STATE OF MICHIGAN

COURT OF CLAIMS

CAPITAL ONE, N.A. v NICK A. KHOURI *et al.*

Case No. **16-000201-MT** **Hon. Michael J. Talbot**

ORDER

At a session of said Court held,
Detroit, Wayne, Michigan, on
September 29, 2017.

Plaintiff Capital One, N.A., having filed a motion for summary disposition pursuant to MCR 2.116(C)(10);

Defendants, having filed a cross-motion for summary disposition under MCR 2.116(C)(10);

IT IS HEREBY ORDERED that Plaintiff's motion for summary disposition is DENIED and Defendants' motion for summary disposition is GRANTED pursuant to MCR 2.116(C)(10).

IT IS HEREBY FURTHER ORDERED that Defendants' motion to strike and Plaintiff's motion for leave to file a reply and witness list are DENIED as moot.

This is a final order that resolves the last pending claim and closes the case.

Michael J. Talbot, Judge

Court of Claims State of Michigan

A true copy entered and certified by Jerome W. Zimmer Jr., Clerk, on

SEP 29 2017
Date

Clerk

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. 16-000201-MT Hon. Michael J. Talbot

Currently before the Court is Plaintiff Capital One N.A.'s ("Capital One") motion for summary disposition pursuant to MCR 2.116(C)(10), as well as Defendants' (hereinafter collectively referred to as, "Treasury") motion for the same. Also before the Court is Treasury's motion to strike an affidavit filed in support of Capital One's motion for summary disposition, and Capital One's motion for leave to file a witness list. Because there is no genuine issue of material fact and Capital One was not entitled to the tax refund it claimed, summary disposition in favor of Treasury is GRANTED, and the motions to strike and for leave to file a reply and witness list are DENIED as moot.

I. BACKGROUND

This case involves a claim for a refund under MCL 205.54i, the "bad-debt deduction" for accounts that Capital One either acquired by way of purchasing accounts that originally belonged to another entity, HSBC, or by way of directly financing purchases made by retail customers.

The following facts are not in dispute. In 2012, Capital One acquired certain credit card accounts, including private label credit card accounts (PLCCs)[1] belonging to HSBC. On or about September 27, 2013, Capital One sent a single-paragraph refund request to Treasury seeking a bad-debt refund of $8,691,658.20[2] "relating 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." The request spanned the time period of October 1, 2009, through June 30, 2013.

Capital One's request was based on the "bad-debt" deduction—oftentimes referred to as a bad-debt refund or credit—under MCL 205.54i. In short, MCL 205.54i provides a tax credit or refund of sales tax remitted on an account that becomes uncollectible. See *Menard Inc v Dep't of Treasury*, 302 Mich App 467, 480; 838 NW2d 736 (2013). The issue in this case involves retail purchases made on PLCCs and accounts receivable that became worthless and uncollectible. The credit or deduction allowed under MCL 205.54i(2) can be claimed by the vendor who made the sale, or by a lender who holds the account receivable, provided certain statutory requirements are met.

Treasury responded to Capital One's request in February 2015 with a letter informing Capital One that documentation was needed to substantiate the refund claim. Treasury informed Capital One that, although a bad-debt credit could be claimed by a third-party lender, the retailer and lender had to "execute and maintain" a written election designating which party could claim

---

[1] The term "private label credit card" "means any charge card, credit card, or other instrument serving a similar purpose that carries, refers to, or is branded with the name or logo of a vendor and that can only be used for purchases from the vendor." MCL 205.54i(1)(d).

[2] Capital One later reduced its claim to $1,914,071.22, based on its own review of the pertinent accounts at issue. However, its complaint, which was filed after the date on which it revised the claim, once again sought a refund in the amount of $8,691.658.20.

the deduction. Additionally, Treasury asked Capital One for documentation to substantiate that the accounts had been found worthless and written off for the years in question. Further, Treasury asked Capital One to provide, by way of "a sampling of customer account statements," evidence that sales tax was paid on the original taxable transaction, as well as credit card statements for the purchases that "detail all items purchased during the period." Finally, Treasury noted that, under the plain language of MCL 205.54i(1)(a), the "bad-debt" credit could not be sought for any repossessed property.

