State and Local Taxation Committee - The Latest Developments in Michigan State and Local Taxation

Joanne B. Faycurry
Schiff Hardin LLP
Ann Arbor

Exhibit

Exhibit A
PowerPoint Presentation

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In Cooperation with: The Institute of Continuing Legal Education

State and Local Taxation Committee - The Latest Developments in Michigan

Panel: Joanne B. Faycurry, Partner, Schiff Hardin, LLP, Detroit and Ann Arbor
Arthur R. Rosen, Partner, McDermott Will & Emery, LLP, New York
Panel Moderator: Wayne D. Roberts, Partner, Dykema, Grand Rapids

AGENDA

I. Round-Up of Recent Michigan State Tax Cases

A. Sales and Use Tax Cases

1. Sales of TPP or Services
2. Industrial Processing Exemption
3. Direct Pay
4. Exemption from Use Tax where transaction subject to Sales Tax
5. Returned Goods – Sales Tax Credit
6. Presumption of Taxability
7. Liability for tax as between Lessor vs Lessee
8. Bad Debt Deduction
9. Use-Based Exemptions – Aircraft Cases
10. Adequacy of Records

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AGENDA
cont'd

B. SBT/MBT Cases
    1. Different Reporting Methods
    2. Tax Base – Add backs/deductions
    3. Apportionment
        a. MTC Election
        b. Sourcing Sales

C. Income Tax Cases
    1. Unitary Business Principle

D. "Procedural" Issues
    1. Notice
    2. SOL
    3. Tolling
    4. Calculating Interest on Refunds

E. Corporate Officer Liability

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AGENDA
cont'd

II. Highlights of Select State/Federal Legislative Developments

A. Offer-In-Compromise (Michigan)

B. Officer Liability (Michigan)

C. Affiliate and Click-Through Nexus – Sales and Use Tax (Michigan and Other States)

D. Market Place Fairness Act

III. Round-Up of Select Recent Property Tax Cases

A. Transfer of Real Property Ownership, Uncapping of Taxable Value and Real Estate Transfer Tax

B. Property Tax Exemptions
    1. Charitable
    2. PRE

C. Valuation Issues

D. Special Assessment Appeal - SOL/Tolling

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ROUND UP OF RECENT STATE TAX CASES

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ROUND UP OF RECENT STATE TAX CASES

Sales and Use Tax Cases

Sale of TPP or Services

***HOV Services Inc. v Dept of Treasury,* (Unpublished) 2013 Mich App LEXIS 552 (dec'd Mar 21, 2013)**

- Taxpayer is a Michigan-based printing and mail operation. It prints bills and statements from PDF images provided by its clients. It does not create or modify the PDF images.
- It's Livonia facility is used exclusively for "printing, folding, inserting, sealing, and applying postage to documents and was designed for mass printing."
- Treasury asserted that taxpayer was engaged in performing a service under *Catalina* and that the printed bills and statements were merely incidental to that service.
- Treasury assessed use tax based on the denial of the industrial processing exemption and assessed SBT based on sourcing the receipts from the activity to Michigan under cost of performance test.

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ROUND UP OF RECENT STATE TAX CASES
Sales/Use Tax Cases cont'd

***HOV Services* (cont'd)**

- **Held**: Taxpayer was engaged in producing tangible personal property and not performing a service because the taxpayer did not create the content of the items printed, and the printed material was not merely incidental to a service but was the object of the transaction.

Industrial Processing Exemption

***K & S Industrial Services, Inc v Dep't of Treasury*, 2012 Mich App LEXIS 1882 (dec'd Sept 27, 2012); MTT Docket No. 311923; dec'd July 15, 2011**)

- During the relevant time period (June 1995 - December 1999), "industrial processor" was defined as one "who transforms, alters, or modifies tangible personal property by changing the form, composition, or character of the property for ultimate sale at retail."

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ROUND UP OF RECENT STATE TAX CASES
Sales/Use Tax Cases cont'd

***K & S Industrial* (cont'd)**

- K & S reconditions circuit boards for sale to auto manufacturers. The auto manufacturers use computer assisted manufacturing (CAM) systems to fabricate cars for sale. CAM systems require use of robotics and automated machines, which machines in turn require functional computer circuit boards.
- K&S takes nonfunctioning circuit board and uses its test beds and test stands to diagnose the problem;
- The test beds and stands are integral to the repair and reconditioning process of the circuit boards.
- K&S either makes the necessary repairs or obtains a replacement board.

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ROUND UP OF RECENT STATE TAX CASES

Sales/Use Tax Cases cont'd

***K & S Industrial* (cont'd)**

- Per contract, K&S's customers are not entitled to return of the defective circuit board, because K&S can elect to either order a new board or repair the existing board.
- K&S's customers transfer title to the defective boards to K&S based on its promise to return a functional circuit board and K&S agrees to provide a functional circuit board in exchange for its customers' promise to pay for it.
- K&S sells the reconditioned circuit board for a set price, regardless of the repair costs.

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ROUND UP OF RECENT STATE TAX CASES

Sales/Use Tax Cases cont'd

***K & S Industrial* (cont'd)**

- Department assessed use tax against K&S for (1) purchasing and using the test beds and stands to diagnose and repair the circuit boards, and (2) consuming utilities while operating these tests.
- K&S argued that the repair process changes the board from a nonfunctional state to a functional state by altering the flow of electricity threw them.
- Dept argued that the whole process is mere repairs.
- The Tax Tribunal found that,
  - K&S received malfunctioning circuit boards from its customers and replaced or repaired the nonfunctioning components, thereby substantially modifying the character and composition of the boards.
  - The circuit boards were changed for ultimate sale at retail, for after they were acquired and reconditioned by K&S, the circuit boards were sold back to K&S's customers.

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ROUND UP OF RECENT STATE TAX CASES

Sales/Use Tax Cases cont'd

***K & S Industrial* (cont'd)**

- Court of Appeals agreed with Dept that K&S's activities of, "merely fixing something that was already in its final form; changing it from a broken to a non-broken state;" was not the kind of "change to form, composition or character intended by the Legislature to trigger the exemption."

