STATE OF MICHIGAN

COURT OF CLAIMS

VECTREN INFRASTRUCTURE SERVICES CORP., successor of MINNESOTA LIMITED, INC.,

Plaintiff,

v

DEPARTMENT OF TREASURY,

Defendant.
_____/

OPINION AND ORDER

Case No. 17-000107-MT

Hon. Colleen A. O'Brien

Pending before the Court are the parties' competing motions for summary disposition pursuant to MCR 2.116(C)(10). For the reasons stated herein, defendant's motion is GRANTED pursuant to MCR 2.116(C)(10), and plaintiff's competing motion for the same is DENIED. This matter is being decided without oral argument pursuant to LCR 2.119(A)(5).

I. BACKGROUND

Plaintiff is the successor-in-interest to Minnesota Limited Inc. (MLI), a Minnesota-based S-Corporation ("S-Corp"). In March 2011, the shareholders of MLI sold their shares to plaintiff. The parties to the sale were in agreement that the shareholders would treat the sale as an asset sale, pursuant to an election made under 26 USC 338(h)(10). The issues in this case arise from MLI's Michigan Business Tax (MBT) return for the short tax year of January-March 2011 (2011 Short Year).

When MLI filed its 2011 Short Year return, it included the gain on the sale in its "business income" for purposes of calculating business income tax due under the MBT. Also, when MLI calculated the "sales apportionment factor" under MCL 208.1303, it included the sale in the denominator of the fraction. MLI calculated its sales apportionment factor at approximately 14.99%.

On audit, defendant agreed that the gain on the sale was "business income." However, the auditor determined that the sale of stock should not have been included in the denominator of the sales apportionment factor. After removing the sale from the denominator, the auditor determined that the sales apportionment factor was approximately 69.96%. The effect of changing the sales apportionment factor increased MLI's MBT liability by $2,388,963. Defendant issued a final assessment in this amount, plus $550,792.07 in interest, as well as a $112,979 late-payment penalty.

Plaintiff requested an informal conference and penalty relief in June 2016. In addition, plaintiff submitted a request for alternative apportionment under MCL 208.1309. After defendant denied the request for alternative apportionment, plaintiff withdrew its request for informal conference, and filed this complaint. Plaintiff alleges that the gains on the sale of MLI stock should not have been included in the calculation of MLI's "business income" under the MBT.[1] Alternatively, plaintiff argues that it should be entitled to alternative apportionment because the standard apportionment formula unfairly taxes the extent of MLI's business activities in this state. In making its request for alternative apportionment, plaintiff points out

[1] Plaintiff does not challenge the decision of the auditor to remove the gains on the sale from the sales factor denominator.

that its sales within this state were, based on a contract to provide clean-up services in relation to the Enbridge oil spill near the Kalamazoo River, significantly higher than they had ever been. In addition, plaintiff argues that the 2011 Short Year's sales were further inflated by the sale of MLI's stock to plaintiff. Finally, plaintiff argues that it is entitled to penalty abatement.

II. ANALYSIS

Plaintiff and defendant agree that this case is ripe for summary disposition under MCR 2.116(C)(10). A motion for summary disposition under MCR 2.116(C)(10) tests the factual sufficiency of the complaint. *Joseph v Auto Club Ins Ass'n*, 491 Mich 200, 206; 815 NW2d 412 (2012). Summary disposition is appropriate under MCR 2.116(C)(10) if there is no genuine issue as to any material fact and the moving party is entitled to judgment as a matter of law. *Barnard Mfg Co, Inc v Gates Performance Engineering, Inc*, 285 Mich App 362, 369; 775 NW2d 618 (2009).