On October 23, 2015, Capital One sent a response to Treasury and provided a CD "with an account level spreadsheet of the accounts included in the refund claim." The response also included a "randomly selected [ ] sample of 50 accounts." According to Capital One, the payment histories included therein showed purchases on the accounts, as well as debits and credits on the account. Of the 14,954 accounts listed in the documentation provided by Capital One, 13,240 were charged off as uncollectible by HSBC before the date on which Capital One purchased the accounts. Capital One submitted excerpts from certain PLCC agreements, as well as written election forms, the vast majority of which were executed after the debts were written off as uncollectible, purporting to give Capital One the right to claim the bad-debt refunds sought in this case. Finally, Capital One represented that it "did not repossess" any of the property financed in the transactions at issue.

At some point Capital One adjusted its refund request from $8,691,658.20 down to $1,914,071.22. On May 23, 2016, Treasury denied the request for the full amount of $1,914,071.22 and concluded that Capital One was only entitled to a refund in the amount of

$5,957.23.[3] The denial letter began by noting that, under MCL 205.54i(4), any request for a bad-debt refund must be supported by the evidence required by Treasury. The letter noted that Capital One submitted documentation in response to Treasury's request, but that documentation was insufficient. Firstly, Treasury asked for credit card statements detailing all items purchased during the relevant time period, but the "[d]ocumentation received does not indicate the items that were purchased by the customer[s]." Secondly, Treasury found that all but one of the written elections submitted by Capital One were deficient. Citing Revenue Administrative Bulletin (RAB) 2015-27, Treasury stated that the written elections had to have been executed before the bad debt was incurred. And in this case, the written elections occurred after the bad debt was incurred, with the lone exception being a written election for Helzberg's Diamond Shops. Treasury contended that the remaining documentation for Helzberg's was deficient in that Capital One did not provide "an itemized listing of the purchases" or that the items sold were not repossessed. Nevertheless, Treasury stated that "we believe the items (jewelry) sold were taxable to the customer and not repossessed," so it issued a $5,957.23 refund in regard to the Helzberg's accounts.

Thereafter, Capital One filed a complaint in this Court. The parties, having fully and adequately briefed the pertinent issues, contend that the matter is ripe for decision under MCR 2.116(C)(10). Summary disposition is appropriate under MCR 2.116(C)(10) if there is no genuine issue of material fact and the moving party is entitled to judgment as a matter of law. "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

[3] The parties occasionally represent that the amount of the refund was $6,600.46.

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).

II. ANALYSIS

The arguments raised in this case require examination of MCL 205.54i. "The judiciary's objective when interpreting a statute is to discern and give effect to the intent of the Legislature. Once the intent of the Legislature is discovered, it must prevail regardless of any rule of statutory construction to the contrary." *Menard Inc*, 302 Mich App at 471 (citation omitted). The starting point for this inquiry is the plain language of the statute. *Id.* This case involves a claimed deduction under MCL 205.54i. Taxation is the rule, and deductions are considered a "matter of legislative grace . . ." and are generally disfavored. *Id.* at 473. Deductions, like exemptions, are construed strictly against the taxpayer. *Id.* Moreover, Capital One, as the party claiming entitlement to the deduction, bears the burden of proof. *Id.* at 473, 479.

The exemption claimed in this case arises under the general sales tax act, MCL 205.51 *et seq*. "[T]he legal responsibility for the sales tax falls on the retail seller, with the tax being levied for the privilege of making sales at retail." *Andrie Inc v Dep't of Treasury*, 496 Mich 161, 169; 853 NW2d 310 (2014). Although the retail seller bears responsibility for sales tax, the seller may pass the economic burden of the tax onto the customer at the point of sale by collecting the tax from the customer. *Id.* See also *Menard Inc*, 302 Mich App at 480. Regardless of whether the seller collects sales tax from the customer, however, the seller remains responsible for remitting sales tax to the state. *Andrie*, 496 Mich at 169. While the seller is responsible for remitting the tax, our Supreme Court has held, particularly in a case involving a claimed exemption, that courts should not presume sales tax has been paid at the point of sale. *Id.* at 171.