- However, the Court of Appeals affirmed the Tax Tribunal.
  - Interpret statutes as they are actually written
  - Dept conceded that if Rule 40 given the "force and effect of law" - which COA held it was - K&S wins.

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ROUND UP OF RECENT STATE TAX CASES

Sales/Use Tax Cases cont'd

Direct Pay

Knight Facilities Management v. Dept of Treas., MTT No. 0319568 (October 21, 2010)

- Petitioner Knight Facilities and GM entered into contract whereby Petitioner provided GM with managers who supervise GM's janitorial employees.
- Petitioner purchases the majority of the supplies used by the janitorial staff from Supply Pro, which ships the supplies directly to GM.
- Petitioner provided Supply Pro with its resale exemption certificate.
- GM also provided Petitioner with a direct pay permit – instructing Petitioner not to charge sales or use tax.
- Following an audit, the Department determined that Petitioner was a service provider and not a seller of tangible property and assessed it use tax and penalty in excess of $1 Million.
- Petitioner argued (1) that its purchases were resold to GM and not used or consumed by it and thus exempt from sales/use tax as purchase for resale, MCL 205.94(1)(c) and 205.54(1)(b), and (2), it was not liable for sales tax on its sale of goods to GM under GM's Direct Pay Permit and MCL 205.98.

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ROUND UP OF RECENT STATE TAX CASES

Sales/Use Tax Cases cont'd

***Knight Facilities* cont'd**

- Tax Tribunal's Initial Holding: Petitioner was not a servicer and did not consume the janitorial supplies. Petitioner supplied a service and tangible personal property, both of which were separately itemized.

and

- Petitioner's receipt of GM's Direct Pay Permit did not exempt Petitioner from collecting sales tax. Petitioner sold items that were listed as ineligible on GM's Direct Pay Permit.

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ROUND UP OF RECENT STATE TAX CASES

Sales/Use Tax Cases cont'd

***Knight Facilities* (cont'd) Reconsideration granted July 29, 2011**

- Petitioner filed a Motion for Reconsideration arguing:
  - Under the GSTA, the transaction is exempt upon receipt of the Direct Pay Permit. MCL 205.54a(n)
  - Maintaining the records satisfies the requirement of good faith and eliminates any liability to the seller.
  - The Tribunal's determination contradicts the intent of Direct Pay as sellers will not know how the purchaser intends to use the property.
  - The Tribunal's determination imposes a double tax: GM will have paid the tax and the Direct Pay Seller will be assessed the tax.

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ROUND UP OF RECENT STATE TAX CASES
Sales/Use Tax Cases cont'd

***Knight Facilities on Reconsideration* (cont'd)**

- Treasury responded:
  - Petitioner cannot use a Direct Pay permit to avoid liability if it was a servicer AND Direct Pay Permits do not relieve servicers.
  - RAB 2000-3 states: "The Department will hold a seller responsible for sales or use tax on a purchase or lease that is *specifically* listed in the authorization letter as being ineligible for direct payment authorization."

MTT Holding on Reconsideration: The seller is not required to review the Direct Pay Permit to determine whether use of the permit was authorized. It is not possible or practicable for the seller to know of the purchaser's use. RAB 2000-3 does not authorize the Department to hold Petitioner liable. Petitioner kept the required records and satisfied the requirement of good faith. Petitioner is not liable.

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ROUND UP OF RECENT STATE TAX CASES
Sales/Use Tax Cases cont'd

***Knight Facilities – Court of Appeals Unpublished Opinion, 2012 Mich App LEXIS 1886 (dec'd Sept 27, 2012)* (cont'd)**

- On appeal, Treasury did not appeal MTT's finding that Petitioner was not liable for sales tax because entitled to rely on GM's Direct Pay Permit and only appealed MTT's finding regarding purchase for resale exemption.

COA Holding: Petitioner's contract with GM provided that Petitioner would purchase supplies and equipment and would bill GM the costs. Petitioner's invoices differentiated between costs associated with supplies and equipment and costs for Petitioner's supervisory services. Dept failed to show that the MTT either misapplied the law or adopted an erroneous principle.

- Property purchased for resale is completely exempt.

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ROUND UP OF RECENT STATE TAX CASES

Sales/Use Tax Cases cont'd

Exemption From Use Tax Where Transaction Subject to Sales Tax

- The UTA exempts from use tax property that was sold in this state on which transaction a sales tax was paid. MCL 205.94(1)(a) (No pyramiding of sales and use taxes.)

- ***Andrie, Inc v Dep't of Treasury*, ___ Mich App ___; 2012 WL 1448275 (dec'd April 26, 2012)**
  - The Court of Appeals held in *Andrie v Dept of Treasury,* that if a transaction is a sales-taxable transaction, the purchaser does not have the burden of proving that the sales tax was paid in defending against a Treasury Department assessment of use tax on the purchaser and the Department is obligated to pursue the seller for sales tax. The Court held:

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ROUND UP OF RECENT STATE TAX CASES

Sales/Use Tax Cases cont'd

- ***Andrie, Inc v Dep't of Treasury* (cont'd)**
  - "Our Supreme Court and this Court have held on multiple occasions that the mere fact that a transaction is subject to sales tax necessarily means that the transaction is not subject to use tax. See, *e.g., Elias Bros Restaurants v Dept of Treasury, 452 Mich 144, 146 n1; 549 NW2d 837 (1996)* ('The Use Tax Act is complementary to the Michigan General Sales Tax Act . . . and is designed to cover those transactions not subject to the sales tax.').
  - "In the present case, there is no dispute that the transactions in question involved Michigan retailers and transfers of title within the state of Michigan. Because the retailer has the ultimate responsibility to pay any sales tax, it is erroneous to place a duty on a purchaser to show that the sales tax was indeed paid to the state. *Combustion Eng'g, 216 Mich App at 469.* Thus, the transactions are not subject to use tax, and the trial court properly held in favor of plaintiff on this issue."