A. WHETHER THE SALE OF MLI STOCK IS "BUSINESS INCOME" UNDER THE MBT

The now-repealed MBT, see 2011 PA 39, was comprised of two taxes: the business income tax, see MCL 208.1201, and the modified gross receipts tax, see MCL 208.1203. The taxation at issue concerns MLI's business income tax. The first issue framed by the parties is whether the sale of MLI stock by the company's shareholders constitutes "business income" of MLI. The business income tax was imposed on a taxpayer's "business income tax base, after allocation or apportionment to this state[.]" MCL 208.1201(1). Resolution of this issue involves an examination of pertinent statutory definitions found within the MBA. When interpreting a statute, this Court's "primary goal is to discern and give effect to the Legislature's intent." *TMW v Dep't of Treasury*, 285 Mich App 167, 172; 775 NW2d 342 (2009). The Court must look to the plain language of the statute and must "give effect to every word, phrase, and clause in a

statute, and [ ] avoid an interpretation that would render any part of the statute surplusage or nugatory." *Id.* (citation and quotation marks omitted). Moreover, because the statute at issue concerns the imposition of tax liability, any ambiguities in the statute must be resolved in favor of the taxpayer. *Alliance Obstetrics & Gynecology v Dep't of Treasury*, 285 Mich App 284, 286; 776 NW2d 160 (2009).

The starting point for determining whether the sale of MLI stock constitutes "business income" is MCL 208.1105(2), which defines "business income" to mean "that part of federal taxable income derived from business activity. For a partnership or S corporation, business income includes payments and items of income and expense that are attributable to business activity of the partnership or S corporation and separately reported to the partners or shareholders." In this case, MLI was an S-Corp, meaning that it had "no federal taxable income at the federal level[.]" *TMW*, 285 Mich App at 167. Hence, in order to determine its "business income" for purposes of the MBT, the statute directs that the Court look to "payments and items of income and expense" that are: (1) attributable to the business activity of the S-Corp; and (2) separately reported to the shareholders of the S-Corp. MCL 208.1105(2).

The parties do not dispute that the sale represents "income" that was separately reported to the shareholders of MLI. They dispute, however, whether the income is "attributable to the business activity" of MLI. The MBT defines "business activity" to mean:

> a transfer of legal or equitable title to or rental of property, whether real, personal, or mixed, tangible or intangible, or the performance of services, or a combination thereof, made or engaged in, or caused to be made or engaged in, whether in intrastate, interstate, or foreign commerce, with the object of gain, benefit, or advantage, whether direct or indirect, to the taxpayer or to others, but does not include the services rendered by an employee to his or her employer or services as a director of a corporation. [MCL 208.1105(1).]

Relying on the structure of transaction between the shareholders and plaintiff and on the structure of an S-Corp, plaintiff contends that the sale cannot be deemed to be the "business activity" of MLI. In doing so, plaintiff notes that the only parties to the sale were the shareholders and plaintiff; MLI was not a party to the transaction. The sale of stock by shareholders, argues plaintiff, cannot reasonably be considered part of MLI's business activity.

However, as defendant points out, the § 338(h)(10) election in place treated the sale as a sale of all of the S-Corp's assets. See 26 USC 338(a)(1). The Court concludes that the § 338 election chosen by plaintiff and MLI's shareholders is of particular significance to this case. In light of this election, the Court cannot agree with plaintiff's contentions about the nature of the MLI sale, i.e., that it was merely a sale of shares with no relation to the "business activity" of MLI. Pursuant to this election, plaintiff and MLI expressly chose to treat the sale as an asset sale. As noted, the term "business activity" under the MBT refers to the "transfer of legal or equitable title to . . . property, whether real, personal, or mixed, tangible or intangible . . . ." MCL 208.1105(1). This also includes activities that are merely "incidental" to the taxpayer's business's activities. *Id*. In this case, selling all of the assets of MLI, tangible or otherwise, is, at a minimum, incidental to MLI's business activity. The definition of "business income" under the MBT asks the Court to consider the business activity of an S-Corp that is "separately reported to the . . . shareholders." MCL 208.1105(2). Here, the sale was expressly reported to the shareholders as a sale of the S-Corp's assets. See 26 USC 338(a). Accordingly, the Court concludes that the sale in this case generated "business income" i.e., income that was attributable to the business activity of an S-Corp and separately reported to the shareholders of the S-Corp. See MCL 208.1105(2). This business income was properly subject to taxation under the MBT.

