ally Financial's own accounting records showing that the accounts at issue were charged off as uncollectible. Ally Financial has not produced its own internal accounting

records, but instead has produced: (1) IRS Form 1120's; and (2) spreadsheets compiled by a third party.

Having reviewed the documentation, the Court agrees that Ally Financial failed to provide the requested documentation, and that the Department had a rational basis to request additional accounting records. Initially, the IRS Form 1120's lack the degree of specificity necessary to allow the conclusion that Ally Financial wrote off the accounts at issue in its claim as uncollectible. Notably, the forms do not specify the source of the bad debts (e.g., whether the bad debts originated from retail installment contracts or from leases or from some other type of transaction), or the geographic location of the transaction giving rise to the account (i.e., whether the transaction was taxable in this state). This was, despite Binando's admission at deposition, that additional information could have been obtained by Ally Financial. In sum, the IRS Form 1120's simply do not establish that the particular accounts at issue were written off as uncollectible by Ally Financial. MCL 205.54i(2) specifies that, in order to obtain a refund under the bad-debt statute, the amount "deducted *must be charged off as uncollectible on the books and records of the taxpayer . . .*" (emphasis added). See also *Ally Fin*, 502 Mich at 507 ("In order to claim a bad-debt deduction or refund under the statute, the debt must have been charged off as uncollectible in the records of the entity claiming the deduction or refund."). Documents showing what Ally Financial claimed as bad-debt amounts, which may or may not correspond to the accounts at issue, falls short of showing that the accounts were written off by Ally Financial as uncollectible.

The spreadsheets submitted by Ally Financial do not offer the requisite level of clarity, either. Column E of the spreadsheets purports to show charge-off dates, meaning the dates on which the accounts were written off by Ally Financial. However, the spreadsheets are not, as an

initial matter, Ally Financial’s own accounting records. The Department, consistent with MCL 205.54i(4), demanded Ally Financial’s accounting records, not a summary prepared in anticipation of a refund claim by a third party. Just as in *Ally Fin*, 502 Mich at 504-505, the Department did not lack a rational basis to request the “best evidence” of the matter at issue, particularly when the proffered documentation fails to establish the matter at issue. Moreover, there are some inaccuracies—or in the case of an updated spreadsheet submitted in this case, incomplete entries—apparent in the spreadsheets. For instance, the amount of tax noted on the spreadsheets does not match amounts listed on RD-108 forms⁴—validated or otherwise—submitted for many accounts. In addition, the spreadsheets contain transactions relating to out-of-state accounts, as well as accounts on which it appears Ally Financial obtained a subsequent recovery.⁵ In light of these inaccuracies and inconsistencies, the Department had reason to request additional information beyond the spreadsheets and to doubt the accuracy of the same.

In sum, a rational basis exists to support the Department’s decision to demand Ally Financial’s own accounting records. Again, MCL 205.54i(2) requires that the bad-debt amounts “must be charged off as uncollectible *on the books and records of the taxpayer*[.]” See also *Ally Fin*, 502 Mich at 507. As the Department notes, Ally Financial’s accounting records would be the primary and best source of evidence to demonstrate that Ally Financial had in fact charged off the accounts as uncollectible. And Ally Financial has not, despite requests, produced its own

⁴ The RD-108 form is intended to show proof of sales tax remitted

⁵ See MCL 205.54i(2) (specifying that if a consumer “pays all or part of a bad debt with respect to which a taxpayer claimed a deduction under this section, the taxpayer is liable for the amount of taxes deducted in connection with that portion of the debt for which payment is received and shall remit these taxes in his or her next payment to the department.”). There is no indication in the spreadsheets whether Ally Financial made the adjustments contemplated by MCL 205.54i(2).

books and records. Moreover, Binando admitted in his deposition that more specific information could have been obtained by Ally Financial. Where that information could have been obtained, and where the information produced did not demonstrate that Ally Financial in fact wrote off the accounts at issue as uncollectible, the Department's discretionary decision to demand additional documentary evidence was supported by a rational basis. See *Ally Fin*, 502 Mich at 504-505.

The only response Ally Financial has presented to the Department's contentions is to assert that the Department has "no basis for challenging" the spreadsheets and other data provided because, according to Ally Financial, other taxing authorities have audited Ally Financial's "data warehouse" or "information warehouse" and found it to be accurate. This contention does not acknowledge MCL 205.54i(4). Consistent with the express authority granted to it by MCL 205.54i(4), the Department has asked Ally Financial for documentation to support its refund claim. In response, Ally Financial has replied that it need not comply with the Department's requests, but that the Department should instead trust that the information Ally Financial chose to provide is sufficient. This response does not find solace in the pertinent authorities, which give the Department discretion to request documentation, see MCL 205.54i(4), and which place on the taxpayer the burden of demonstrating entitlement to a tax refund, see *Andrie*, 496 Mich at 171.

III. REMAINING ISSUES

Because the above discussion is sufficient to resolve the pending motions for summary disposition, the Court need not address the remaining issues raised in the parties' briefing. However, the Court will note that it agrees with the Department's contention regarding Ally Financial's admission in ¶ 8 of its response to the Department's first discovery requests that it failed to provide many validated RD-108 forms in support of its claim. These forms are required

for a valid refund claim, see *Ally Fin*, 502 Mich at 504-505, and Ally Financial offered a binding admission that it failed to produce them. In other words, Ally Financial admitted that grounds existed for the Department to deny the refund claim. Ally Financial cannot subsequently contradict or explain that admission. *Radtke v Miller, Canfield, Paddock & Stone*, 453 Mich 413, 421; 551 NW2d 698 (1996). Ally Financial could have moved to amend or withdraw its unequivocal admission, see MCR 2.312(D)(1), but it failed to do so. Moreover, on the Court's review of the forms subsequently submitted by Ally Financial, many of the forms are not validated. Ally Financial's response to the lack of validated forms is to assert that it is attempting to obtain them. For purposes of summary disposition review, a promise to find additional documentary evidence is insufficient. *Lowrey*, 500 Mich at 7-8. Moreover, because Ally Financial is seeking a tax refund, it bears the evidentiary burden of proving entitlement to the refund. See *Andrie*, 496 Mich at 171.

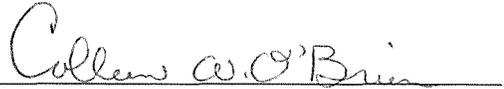
IV. CONCLUSION

IT IS HEREBY ORDERED that defendant State of Michigan's motion for summary disposition is GRANTED pursuant to MCR 2.116(C)(8), and defendant Department of Treasury and defendant Nick Khouri's motion for summary disposition is GRANTED pursuant to MCR 2.116(C)(10).

IT IS HEREBY FURTHER ORDERED that plaintiff's motion for partial summary disposition is DENIED.

This order resolves the last pending claim and closes the case.

Dated: January 14, 2019


Colleen A. O'Brien, Judge
Court of Claims