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ROUND UP OF RECENT STATE TAX CASES

Sales/Use Tax Cases cont'd

Andrie v Dept of Treasury (cont'd)

- Department filed an application for leave to appeal the COA decision.
- On December 5, 2012, Supreme Court granted leave to appeal, instructing the parties to address:
  - (1) Whether the Court of Appeals correctly determined that a retail transaction in Michigan subject to the sales tax, *MCL 205.51 et seq.*, is not subject to the use tax, *MCL 205.91 et seq.;*
  - (2) Whether a retail purchaser is entitled to a presumption that sales tax is paid on retail transactions in Michigan; and
  - (3) Whether the exemption in *MCL 205.94(1)(a)* applies in this case.

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ROUND UP OF RECENT STATE TAX CASES

Sales/Use Tax Cases cont'd

Returned Goods – Sales Tax Credit

***Discount Tire Co. v Dept of Treasury,* ___ Mich App ___; 2012 Mich App LEXIS 2201 (dec'd Nov 6, 2012) (Published Decision)**

- When Discount Tire sells a tire to a customer, customer has the option of purchasing a "Certificate for Repair, Refund, or Replacement" at an extra cost.
- Per the Certificate, if a tire can't be repaired, customer is entitled to a full cash refund equal to the purchase price and sales tax paid on the tire.
- At customer's request, DT must provide customer with opportunity to purchase a comparable replacement tire at a price not exceeding the purchase price of the original tire.
- Customer not obligated to purchase another tire. It is free to take the cash from the refunded purchase price of the original tire and not buy anything from DT.

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ROUND UP OF RECENT STATE TAX CASES
Sales/Use Tax Cases cont'd

***Discount Tire* (cont'd)**

- During tax years 2003-2006, DT charged and remitted sales tax to Dept on the original tire sale.
- When tire returned per the Certificate, DT took a sales tax credit on that remitted sales tax on its next month's sales tax returns.
- In the event the customer purchased a replacement tire with the refunded proceeds from the rescinded sale, DT charged and remitted sales tax on the sale of the replacement tire.
- In order to avoid penalties, DT also remitted use tax on the replacement tire. It requested a refund of the use taxes paid for the tax years at issue on the grounds that DT had paid both sales and use tax on those same replacement tires.
- The Dept denied the use tax refund request on the grounds that the return provided for in the Certificate was not a "return of goods" under the STA as defined by Dept's Admin Rule 16.

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ROUND UP OF RECENT STATE TAX CASES
Sales/Use Tax Cases cont'd

***Discount Tire* (cont'd)**

- Dept determined that the replacement tire was given to the customer for free, and not sold at retail, and DT was therefore required to pay use tax on the replacement tire.
- Statutory provision governing "returned goods," *MCL 205.56b,* provides, "a taxpayer may claim a credit or refund [of sales tax paid] for returned goods. . ."
- *Dept's Rule 16, issued to clarify the meaning of "returned goods" under the STA, provides:*

  > "Credits or refunds for returned goods, the sales of which have been subject to tax, may be deducted only if the goods are voluntarily returned for full exchange, an entire refund of purchase price, or full credit. When the property is returned within a reasonable time after the date of sale, and the purchase [sic] is made whole, a credit may be had on the tax paid on the rescinded sale."

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ROUND UP OF RECENT STATE TAX CASES
Sales/Use Tax Cases cont'd

***Discount Tire* (cont'd)**

- Court of Appeals Holding: Administrative Rule 16 invalid as a matter of law. It changes the scope of, modifies, and narrows the "returned goods" credit in the STA. Rule 16 contains far more restrictive language than *MCL 205.56b*.
  - Even if Rule 16 valid legislative rule, DT met the requirements: (1) Tires were voluntarily returned. (2) Tire was returned for a full refund or credit. (3) Tire was returned within a "reasonable time" after the date of sale. (3 years for a tire may be reasonable time while it may not be for an 8 year old's soccer cleats.)
  - Because the sales of tires were sales at retail, sales tax was due on original sale and sale of replacement tire. Use tax was due on neither sale.
  - Refund ordered.

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ROUND UP OF RECENT STATE TAX CASES
Sales/Use Tax Cases cont'd

Presumption of Taxability

***Free Enterprises, LLC v Dept of Treasury,* Unpublished COA Opinion, 2012 Mich App LEXIS 2216 (dec'd Nov 6, 2012)**

- Petitioner was formed on 4/11/2007 as a Montana-based LLC whose sole member was Frank Rudlaff.
- On 5/7/2007, Petitioner purchased a Recreational Vehicle in Florida and took delivery in Florida.
- Petitioner titled the RV in Montana.
- Petitioner did not pay any sales or use tax on purchase of RV because Montana does not impose sales/use taxes and Florida defers taxation of vehicles to state of registration.
- Rudlaff and wife used RV for personal purposes.
- RV first entered Michigan on May 30, 2008, and was used/stored in Michigan on 6 separate occasions between 5/30/2008 and Sept 13, 2010, totaling approx. 300 days.

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ROUND UP OF RECENT STATE TAX CASES
Sales/Use Tax Cases cont'd

***Free Enterprises*, (cont'd)**

- When not in use, RV was stored in Florida.
- Rudlaff was a Michigan resident when LLC was formed, but then became a Florida resident on March 24, 2009.
- RV was re-registered in Florida.
- After observing the RV in the Traverse Bay RV Park in Acme on July 31, 2008, Dept issued a use tax bill in the amount of $39,253.
- Court of Appeals aff'd MTT Holding: Use tax improperly assessed because Petitioner came under the presumption of exemption in *MCL 205.93(1)(b)(i) or (ii).*
  - *MTT and COA rejected Dept's argument that use tax exemption should be denied because transaction was structured to avoid taxes and Petitioner intended to, and actually did, use the RV in Michigan.*

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ROUND UP OF RECENT STATE TAX CASES
Sales/Use Tax Cases cont'd

***Free Enterprises*, (cont'd)**

- *MCL 205.93(1)* provides the following presumptions:
  - (a) TPP purchased is subject to use tax if brought into state within 90 days of purchase date and is considered as acquired for storage, use or other consumption in this state.
  - (b) TPP used solely for personal nonbusiness purposes that is purchased outside of this state and that is not an aircraft is exempt from use tax if 1 or more of the following conditions are satisfied:
    - (i) Property is purchased by a person who is not a resident of Michigan at time of purchase and is brought into state more than 90 days after date of purchase.
    - (ii) Property is purchased by person who is a resident of state at time of purchase and is brought into this state more than 360 days after date of purchase.