In advocating for a different result, plaintiff asks this Court to conclude that the § 338 election has no bearing on the question of whether the sale of shares amounted to "business income" or "business activity" under the MBT. Plaintiff points to another section of the MBT which defines the term "gross receipts" for purposes of the imposition of the modified gross receipts tax under MCL 208.1203. To that end, "gross receipts" is defined under MCL 208.1111(1) to mean "the entire amount received by the taxpayer *as determined by using the taxpayer's method of accounting used for federal income tax purposes* . . . ." Plaintiff argues that this Court should construe as intentional: (1) the inclusion of the phrase "method of accounting for federal income tax purposes" in the definition of "gross receipts"; and (2) the exclusion of any reference to federal accounting methods in the definition of "business income."

The Court rejects plaintiff's argument. The phrase "method of accounting used for federal income tax purposes" does not mean what plaintiff insinuates it means, and plaintiff's argument overstates the phrase's significance. The phrase is not defined in the MBT; as such, the Court should look to the Internal Revenue Code for guidance. See MCL 208.1103. The Internal Revenue Code, in 26 USC 446, describes several different "methods of accounting" including, in 26 USC 446(c), those methods deemed to be "permissible methods" for computing taxable income. Stated otherwise, this reference to "methods of accounting" in the definition of gross receipts simply refers to accounting methods that may be utilized by a taxpayer to track its receipts. And it is not remarkable that the MBT's definition of "gross receipts" permits a taxpayer to report those receipts based on a federal accounting method for doing the same. MCL 208.1111(1). Thus, plaintiff's attempt to exclude the effect of a § 338(h)(10) election on a taxpayer's "business income" by pointing to the definition of "gross receipts" is ineffective.

Moreover, and contrary to plaintiff's contentions, MCL 208.1105(2) does incorporate the "federal accounting fiction" occasioned by a § 338 election. Notably, MCL 208.1105(2)'s definition of "business income" refers to items of income and, for an S-Corp, inquires as to how those items are "separately reported to the . . . shareholders." Here, as noted above, a § 338(h)(10) election directly affects how income is "separately reported" to the S-Corp's shareholders. Thus, considering the effect of a § 338(h)(10) election is contemplated by MCL 208.1105(2). Furthermore, in general, the MBT expressly notes that, "[a] reference in [the MBT] to the internal revenue code *includes other provisions of the laws of the United States relating to federal income taxes*." MCL 208.1103 (emphasis added). Here, the definition of "business income" expressly refers to the taxpayer's federal income tax under the Internal Revenue Code. Consistent with MCL 208.1103, this Court is to construe the reference to the Internal Revenue Code in MCL 208.1105(2)'s definition of "business income" to include other pertinent provisions of the Internal Revenue Code. Hence, the § 338(h)(10) election controls the outcome in this case.

B. WHETHER PLAINTIFF SUSTAINED ITS BURDEN WITH RESPECT TO ITS REQUEST FOR ALTERNATIVE APPORTIONMENT

The next set of issues in this case involves plaintiff's request for alternative apportionment. MCL 208.1309(1) allows a taxpayer, in instances where the "apportionment provisions of this act"—in this case, the sales-apportionment factor—"do not fairly represent the extent of the taxpayer's business activity in this state[,]" to petition defendant for alternative apportionment. Alternative apportionment is not, however, an "all-purpose tax equity provision." *Trinovia Corp v Dep't of Treasury*, 433 Mich 141, 164; 445 NW2d 428 (1989), aff'd *Trinovia v Mich Dep't of Treasury*, 498 US 358; 111 S Ct 818; 112 L Ed 2d 884 (1991). In order to be entitled to alternative apportionment, a taxpayer must overcome the rebuttable