Pertinent to this case, the bad-debt deduction "allows taxpayers to recover overpayment when expected sales proceeds are not received." *Menard Inc*, 302 Mich App at 480 (citation and quotation marks omitted). As used in the statute, the term "bad debt" means, in pertinent part,

> any portion of a debt that is related to a sale at retail taxable under this act for which gross proceeds are not otherwise deductible or excludable and that is eligible to be claimed, or could be eligible to be claimed if the taxpayer kept accounts on an accrual basis, as a deduction pursuant to section 166 of the internal revenue code, 26 USC 166. [MCL 205.54i(1)(a).]

The statute permits a taxpayer to

> deduct the amount of bad debts from his or her gross proceeds used for the computation of the tax. The amount of gross proceeds deducted must be charged off as uncollectible on the books and records of the taxpayer at the time the debt becomes worthless and deducted on the return for the period during which the bad debt is written off as uncollectible in the claimant's books and records and must be eligible to be deducted for federal income tax purposes. [MCL 205.54i(2).]

The statute imposes two key requirements on claimants who seek the deduction. Firstly, in situations such as the instant case that involve a lender, there must be a written election designating which party may claim the deduction. See MCL 205.54i(3). Secondly, the statute specifies that "[a]ny claim" under this section "shall be supported by that evidence required by the department." MLC 205.54i(4). Treasury argues that it is entitled to summary disposition for a number of reasons, including that: (1) the written elections submitted in this case do not satisfy MCL 205.54i(3); and (2) Capital One failed to submit the requisite supporting evidence. This Court agrees with Treasury in both respects.

A. WRITTEN ELECTION AGREEMENTS

Turning first to the issue of the written elections—and assuming, without deciding, that the remainder of Capital One's arguments are correct—the undisputed facts demonstrate that Treasury is entitled to judgment as a matter of law. The election forms in this case do not satisfy

the requirements of the bad-debt statute because they were executed *after* the bad debts were charged off as uncollectible.[4] Capital One argues that such a requirement is not within the plain language of MCL 205.54i, and urges this Court to disagree with Treasury's position.

The requirement that a retailer and a lender enter into a written election is set forth in MCL 205.54i(3), which provides:

> (3) After September 30, 2009, if a taxpayer who reported the tax and a lender execute and maintain a written election designating which party may claim the deduction, a claimant is entitled to a deduction or refund of the tax related to a sale at retail that was previously reported and paid if all of the following conditions are met:
>
> (a) No deduction or refund was previously claimed or allowed on any portion of the account receivable.
>
> (b) The account receivable has been found worthless and written off by the taxpayer that made the sale or the lender on or after September 30, 2009.

The Court of Appeals in *Ally Fin, Inc v State Treasurer*, 317 Mich App 316, 327; 894 NW2d 673 (2016), explained that the language employed in MCL 205.54i(3) "creates a condition precedent to a tax refund." The taxpayer and lender must execute the written election, and the failure to do so is fatal to a claim under the bad-debt deduction. *Id.* Moreover, the statute is clear that the taxpayer and lender must "maintain" the written election.

Treasury, pursuant to its authority to issue RABs, has issued guidance on written elections between taxpayers and lenders. As Treasury points out, RAB 2015-27 specifies that "[t]he written election must be executed *before* the bad debt is incurred." RAB 2015.27, p 4 (emphasis added). Treasury's interpretation of tax statutes in an RAB is entitled to respectful

[4] Save for the Helzberg's Diamond election form, for which Treasury granted Capital One's request for refund.

consideration, but is not binding "and cannot conflict with the plain language of the statute . . ." *Ally Fin*, 317 Mich App at 336 (citation and quotation marks omitted). Capital One argues that Treasury's interpretation of MCL 205.54i(3) conflicts with the plain language of the statute by adding a requirement—that the written election be executed before the bad debt is incurred—that is not found within the plain language of the statute.