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ROUND UP OF RECENT STATE TAX CASES
Sales/Use Tax Cases cont'd

***Free Enterprises* (cont'd)**

- COA Holding (cont'd):
  - Whether Petitioner was formed for purpose of legally avoiding taxes is irrelevant.
  - Per *MCL 205.93(1)*, exemptions at issue were included in UTA "for the purpose of the proper administration of [the UTA] and to prevent the ***evasion*** of the tax."
  - "Tax evasion" is the willful attempt to defeat or circumvent the tax law in order to **illegally** reduce one's tax liability.
  - Contrast, "tax avoidance" – "taking advantage of ***legally*** available tax-planning opportunities in order to minimize one's tax liability."
  - Though Petitioner LLC may have been created in order to minimize tax liability (tax avoidance), no evidence that Rudlaff failed to pay any required taxes or fees in Florida or Montana or otherwise did anything illegal (tax evasion).

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ROUND UP OF RECENT STATE TAX CASES
Sales/Use Tax Cases cont'd

Liability for Tax as Between Lessor vs Lessee

***Musashi Auto Parts of Mich v Dept of Treasury,* Unpublished COA Opinion, 2012 Mich App LEXIS 2526 (dec'd Dec 13, 2012)**

- Musashi employees wear uniforms rented from Gallagher Uniform Rental Comp.
- Contract between Musashi and Gallagher silent as to who is responsible for use taxes.
- When Gallagher invoiced Musashi for the uniforms, no charge for use tax.
- After audit, Dept assessed Musashi use tax deficiency for rental of uniforms.
- Musashi argued that lessor Gallagher was responsible for the use tax, not Lessee Musashi.
- Dept argued that because Lessor Gallagher didn't pay use tax, Lessee Musashi has to.

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ROUND UP OF RECENT STATE TAX CASES

Sales/Use Tax Cases cont'd

Musashi Auto Parts (cont'd)

- Court of Claims Holding: Summary disposition in favor of Musashi, ruling Lessor was responsible for use tax because it was in the position to know whether the sales tax had been paid and contract does not specify that Lessee responsible for payment.
- Court of Appeals Holding: Sec. 95(4) of UTA specifically references the obligation of a lessor to pay the use tax, stating, "a lessor may elect to pay use tax on receipts from the rental or lease of the tangible personal property in lieu of payment of sales or use tax on the full cost of the property at the time it is acquired."
  - Admin Rule 82 consistent with Sec 95(4): "a person engaged in the business of renting or leasing tangible personal property to others *shall* pay use tax on the rental receipts from the rental thereof."
  - Pursuant to Rule 82, "lessors are obligated to pay the use tax, without any type of corresponding responsibility belonging to lessees."

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ROUND UP OF RECENT STATE TAX CASES

Sales/Use Tax Cases cont'd

Musashi Auto Parts (cont'd)

•On May 22, 2013, Supreme Court granted Department's Application for Leave to Appeal.

- However, held in abeyance pending Supreme Court's decision in *NACG Leasing v Dept of Treasury*, wherein Supreme Court instructed parties to address applicability of use tax to a transaction where tangible personal property is purchased by one party and leased to another party when the purchaser/lessor does not obtain actual possession of the property.

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ROUND UP OF RECENT STATE TAX CASES

Sales/Use Tax Cases cont'd

***Home Depot USA, Inc v Dep't of Treasury*, Unpublished CoA Opinion (Docket No. 301341) (dec'd May 24, 2012), *lv den* 493 Mich 870 (10/22/2012)**

- Retailer that contracted with finance companies entitled to bad debt deduction.
  - Taxpayer entered into private label credit card (PLCC) agreements with certain finance companies.
  - Michigan sales taxes were remitted by taxpayer on purchases made by PLCC holders who later failed to pay their credit card bills.
  - The taxpayer sought a refund of taxes paid between September 1, 1999 and January 31, 2007, despite having received compensation for the purchases and the tax pursuant to its contracts with the finance companies.

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ROUND UP OF RECENT STATE TAX CASES

Sales/Use Tax Cases cont'd

***Home Depot* (cont'd)**

- In *Daimler Chrysler v Dept of Treasury*, COA No. 264323, July 25, 2006, the court held that parties acting in concert could be viewed as a unit for purposes of the bad debt statute. In amending the statute in 2007, the legislature did not expressly override this conclusion but merely stated that only the retailer was entitled to the bad-debt deduction for periods on or preceding September 30, 2009.
- The taxpayer did have the legal liability to remit the sales tax on the retail sales for which the bad-debt deduction is recognized for federal income tax purposes. The fact that the finance companies wrote off the bad debts did not diminish the taxpayer's qualification under the statute.
- According to the principles of *Daimler Chrysler*, the finance companies' actions in writing off the debts satisfied the requirements of MCL 205.54(i)(2).

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ROUND UP OF RECENT STATE TAX CASES

Sales/Use Tax Cases cont'd

Use-Based Exemptions – Aircraft Cases

***NACG Leasing f/k/a Celtic Leasing, Inc. v Dept of Treasury,* COA Unpublished Decision, dec'd October 16, 2012**

- Plaintiff formed as an LLC
- 2 Members, each with 50% ownership in Plaintiff: Murray Aviation, Inc and HBJ Leasing, LLC
- Plaintiff was formed for purpose of engaging in activity of aircraft leasing and operations.
- In 2005, Plaintiff purchased a DC-8 aircraft and simultaneously entered into a lease agreement with Murray.
- Department assessed use tax of $414,000, plus penalty of $103,500.

