STATE OF MICHIGAN

COURT OF CLAIMS

CAPITAL ONE, N.A.,

Plaintiff,

v

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

Defendants.
_____/

OPINION AND ORDER

Case No. 17-000282-MT

Hon. Colleen A. O'Brien

Pending before the Court is defendant State of Michigan's motion for summary disposition pursuant to MCR 2.116(C)(8), as well as defendant Nick Khouri and defendant Department of Treasury's motion for summary disposition pursuant to MCR 2.116(C)(10). The Court also has pending before it plaintiff's competing motion for summary disposition under MCR 2.116(C)(10). For the reasons stated herein, defendants' motions are GRANTED, and plaintiff's motion is DENIED.

I. BACKGROUND

Plaintiff is a private-label credit card (PLCC) issuer that provides consumers with financing for retail purchases. As explained in the complaint, a PLCC is a "credit card that bears the name and logo of a specific retailer and that can only be used to make purchases at that retailer or at closely related affiliates." The complaint alleges that when retail purchasers made purchases using PLCCs, the retailers remitted the full amount of the sales tax on the purchases to

the State. Plaintiff financed the transactions, and the purchaser agreed to repay plaintiff for the full amount financed, which included the sales tax.

Plaintiff alleges that many retail purchases defaulted on the amounts owed on the PLCCs. Plaintiff alleges that it determined the unpaid portions of these accounts to be worthless and uncollectible for state and federal income tax purposes, and that it claimed the worthless accounts as "bad debts" on its income taxes. Plaintiff seeks a refund under MCL 205.54i(2), the bad-debt statute, which allows taxpayers or lenders such as plaintiff to "deduct the amount of bad debts from his or her gross proceeds used for the computation of" sales tax owed.

On October 29, 2015, plaintiff's counsel sent defendant Department of Treasury (the Department) a one-paragraph letter requesting a refund under MCL 205.54i. Plaintiff sought a total of $419,292.19. The Department responded by asking plaintiff for documentation and evidence to support its claim, and, following an exchange of documents by plaintiff, the Department ultimately issued a partial refund in the amount of $90,722.79. Plaintiff's complaint challenges the partial denial. Initially, plaintiff sought $293,434.40, which was the amount denied by the Department in July 2017. However, following discovery, and admission by plaintiff that it lacked the requisite written elections with respect to many of the bad-debt accounts included in its claim, see MCL 205.54i(3), plaintiff has subsequently reduced the amount it seeks to $168,131.52.

The Department's position throughout this litigation is essentially that plaintiff has failed to provide the requisite documentation to support its claim. The Department also notes that hundreds of the accounts that make up plaintiff's claim were sold to third-party debt collectors; the Department contends that sold accounts are expressly excluded from the definition of "bad

debt" under MCL 205.54i, such that they are ineligible for a refund under the statute. This Court agrees with the Department in both respects.

II. SUMMARY DISPOSITION UNDER MCR 2.116(C)(10)

Plaintiff and the Department agree that this matter is ripe for summary disposition under MCR 2.116(C)(10). "When entertaining a summary disposition motion under Subrule (C)(10), the court must view the evidence in the light most favorable to the nonmoving party, draw all reasonable inferences in favor of the nonmoving party, and refrain from making credibility determinations or weighing the evidence." *Dillard v Schlussel*, 308 Mich App 429, 445; 865 NW2d 648 (2014).

Plaintiff is seeking a refund or deduction under the bad-debt statute, 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 proof. *Andrie Inc v Dep't of Treasury*, 496 Mich 161, 171; 853 NW2d 310 (2014). When, as in this case, a taxpayer seeks a refund of sales taxes purportedly paid, the taxpayer's burden extends to showing that sales tax was in fact paid; this burden is not relieved by the fact that a retail seller has a legal obligation to remit sales tax. *Id.* at 176 ("Although a retail seller has a legal obligation to remit sales tax . . . this does not mean that the tax necessarily was paid by the seller . . . ."). Moreover, the bad-debt deduction statute expressly gives the Department discretion to determine the evidence that a claimant must produce. *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*, 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." *Id.*