At first glance, Capital One's argument has some appeal. However, the plain language of MCL 205.54i(3) requires a retailer and lender to "execute and maintain" a written election specifying who can claim the deduction. The word "maintain" is not defined in the statute, but is generally defined to mean "to continue or persevere[.]" *Meriam-Webster's Collegiate Dictionary*, (11th ed).[5] The use of the word "maintain" in the statute suggests a durational requirement for the written election, i.e., that the election must be kept for some period of time. Treasury's interpretation in RAB 2015-27 gives meaning to this idea by requiring that the written election be in place *before* the bad debt is incurred and at the time the agreement is made between the retailer and the lender. Stated otherwise, Treasury's interpretation of MCL 205.54i(3) as expressed in RAB 2015-27[6] is consistent with the statute and gives meaning to an otherwise undefined statutory term. Accordingly, there is merit to Treasury's contention that written elections between a retailer and lender must be executed *before* the bad debt is incurred, i.e., at the time the retailer assigns the accounts receivable to the lender. And an attempt to

[5] When words of phrases are undefined in a statute, Courts may turn to a dictionary for guidance. *Weaver v Giffels*, 317 Mich App 671, 678; 895 NW2d 555 (2016).

[6] Capital One notes that RAB 2015-27 was issued *after* it submitted its claim for refund in this case. While it is true that the RAB was not in effect at the time Capital One submitted its refund claim, the RAB interprets the version of MCL 205.54i(3) that was in effect at the time Capital One sought the refund.

create a post-hoc written election, as occurred here, does not comport with the statutory requirement that the election be "maintained."

Based on that understanding of the written-election requirements in MCL 205.54i, the written elections in this case were deficient. Save for the written election with Helzberg's diamonds, there is no dispute that the written elections executed in this case were executed *after* the debts were charged off as uncollectible. Because the written elections were not "maintained" as is required by the plain language of MCL 205.54i(3), Capital One failed to satisfy a necessary "condition precedent to a tax refund," and this failure of a condition is fatal to Capital One's claimed entitlement to a refund. See *Ally Fin*, 317 Mich App at 327.

B. LACK OF REQUISITE SUPPORTING EVIDENCE

Capital One's failure to submit the requisite supporting evidence, as mandated by MCL 205.54i(4) represents an independent basis for granting summary disposition in favor of Treasury. As noted, MCL 205.54i(4) specifies that any claim for a refund or deduction under the statute "shall be supported by that evidence required by the department." MLC 205.54i(4). In *Ally Fin*, 317 Mich App at 331, the Court of Appeals adopted this Court's conclusion that MCL 205.54i(4) "placed in the Department's control" the ability to specify the evidence required of a claimant under the statute. *Id.* Further, as the Court of Appeals explained in *Ally Fin*, the fact that MCL 205.54i provides a deduction or exemption means that the claimant bears the burden of providing the evidence required by Treasury. *Id.* In that regard, Treasury has specified in RABs the evidence required of a claimant under MCL 205.54i(4). See RAB 2015-27; RAB 1989-61.

On the evidence presented in this case, Capital One failed to substantiate its claims for a refund. Commensurate with its authority to request a claimant furnish the requisite

documentation, Treasury in this case asked Capital One to provide proof showing that sales tax was, in fact, paid on the underlying retail sales, and the amount of such sales tax. Treasury's February 18, 2015 letter, the purpose of which was to ask Capital One for information to substantiate the claim, sought "[e]vidence that the tax was paid," and suggesting that "credit card statements" should contain such detail. In response, Capital One produced two spreadsheets of the accounts: they are attached to Defendants' motion for summary disposition as Exhibits H and L,[7] and were filed under seal. Both exhibits contain a representative sampling of 50 accounts as well as a CD that contains entries for 14,954 accounts. However, the spreadsheets do not show that sales tax was in fact paid or the amount of sales tax, if any, that was paid.[8] At best, the representative sampling spreadsheets have columns showing the "sales tax rate," and the amount charged off on the account. However, this is merely an *assumption* that sales tax was paid, and not a record or proof that sales tax was paid. Nor does Capital One's documentation contain specifics on the purchase history or purchases at issue; instead, it merely shows the total account balance at the time the account was charged off as uncollectible.