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ROUND UP OF RECENT STATE TAX CASES

Sales/Use Tax Cases cont'd

***NACG Leasing* (cont'd) - Aircraft Cases cont'd**

- Tax Tribunal first granted summary disposition in Plaintiff's favor.
- On the Department's motion for reconsideration, the Tribunal reversed and granted the Department's motion for summary disposition.
- Tax Tribunal believed reversal was required because of Court of Appeals then recently issued decision in *Fisher & Co v Dept of Treasury,* 282 Mich App 207 (2009), wherein one sentence in the opinion stated: ***"Entering into a contract to give up some of one's right to possession or control is, itself, an exercise of those rights."***

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ROUND UP OF RECENT STATE TAX CASES
Sales/Use Tax Cases cont'd

***NACG Leasing* (cont'd)**

- Court of Appeals reversed:
  - Distinguished *Fisher*
  - *Persuaded by the following facts:*
    - Undisputed that the lease executed contemporaneously with Plaintiff's purchase of aircraft ceded total control/possession of aircraft to Murray.
    - Murray was responsible for maintenance, insurance, taxes and bore the risk of loss.
    - The aircraft was in Murray's possession prior to Plaintiff's purchase and that possession was not interrupted.
  - Holding: Plaintiff did not "use" the aircraft as that term is defined in UTA, MCL 205.92(b), "the exercise of a right or power over tangible personal property incident to the ownership of that property including transfer of the property in a transaction where possession is given."

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ROUND UP OF RECENT STATE TAX CASES
Sales/Use Tax Cases cont'd

***NACG* (cont'd)**

- On May 22, 2013, Supreme Court granted Department's Application for Leave to Appeal.
  - Directed the parties to address applicability of use tax to a transaction where tangible personal property is purchased by one party and leased to another party when the purchaser/lessor does not obtain actual possession of the property.

ROUND UP OF RECENT STATE TAX CASES

Sales/Use Tax Cases cont'd

***CCXLS, LLC v Dept of Treasury,* Unpublished CoA decision; dec'd October 11, 2012, *lv den* 2013 Mich LEXIS 571 (April 29, 2013).**

- Tax Tribunal upheld assessment of use tax and penalty.
- Court of Appeals reversed: Terms of the agreement between Petitioner and ASI unambiguously reflect the presence of the requisite elements for a "lease" under MCL 205.92b(k)
  - The Department could identify no authority for the proposition that for use tax purposes a lease cannot exist in the context of a management agreement.

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ROUND UP OF RECENT STATE TAX CASES

Sales/Use Tax Cases cont'd

Rule 82 Election

***Devonaire Enterprises, LLC v. Dep't of Treasury*, 297 Mich App 90 (2012). (approved for publication 6/19/2012)**

- Taxpayer, a limited liability company, had only one member, DJS Enterprise Group, and the sole members of DJS were Donald and Cynthia Smith.
- Taxpayer purchased aircraft and then entered into two lease agreements. First lease with DJS provided that DJS was to lease the aircraft for $200 per flight hour, plus pay all operations costs including maintenance, storage, fuel, and repairs. This lease was nonexclusive and terminable at will by the taxpayer.
- The second lease was with Donald Smith, who was to lease the aircraft for $636 per flight hour (later adjusted to $680 per flight hour).

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ROUND UP OF RECENT STATE TAX CASES
Sales/Use Tax Cases cont'd

***Devonaire Enterprises* (cont'd.)**

- The only business or selling activities that the Taxpayer engaged in was a leasing agreement with its sole member DJS , and a leasing agreement with DJS's member Smith.
- These leases did not reflect arm's-length transactions given the extremely favorable leasing terms with regard to the Smith agreement, and the unreasonable leasing terms provided in the DJS agreement.
- Taxpayer did not seek out any other leasing opportunities such as advertising its purported aircraft leasing business, and as a result the aircraft was flown a minimal number of hours compared to the typical leases, producing little income for the Taxpayer.
- Holding: Assessment of use tax based on full purchase price upheld because taxpayer did not qualify as a lessor under Rule 82.

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Duty to Maintain Accurate Records

***Plum Hollow Market, Inc v Dept of Treasury,* Unpublished CoA decision, 2012 Mich App LEXIS 1997 (dec'd October 16, 2012)**

- Petitioner is a retail business that sells groceries, liquor, beer and wine. Also sells food for immediate consumption.
- Petitioner did not keep records of inventory items that were made into prepared foods;
- Did not keep daily cash register receipts. Instead, recorded the sales reported on the daily receipts into a worksheet and then discarded the receipts.
- Monthly sales summaries that broke sales down into general taxable and nontaxable categories, without further specification, were provided to Petitioner's accountant.
- Dept's auditor determined Petitioner's record-keeping was inadequate. She therefore referred to supplier invoices to determine which items were used in prepared food, based on her visual inspection of prepared foods sold in the store.

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Duty to Maintain Accurate Records

***Plum Hollow Market* (cont'd)**

- She then determined the average "markup" of those items based on Petitioner's reports of sale price versus price it paid for the item. This amount didn't match Petitioner's federal tax return.
- Auditor determined that portion of Petitioner's gross receipts reported were mischaracterized as nontaxable income and assessed additional tax, plus negligence penalty.
- Court of Appeals Holding: Sec 7(1) of STA allows the Dept to assess taxes based on information that is available or that may become available to Dept. That assessment is considered prima facie correct for the purpose of the STA and burden of proof of refuting the assessment is on taxpayer.
- Petitioner's record keeping did not comply with Sec 791) of STA. Auditor could not verify from Petitioner's records if the proper amount of sales tax had been collected to satisfy the liability imposed on Petitioner.
- Receipts of daily sales should have been maintained.