The first issue presented in this case concerns the Department's demand that plaintiff produce evidence establishing that sales tax was paid on the underlying retail sales. In order to examine whether that request is supported by a rational basis, a brief review of the Supreme Court's decision in *Ally Fin* is beneficial. In that case, which involved a bad-debt refund request filed by automobile financing companies, the Department asked the taxpayers to provide what is known as an "RD-108" form as proof that sales tax was paid. *Id.* at 504-505. The taxpayers in that case disagreed such a form was necessary, contending that because the automobile dealers who made the sales had the RD-108 forms, and the dealers might have lost the forms, the taxpayers should not be expected to produce them. *Id.* at 504. Moreover, the taxpayers argued that, although they could obtain the forms from the Secretary of State, it would cost $11 per form, and, in light of these circumstances, the Department should have accepted the taxpayers' "own spreadsheets tracking the amount of tax paid on each vehicle." *Id.*

The Supreme Court rejected the taxpayers' argument and held that the Department had a rational basis to demand the validated RD-108 forms. *Id.* at 504-505. The Court rejected the notion that the spreadsheets provided by the taxpayers were sufficient to establish that the pertinent sales tax had been paid: "[the taxpayers] provided their own internal records accounting for the payments, but these records do not show that the taxes were actually remitted." *Id.* at 504. In addition, the Court agreed with the Department that the taxpayers failed to show the amount of any taxes paid, even if they could show proof of payment. *Id.* at 504-505. "As a result, [the taxpayers] have not shown that the Department's requirement that plaintiffs provided the validated RD-108 forms had no rational basis" and the Department "properly exercised its

discretion under the bad-debt statute . . . ." *Id.* at 505. In so concluding, the Court stated, in a footnote, that the taxpayers were "not left without any method of obtaining the refunds because they can obtain these [validated RD-108] forms from the Secretary of State for a reasonable cost." *Id.* at 505 n 41.

Returning to the instant case, the Department repeatedly asked plaintiff for proof that sales tax was paid on the original taxable transactions giving rise to the bad-debt accounts. In its January 27, 2017 letter, the Department indicated that a "sampling of customer account statements" which "detail[ed] all items purchased during the period" would suffice. In response, plaintiff provided spreadsheets that noted items like "adjusted principal charge off amount," as well as information about customers and retailers. Plaintiff contends that the spreadsheets detailed the payment of sales tax by the pertinent retailers by way of a fraction plaintiff developed. The fraction, referred to as a "taxable percentage," was derived from plaintiff's communications with select retailers and it consists of the retailers' calculations of "gross taxable sales divided by all sales made by each PLCC Michigan retailer." Plaintiff contends that this "taxable percentage" is sufficient to show proof of sales tax paid. The Department disagrees.

On a review of the record, this Court agrees with the Department's position. As a result, the Court concludes that the Department had a rational basis to request additional information from plaintiff, and that plaintiff has not satisfied its burden of demonstrating entitlement to the claimed deduction. At the outset, it must be noted that the issue concerns the Department's request for evidence that sales tax was in fact paid. In response to this request, plaintiff submitted its "taxable percentage." An overarching problem with this percentage is that it merely *assumes* sales tax was paid. In other words, the formula calculates sales subject to taxation, but it does nothing to demonstrate that sales tax was in fact paid. The percentage sheds

no light on the question posed by the Department's inquiry, which was for proof that sales tax was remitted by the retailers. As noted by the Supreme Court, pointing out that "a retail seller has a legal obligation to remit sales tax . . . does not mean that the tax necessarily was paid by the seller . . . ." *Andrie*, 496 Mich at 176. Rather, the taxpayer seeking a refund must establish that the tax was paid.

In addition to the above, the Court finds the Department had a rational basis for its request because of apparent discrepancies in the documentation submitted by plaintiff. For instance, one retailer, Saks Incorporated, reported a taxable percentage indicating *more than* 100%—108.75%—of all sales in December 2010 were taxable. In addition, some of the customer account samplings provided by plaintiff—which is something the Department's January 2017 letter suggested would suffice—contained out-of-state purchases. There is no evidence in the record reconciling these out-of-state purchases with a request for a refund of Michigan sales tax. Additionally, none of the customer account samplings even speak to the payment of sales tax, which was the core issue cited by the Department. Such matters provide additional support for the conclusion that the Department's decision to request additional information did not lack a rational basis. See *Ally Fin*, 502 Mich at 504-505.