presumption that the apportionment provisions of the MBT "fairly represent the business activity attributed to the taxpayer in this state, taken as a whole and without a separate examination of the specific elements of either tax base[.]" MCL 208.1309(3). To do so, the taxpayer must 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." MCL 208.1309(3). Such a showing must be made by "clear and cogent evidence." *Trinovia*, 433 Mich at 146. When interpreting a similarly phrased provision in the now-repealed Single Business Tax (SBT), the Court of Appeals explained that alternative apportionment should be applied in only "the most unusual circumstances[.]" *Corning Inc v Dep't of Treasury*, 212 Mich App 1, 5; 537 NW2d 466 (1995).

Plaintiff contends that the apportionment formula as applied to the sale of MLI was out of all appropriate proportion to the business MLI conducted in Michigan and to MLI's activities in Michigan. However, while plaintiff generally frames its argument in this manner, the crux of plaintiff's contention is really with the computation of its tax base. Plaintiff's arguments stem directly from the inclusion of the gain on the sale in the computation of MLI's "business income" for the 2011 Short Tax Year. As noted in *Trinovia*, 433 Mich at 159 n 21, this type of argument is not concerned with the result or constitutionality of the apportionment formula, but it is simply a disagreement with the computation of MLI's tax base. This type of argument is inconsistent with "the proper function" of alternative apportionment. *Id.* The purpose of alternative apportionment is "to provide relief when the statutory apportionment provisions result in the unconstitutional taxation of a unitary business." *Id.* Alternative apportionment does not, on the other hand, operate to "shelter the taxpayer from rightful tax liability" and it does not

operate to "provide apportionment relief anytime a taxpayer can show, by manipulating its tax base, that a lower tax liability can be achieved." *Id*. And here, plaintiff's argument, and even one of its proposed alternatives,[2] is predicated on the notion that a different result can be achieved by the simple manipulation of its tax base. Although plaintiff's briefing dedicates a substantial amount of time to plaintiff's contentions about the percentage by which the standard apportionment formula increased MLI's tax liability, an examination of plaintiff's claims reveals that plaintiff's complaint is not with the standard apportionment formula or any effect the formula had on the tax imposed. Rather, the true nature of plaintiff's complaint is with the underlying calculations of its tax base, i.e., its business income. Indeed, plaintiff does not dispute its sales in Michigan for the 2011 Short Year, nor does plaintiff generally dispute the validity of the sales-apportionment formula. For that reason alone, plaintiff's appeal to alternative apportionment is unavailing. See *Trinovia*, 433 Mich at 159 n 21. And, for that reason, plaintiff's citation to the United States Supreme Court's decision in *Hans Rees' Sons, Inc v North Carolina*, 283 US 123; 51 S Ct 385; 75 L Ed 879 (1931), where the plaintiff presented evidence of the distortion and did not quarrel with the calculation of the tax base, is unavailing. As a result, plaintiff cannot overcome the presumption that the standard apportionment formula fairly represents the business activity of MLI in this state. See MCL 208.1309(3).

This conclusion is further underscored by taking note of plaintiff's claims about the Enbridge contract and the sale of MLI. Plaintiff notes that these events drastically increased

[2] One of plaintiff's suggested alternative methods of apportionment includes the sale in the sales factor denominator. Again, plaintiff has not argued, under the plain language of the MBT, that this sale *should* be included in the denominator. Instead, it has alleged the opposite: that including this number in the denominator achieves a fairer result as an *alternative*, i.e., non-statutory, form of apportionment.