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ROUND UP OF RECENT STATE TAX CASES
SBT/MBT Cases

Different Reporting Methods

Lear Corp v Dept of Treasury, __ Mich App __ (Dkt No. 309445; dec'd Feb 21, 2013)

- Plaintiff is a manufacturing corp. It incurs research and experimental (R&E) expenditures relating to its mfg business.
- Plaintiff incurred $205,000,000 of deductible R&E expenditures, which it elected to amortize over a period of 10 years pursuant to §59(e) of IRC.
- Because SBTA did not have a provision equivalent to §59(e) of IRC, Plaintiff used identical calculations to prepare its SBT and its federal tax returns for years at issue, 1/1/2004 – 12/31/2007.
- Plaintiff continued to use a ratable deduction for its federal tax returns. But after the SBTA was repealed, Plaintiff sought to go back and amend its SBT returns deducting the entire $205,000,000 in the year in which the R&E expenditures were incurred.

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ROUND UP OF RECENT STATE TAX CASES
SBT/MBT Cases
cont'd

***Lear Corp* (cont'd)**

- Dept dealt with corporations that reported discrepant income between their SBT returns and federal returns.
  - First with GM, after which, Dept adopted an internal policy that prohibited a taxpayer from calculating its business income by taking an immediate deduction of R&E for the tax year if that taxpayer also made an IRC §59(e) election for federal tax purposes.
  - Second involved Delphi Corp. In that case, a bankruptcy court allowed Delphi to treat is SBT returns differently than its federal returns.
- Lear sought SBT refund of $1,585,041, which Dept denied.
- Court of Claims ruled in Lear's favor.

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ROUND UP OF RECENT STATE TAX CASES
SBT/MBT Cases
cont'd

***Lear Corp* (cont'd)**

- Dept's arguments: (1) Plaintiff must report the same taxable income for both its SBT returns and its federal returns. (2) disparate federal and SBT returns due to an IRC §59(e) election occurred in only 2 prior cases. Those cases were isolated and involved circumstances not analogous to Plaintiff's circumstances, and therefore, Dept did not violate Plaintiff's constitutional rights when it denied Plaintiff's refund.
- Court of Appeals:
  - Issue of first impression: whether a C Corp can elect IRC §59(e) to amortize R&E expenditures over 10 years, while at the same time deducting the entire amount for the year in which it was incurred for purposes of the SBT.
  - SBTA contains no ambiguities as to whether a C Corp must report its R&E expenditures in an identical manner to its federal tax returns. SBTA is silent on this issue.

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ROUND UP OF RECENT STATE TAX CASES
SBT/MBT CASES (cont'd)

***Lear Corp* - Different Reporting Methods cont'd**

- Holding: SBTA unambiguously states that "tax base means business income" and "business income means federal taxable income." Because SBTA uses clear and unambiguous language, Plaintiff's tax base must reflect its federal taxable income, including its election to amortize its R&E expenditures under IRC §59(e).
- Therefore, Plaintiff should have used the amortized amount as a starting point to determine its SBT tax base each year in issue.
  - Plaintiff's reliance on *Sturrus*, *Kmart Mich Prop Servs* and *Alliance Obstetrics*
  - Constitutional Claims: Plaintiff failed to show that Dept's disparate treatment of GM and Delphi was intentional and knowing.
    - In *Delphi*, decision made by Bankruptcy Court, not the Dept. If decision was Dept's to make, they would have applied their Internal Policy.
    - In *GM*, decision made decades earlier by administrators no longer with Dept.

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ROUND UP OF RECENT STATE TAX CASES
SBT/MBT Cases cont'd

Tax Base – Add Backs/Deductions

***Orthopaedic Assoc of Grand Rapids v Dept of Treasury,* Unpublished CoA Opinion (dec'd Feb. 19, 2013)**

- Petitioner, a medical practice, assigned all its employment agreements to 3 different employee leasing companies or Professional Employer Organizations (PEOs). The PEOs paid the physicians' salaries.
- For all tax years at issue, Petitioner paid medical malpractice insurance (MMI) premiums and continuing medical education (CME) expenses for its physicians.
- Court of Appeals Holding: Payments by Petitioner for (CME) and (MMI) premiums constituted compensation under the SBTA.
  - CME expenses and MMI premiums not "ordinary business expenses" of Petitioner. Physicians required to maintain MMI and legally obligated to attend CME classes. Those payments benefited the physicians and thus constituted compensation.

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ROUND UP OF RECENT STATE TAX CASES
SBT/MBT Cases cont'd

Tax Base – Add Backs/Deductions

***Proquest Information and Learning LLC v Dept of Treasury,* Unpublished CoA Opinion, 2013 Mich App LEXIS 37 (dec'd Jan 15, 2013)**

- Proquest licenses copyrighted content from a wide variety of sources, then aggregates, organizes, abstracts and indexes the content in a searchable form.
- Proquest provides licensed access to both its proprietary content and sources through electronic databases, primarily to librarians and educational markets.
- Under either of Proquest's licensing agreements, the licensee's rights are not transferrable and licensee does not gain any ownership interest in Proquest's product.
- Proquest protects its proprietary content with trademarks and copyrights.

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ROUND UP OF RECENT STATE TAX CASES
SBT/MBT Cases – Tax Base Add Backs/Deductions cont'd

***Proquest* (cont'd)**

- Proquest categorized the licensing fees as "royalties" under the SBTA and thus deducted them from their taxable income.
- Court of Appeals Holding: Proquest's access fees were royalties.
  - Under both of Proquest's licensing models, Proquest acquires the copyrighted materials from other sources, modifies and adopts them, adds content such as abstracts, and then redistributes the product as modified.
  - Proquest's agreements provide that Proquest specifically retains its rights in its proprietary product, and it protects that product under trademarks and copyright laws.
  - Proquest's clients pay Proquest for the use of Proquest's proprietary product connected with the copyrighted content that Proquest licenses from other sources.