In arguing for a contrary result, plaintiff argues that the Department's request was unreasonable because, in plaintiff's estimation, complying with the request would have required plaintiff to obtain tax records possessed by all of the pertinent retail sellers. According to plaintiff, the Supreme Court's decision in *Ally Fin* stands for the proposition that if a claimant under the bad-debt statute neither possesses nor is able to obtain the documentation requested by the Department, the Department's request lacks a rational basis. Plaintiff argues that, by making

the deduction so difficult for lenders such as plaintiff to claim, the Department is thwarting the Legislature's intent.

The Court does not read *Ally Fin* in the same manner as plaintiff does. In that case, the Supreme Court held that the spreadsheets and records provided by the taxpayers did not establish that sales tax was paid, such that the Department's decision to ask for validated RD-108 forms had a rational basis. *Ally Fin*, 502 Mich at 505. In a footnote, the Supreme Court merely pointed out that the taxpayers were "not left without any method of obtaining the refunds because they can obtain these forms [the RD-108s] from the Secretary of State at a reasonable cost." *Id.* at 505 n 41. Contrary to plaintiff's position in the instant case, the Supreme Court did not hold that the Department's request had a rational basis simply because the plaintiffs could obtain the proof requested. Rather, the Court's holding was that the request had a rational basis because the information the plaintiffs provided "does not conclusively establish that taxes were paid." *Id.* at 504-505. And in passing, the Court noted that the plaintiffs could obtain the forms. *Id.* at 505 n 41. In other words, the Court's focus was on the inadequacy of the information provided by the plaintiffs. Thus, the proper inquiry is whether the Department, in light of its statutorily authorized discretion to request evidence to support a claim, has acted with a rational basis. *Id.* at 504. The plaintiff's possession of information could, at times, be relevant to that assessment. However, it should not necessarily be dispositive. Indeed, adopting plaintiff's position in the instant case would essentially allow the taxpayer to dictate the pertinent evidence by simply representing that it lacks what the Department requests. That would turn the discretion afforded to the Department on its head and it would allow the taxpayer to defeat the Department's request

simply by stating that it does not have the evidence.[1] The Court refuses to adopt such a position, based on the plain language of MCL 205.54i(4) and *Ally Fin*'s reasoning.

III. CONCLUSION

IT IS HEREBY ORDERED that defendants' motions for summary disposition are GRANTED pursuant to MCR 2.116(C)(8) (as to the State),[2] and (C)(10) (as to the Department and Khouri).[3]

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

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

Dated: December 18, 2018

Colleen A. O'Brien, Judge
Court of Claims

[1] The Court also notes that the Department's request in this case is not as onerous as plaintiff alleges. The Department stated that plaintiff could provide a sampling of accounts in order to show that sales tax was paid. The Department did not request proof of payment of sales tax on each and every transaction. Plaintiff did not provide an adequate sampling, however.

[2] With respect to the State's motion, the State argues that plaintiff has failed to assert any allegations against it, such that summary disposition is warranted under MCR 2.116(C)(8). Plaintiff has not responded to that motion. Moreover, a review of the complaint reveals no meaningful allegations against the State. As a result, the motion is granted. Moreover, plaintiff's complaint is dismissed under MCR 2.116(C)(10), for the reasons stated above.

[3] Because defendants are entitled to summary disposition, the Court need not address the other arguments raised by defendants. However, the Court briefly notes that accounts which have been sold to third parties for collection are expressly excluded from the definition of "bad debt" in MCL 205.54i(1)(a). Moreover, the Supreme Court's discussion in *Ally Fin*, 502 Mich at 496-498, forecloses any contention by plaintiff that it can seek a refund for any account that was sold to a third party for collection, even where the sale was for an amount less than what was owed on the account.