MLI's tax liability under the MBT. However, the crux of plaintiff's contentions is not that these events attributed to Michigan activity occurring outside of the state. Rather, plaintiff contends that the "serendipity" of these events distorted MLI's tax liability *from a historical analysis of MLI's business activities*. Plaintiff repeatedly cites the "unique" nature of the transaction and the one-time Enbridge contract in arguing that the tax imposed was disproportionate. As part of its purported "proof," plaintiff points to the 10-year average of MLI's apportionment factor. However, these arguments do not demonstrate that the tax imposed in this case is out of proportion to MLI's activities within the state. These arguments point out that the tax imposed was out of proportion to *MLI's historical activities* in the state; they do not make the same point with respect to MLI's activities *within the state for the pertinent tax year*.

Plaintiff's arguments with respect to the value of the goodwill accrued by MLI fare no better. Plaintiff argues that none of the goodwill accumulated over the 52-year history of MLI can be attributed to the company's activity in Michigan. Plaintiff does not cite any documentary evidence to support this assertion.[3] Plaintiff argues that, because the tax imposed in this case

[3] Plaintiff's brief cites, at page 20, "Hirsch Aff ¶ 19, Ex A" for the proposition that none of MLI's goodwill was attributable to this state. It is unclear whether this is a reference to Bradley Hirsch's affidavit at ¶ 19—the affidavit is "Exhibit 2" to plaintiff's motion for summary disposition—or whether this is a reference to Exhibit A to Hirsh's affidavit, or to both. However, neither Hirsch's affidavit nor Exhibit A to his affidavit states that none of the goodwill accrued by MLI was attributable to this state. Paragraph 19 of Hirsch's affidavit simply explained what Hirsch believed to be goodwill, i.e., his averment that goodwill was "purchase price, less tangible assets, less identifiable intangible assets." Exhibit A to Hirsch's affidavit, meanwhile, is the draft valuation report prepared for plaintiff in advance of plaintiff's purchase of the MLI shareholders' stock. The report covers a wide range of topics, and includes overviews of plaintiff's business and of MLI's business. It also defines and explains the pertinent market in which MLI operated. The report assigns over a $20 million value to MLI's goodwill; however, plaintiff has not identified any sections of the report that source goodwill to any particular state or location.

purports to tax the value of the goodwill accumulated by MLI, the tax imposed extends beyond the actual business activity conducted by MLI in Michigan.

Plaintiff's argument is meritless. Initially, plaintiff has not satisfied its obligation of providing documentary evidence to support its assertion regarding where MLI accrued goodwill. See *Barnard*, 285 Mich App at 369-370. See also *Trinovia*, 433 Mich at 146 (requiring a taxpayer to produce "clear and cogent evidence" of distortion or extraterritorial taxation). Moreover, that a state's apportionment formula is inaccurate or that the formula may result in taxation of some business activity that is not attributable to the taxing state does not amount to a constitutional violation. *Trinovia*, 433 Mich at 158; *Corning*, 212 Mich App at 5-6. Additionally, plaintiff's unsupported contention, that none of the goodwill accumulated by MLI is attributable to this state, lacks merit. MLI conducted business in Michigan for years, and immediately before the sale to plaintiff, MLI significantly—as plaintiff readily admits—increased its presence and its business activity in Michigan by way of the Enbridge project. Hence, the Enbridge project, some of which extended beyond the date of the sale, contributed to the valuation of the company. Defendant was entitled to tax a portion of the goodwill on the sale. Furthermore, by attempting to limit the accumulation of MLI's goodwill solely to Minnesota, plaintiff's argument sounds in the nature of a "geographical accounting" argument that has been rejected. See *Corning*, 212 Mich App at 6.[4]

[4] Plaintiff's citation to a proposed revenue administrative bulletin (RAB) is unavailing. The proposed RAB is just that: a proposal which has not been adopted by defendant. Thus, any persuasive value it could potentially have is significantly undercut. Moreover, the proposed RAB pertains to a different statute and a different tax, and it is not pertinent to the issues raised in the instant case.