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ROUND UP OF RECENT STATE TAX CASES
SBT/MBT Cases – Tax Base Add Backs/Deductions cont'd

CAD

***Random House v Dept of Treasury,* ___ Mich App ___ (dec'd Nov 27, 2012); Published Opinion**

- Plaintiff is "primarily engaged in the publication and sale of books in interstate commerce." From 1993 to 1996, Plaintiff filed SBT returns.
- Plaintiff filed an amended SBT return requesting a refund for CAD "for costs incurred in its book publication activities." I
- In particular, Plaintiff had expended funds purchasing original, or "master manuscripts" from authors.
- Plaintiff argued that the "costs were of the same type that were capitalized and depreciated for federal tax purposes as required by federal auditors in a prior audit."
- Dept argued that Plaintiff purchased the *rights* to publish books, and has thus acquired an intangible asset, not eligible for CAD.

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ROUND UP OF RECENT STATE TAX CASES
SBT/MBT Cases – Tax Base Add Backs/Deductions cont'd

***Random House* - CAD (cont'd)**

- Issue: Whether Plaintiff's costs were for (1) tangible assets and (2) if so, whether those tangible assets were eligible for depreciation, amortization, or accelerated capital cost recovery under the IRC.
  - At the heart of the appeal – determination of what exactly is being purchased by Plaintiff.
  - Plaintiff argues that the costs at issue are associated with purchasing physical "master manuscripts."
  - Department argues that master manuscripts are merely ancillary to Plaintiff's actual purchases, which are intangible publication rights.
  - Court of Appeals Holding: IRC provides that "for purposes of determining whether a taxpayer producing intellectual or creative property is producing tangible personal property or intangible property, the term tangible personal property includes . . . Books . . .

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ROUND UP OF RECENT STATE TAX CASES
SBT/MBT Cases – Tax Base Add Backs/Deductions cont'd

***Random House* - CAD (cont'd)**

- The costs of producing such intangible property, including "prepublication expenditures incurred by publishers, including payments made to authors . . . are required to be capitalized."
- As a result of an IRS audit, Plaintiff was required to capitalize and depreciate its costs associated with the purchase of master manuscripts.
- These costs were not only *eligible* for depreciation under the IRC, but the IRS actually *required* Plaintiff to depreciate these costs.
- Dept's argument that manuscripts and the stories contained therein are not subject to wear and tear, decay or decline, is without merit because the "useful life" was a period over which the asset may reasonably be expected to be useful to the taxpayer in trade or business or in the production of income.
- Taxpayer entitled to CAD under SBT for manuscript purchases.

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ROUND UP OF RECENT STATE TAX CASES
SBT/MBT Cases – Tax Base Add Backs/Deductions cont'd

***TMW Enterprises v Dept of Treasury,* 297 Mich App 590 (2012), *lv den* ___ Mich ___; 828 NW2d 43 (2013)**

- Case before CoA for a second time.
- The tax liability at issue arises from the sale of assets by Plaintiff to a competitor in 1995 giving rise to realizing a gain of more than $200 Million.
- Plaintiff excluded the gain from its SBT return for that year, taking the position that it was entitled to the casual-transaction exclusion under the SBTA
- In first case, CoA ruled that an S Corp are corporations for SBTA purposes and, as such, are not entitled to claim the casual transaction exclusion.
- The trial court was required to follow that principle of law on remand.

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ROUND UP OF RECENT STATE TAX CASES
SBT/MBT Cases – Tax Base Add Backs/Deductions cont'd

***TMW Enterprises* - S Corp (cont'd)**

- In CoA first opinion, the Court did not determine the amount of Plaintiff's taxable income.
- Issue on Appeal: What is proper calculation of Plaintiff's federal taxable income on which the SBT could be levied.
- Parties conceded that S Corps have no federal taxable income at the federal level.
  - Exception: When an S Corp was previously a C Corp, as was Plaintiff, it can have taxable income based on built-in gains and excess passive income.
  - SBT tax base = business income (before apportionment or allocation).
  - For Corporations, business income = federal taxable income.

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ROUND UP OF RECENT STATE TAX CASES
SBT/MBT Cases – Tax Base Add Backs/Deductions cont'd

***TMW Enterprises* S Corp (cont'd)**

- Plaintiff, as an S Corp, had no federal taxable income, except for its built in gains and excess passive income.
- Therefore, only the amount of those built-in gains and excess passive income would constitute business income under the SBTA.
- And, thus, it only owed SBT on that amount.

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ROUND UP OF RECENT STATE TAX CASES
SBT/MBT Cases cont'd

Apportionment

MTC Election

***IBM v Dept of Treasury,* Unpublished CoA Opinion, 2012 Mich App LEXIS 2293 (dec'd November 20, 2012), *lv app pending*.**

- Affirming the lower court, the Court of Appeals held that IBM was required to use the MBT apportionment formula (100% sales) and that the taxpayer was not permitted to elect to use the Multistate Tax Compact's 3-factor apportionment formula (equally-weighted property, payroll and sales.)
- IBM argued that the MBT apportionment formula was optional.
- Dept argued that the MBT apportionment formula was mandatory.
- CoA noted that the MBT statute allowed taxpayers to request permission to use an alternative apportionment method so that unusual situations where the default formula caused distortion would not occur.

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ROUND UP OF RECENT STATE TAX CASES
SBT/MBT Cases cont'd

***IBM* - MTC Election (cont'd)**

- However, the MTC allowed an election of right, presumably exercised in order to obtain a lower tax liability.
- Examining the statutory language, the court noted that the applicable provision in the MBT (MCL 208.1301) absolutely precluded any other apportionment formula except by petition.
- IBM also argued that the Compact was a contract. (Gillette in California has prevailed on this argument.)
- Court noted that statutes were not deemed to be contracts in the absence of an exceedingly clearly-expressed intent by the Legislature. Legislature would have had to use the word "contract" or "covenant," or otherwise explicitly "surrender its power to make changes."
- Compact language did not specify that it was a contract.