In light of Capital One's failure to provide evidence that sales tax was paid, the refund claim fails. MCL 205.54i(4) conditions a claimant's entitlement to a refund on producing that which is required by Treasury. See MCL 205.54i(4); *Ally Fin*, 317 Mich App at 332 ("The Department was granted authority to determine the evidence necessary to support the refund."). In *Ally Fin*, one of the issues before the Court was whether the claimant, consistent with MCL

[7] The second spreadsheet, Exhibit L, appears to have been produced during discovery in this matter.

[8] Nor do they show individualized purchases, which was another piece of evidence requested by Treasury in this case.

205.54i(4)'s plain directive, complied with Treasury's requirement to submit a certain form showing that "the taxes had, in fact, been paid." Just as occurred in the instant case, the taxpayer in *Ally Fin* did not submit the proof as required by Treasury. *Id.* Such a conclusion was not only consistent with the plain language of MCL 205.54i(4), but it was also consistent with the general rules requiring a taxpayer to bear the burden of proof with regard to the claimed exemption. *Id.* at 332-333.

A similar decision is warranted in this case. Treasury required Capital One to submit proof that the tax was paid and the amount of tax paid. Capital One did not comply with this directive in its refund request. Capital One largely does not contest that it failed to provide the information. Instead, Capital One, despite recognizing that MCL 205.54i(4) expressly grants Treasury the discretion to require certain documentation as a condition to obtaining a refund, argues that Treasury can only require documentation if it is expressly listed in the statute. That argument finds no solace in the unambiguous language of MCL 205.54i(4), which, as the Court in *Ally Fin* recognized, grants discretion to Treasury to "determine the evidence necessary to support the refund." *Ally Fin*, 317 Mich App at 332-333. Accordingly, Capital One did not satisfy its burden of showing entitlement to the claimed refund. See *id.* This Court will not presume that sales tax was paid, particularly in the context of a request for a refund. See *id.* See also *Andrie*, 496 Mich at 171. Indeed, "[a] presumption of sales tax payment would shift this burden to the department, contrary to established law regarding tax exemptions." *Id.* at 171-172.

C. REPOSSESSED PROPERTY AND ACCOUNTS SOLD FOR COLLECTION

Although the two reasons stated above are sufficient to warrant summary disposition in favor of Treasury, the Court notes that, based on the evidence presented, some of the charged-off accounts for which Capital One sought refunds either: (1) pertain to repossessed property; or (2)

were sold to a third party for collection. Treasury is correct that the plain language of MCL 205.54i excludes these two types of accounts. Notably, MCL 205.54i(1)(a), which defines the term "bad debt" expressly excludes from the definition of the term:

> any finance charge, interest, or sales tax on the purchase price, uncollectible amounts on property that remains in the possession of the taxpayer until the full purchase price is paid, expenses incurred in attempting to collect any account receivable or any portion of the debt recovered, *any accounts receivable that have been sold to and remain in the possession of a third party for collection, and repossessed property*. [Emphasis added.]

Moreover, as it concerns "repossessed property," the Court of Appeals in *Ally Fin*, 317 Mich App at 333-335, held that the statute expressly excludes such property, no portion of any account involving repossessed property may be included in a refund claim under MCL 205.54i.

III. CONCLUSION

For the reasons stated above, summary disposition pursuant to MCR 2.116(C)(10) is warranted in favor of Defendants. And, because summary disposition is warranted, the Court need not decide Treasury's additional arguments in support of summary disposition, nor does the Court need to decide issues pertaining to witness lists or Treasury's motion to strike.

Dated: September 29, 2017

Michael J. Talbot, Judge