In addition to advocating for alternative apportionment, plaintiff argues that the resulting tax imposed in this case is unconstitutional. "Taxation of the intrastate activity of an interstate enterprise presents the potential for Due Process and Commerce Clause violations." *Trinovia*, 433 Mich at 156. Plaintiff's arguments in support of its constitutional claims are largely tied in with its rationale offered in support of alternative apportionment. Because the claim of unfair apportionment is meritless, and because plaintiff has not asserted that the tax was discriminatory, plaintiff's constitutional claims fail as well. See *id*. at 156, 156 n 17 (describing constitutional claims that can arise out of a taxing state's apportionment formula).

C. WHETHER PENALTY ABATEMENT IS WARRANTED

The final issue in this case concerns the $112,979 late-payment penalty imposed by defendant. In instances where a taxpayer fails to pay tax within the time specified by statute, defendant "shall" impose statutory penalties. See MCL 205.24(2). However, while the imposition of penalties is mandatory, the statutory penalties can be waived on a showing of "reasonable cause." See MCL 205.24(4). Defendant has, pursuant to its statutory rulemaking authority, promulgated rules regarding reasonable cause and penalty waiver. See MCL 205.4; MCL 205.24(2). Mich Admin Code, R 205.1013(3) provides that if a taxpayer requests penalty waiver, such request "shall be in writing and shall state the reasons alleged to constitute reasonable cause and the absence of willful neglect." In making a request, "[t]he taxpayer bears the burden of affirmatively establishing, by clear and convincing evidence, that the failure to file or failure to pay was due to reasonable cause." Rule 205.1013(4).

In this case, plaintiff requested an informal conference in June 2016; in part of that request, plaintiff sought a penalty waiver because, according to plaintiff, MLI "exercised ordinary business care and prudence in complying with and filing and paying MBT for the years

in issue[.]" Plaintiff asserted that any penalty should be waived "based upon reasonable cause[.]" The matter was not explored further at informal conference because plaintiff, after receiving a letter denying its request for alternative apportionment, withdrew its request for informal conference.

Plaintiff's request for penalty waiver in its briefing is terse and conclusory. Plaintiff cites the correct statute, and then states that a penalty wavier can be obtained where the failure to pay is occasioned by an "honest difference of opinion[.]" The Court concludes that plaintiff, through its cursory assertions, has not satisfied its burden. Although plaintiff requested, in accordance with Rule 205.1013(3), a penalty waiver in its request for informal conference, the request was conclusory and it failed to state, in any meaningful fashion, the reasons relied in support of the penalty waiver. This is contrary to the dictates of Rule 205.1013(3), which mandate that the request for penalty waiver "shall state the reasons alleged to constitute reasonable cause and the absence of willful neglect." Moreover, the taxpayer has the burden to establish entitlement to penalty waiver "by clear and convincing evidence," Rule 205.1013(4), and plaintiff failed to identify such evidence in this case. And, in general, when a litigant fails to advance a meaningful argument in support of a position, a court will not make arguments on the party's behalf. See *VanderWerp v Plainfield Charter Twp*, 278 Mich App 624, 633; 752 NW2d 479 (2008).[5]

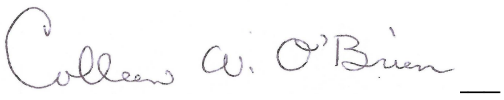
[5] The Court also notes that, although plaintiff argues that its position is attributable to an "honest difference of opinion," this "difference of opinion" did not arise until *after* defendant conducted its audit in this case. Indeed, MLI's 2011 Short Year return included the gain on the sale in MLI's business income. Now, after the sales apportionment factor was adjusted on audit, plaintiff's "difference of opinion" has arisen, as plaintiff argues that the gain should not have been included in the calculation of business income.

III. CONCLUSION

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

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

Dated: August 14, 2018



Colleen A. O'Brien, Judge
Court of Claims