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ROUND UP OF RECENT STATE TAX CASES
SBT/MBT Cases cont'd

***IBM* - MTC Election (cont'd)**

- The Court reasoned that enacting a conflicting statute might be an improper way to repeal the Compact, but not necessarily impermissible.
- Holding: MBT law repealed by implication the MTC apportionment election provision.
- Leave to appeal is pending in the Supreme Court

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ROUND UP OF RECENT STATE TAX CASES
SBT/MBT Cases cont'd

Apportionment - Sourcing Sales

***JRS Distribution Comp v Dept of Treasury,* Unpublished CoA Opinion, Dkt No. 302441 (dec'd Dec 11, 2012)**

- JRS is an Illinois Corp with its principal place of business in Wisconsin.
- PIL is an Illinois Corp with its principal place of business in Illinois.
- During tax years, JRS and PIL were involved in joint venture to sell books in Michigan.
- Per their sales agreements, PIL responsible for creative development and publication of books, which were then purchased by JRS and later sold to Michigan customers.
- PIL held title to all unsold books and title transferred to JRS after purchase.
- JRS stored the purchased books at its warehouses in Wisconsin until shipped to Michigan buyer.

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ROUND UP OF RECENT STATE TAX CASES
SBT/MBT Cases cont'd

***JRS* - Apportionment Sourcing Sales (cont'd)**

- During audit they provided documentation regarding the sale of books to Michigan customers, but not the requested 50-state sales breakout or the 50-state breakdown of costs of performing sales solicitation services.
- Because the Dept did not get the specific documentation it requested, it assessed SBT liability using the "best information available," which it decided was a sales factor composed of Michigan population divided by US population.
- Court held: Dept not statutorily authorized to craft its own calculation to method to figure the sales factor. SBT provided that the sales factor was calculated by Michigan sales divided by total US sales.
- Dept's method was "entirely speculative" and had no relationship to the taxpayer's actual Michigan sales.

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ROUND UP OF RECENT STATE TAX CASES
SBT/MBT Cases cont'd

***JRS* - Apportionment Sourcing Sales (cont'd)**

- The publisher-taxpayer presented evidence that the greater proportion of the costs of performance were outside Michigan.
  - None of the book production services occurred in Michigan and employees in local offices telephoned potential customers for the sales solicitation activities.
  - As these activities were not properly sourced to Michigan under the SBTA, there was no SBT liability.

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ROUND UP OF RECENT STATE TAX CASES
Income Tax Cases

Unitary Business Principle

***Malpass v Dept of Treasury,* 295 Mich App 263 (2011), *lv gtd* 493 Mich 864 (Oct 4, 2012). Supreme Court ordered that this case be argued and submitted to Court together with cases *of Wheeler Estate v Dept of Treasury*, 297 Mich App 411 (July 31, 2012), *lv gtd* 493 Mich 865 (Oct 4, 2012) Oral Arguments Entered in Supreme Court on March 5, 2013.**

•Malpass: Plaintiffs, members of Malpass family, own and control two Michigan companies: East Jordan Iron Works, a foundry in East Jordan, Michigan, and Ardmore Foundry, Inc, which operates a foundry and distribution center in Oklahoma.

- Both companies are subchapter S corps; neither pays federal income taxes. Instead, income or loss is passed through to their shareholders, who report income/loss on individual income tax returns.

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ROUND UP OF RECENT STATE TAX CASES
Income Tax Cases

Unitary Business Principle cont'd

Malpass (cont'd)

•When Plaintiffs initially filed individual income tax returns for 2001-2003, they treated business income from East Jordan and Ardmore as from 2 separate businesses. Plaintiffs attributed business income from East Jordan to Michigan, and included it as income on their returns; they attributed losses from Ardmore to Oklahoma, and added those losses back into their adjusted gross income for Michigan individual income tax purposes.

•Plaintiffs filed amended individual returns for the same years, treating East Jordan and Ardmore as a unitary business, offsetting East Jordan's gains with Ardmore's losses and applying the Michigan apportionment factors to both companies.

•Amended returns sought refunds in excess of $1 Million.

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ROUND UP OF RECENT STATE TAX CASES

Income Tax Cases cont'd

***Malpass* – UB Principle cont'd**

•Court of Appeals Holding: rec'd Ct of Claims, holding lower court erred in allowing Plaintiffs to combine their business income from the 2 companies for the purposes of MCL 206.115. "There is no provision in the ITA that allows individuals to combine their business income from separate businesses and then use a combined apportionment formula on the total." To allow this would raise due process concerns and cause the ITA to be applied inconsistently.

•In determining whether companies constitute a "unitary business," courts consider 5 factors: 91) economic realities, (2) functional integration, (3) centralized management, (4) economies of scale, and (5) substantial mutual interdependence.

- CoA acknowledged that the 2 companies "have many characteristics of a unitary business. However, they remain separate and legally distinct business entities, and nothing in ITA allows for combined-entity reporting.

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ROUND UP OF RECENT STATE TAX CASES

Income Tax Cases

Unitary Business Principle cont'd

Malpass (cont'd)

•CoA cont'd: "A consistent approach would be to apportion all business income at the entity level. That way, if the business conducts multistate activity, the income will be apportioned accordingly. If the business has no nexus to Michigan, none of that income will be attributed to Michigan because its property factor, payroll factor, and sales factor will all be zero."

•Contrary Holding: *Wheeler Estate v Dept of Treasury,* 297 Mich App 411 (dec'd July 31, 2012), *lv gtd* 493 Mich 865 (Oct 4, 2012)

•Petitioners were shareholders of an S Corp called Electro-Wire Products that makes electrical systems for Ford. Ford wanted Electro to establish world wide presence, so it acquired all the business assets of a German business, which was also engaged in the same line of business as Electro.

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ROUND UP OF RECENT STATE TAX CASES

Income Tax Cases

***Wheeler Estate* (cont'd)**

•To accomplish asset purchase, 2 general p'ships were created: (1) an operating company TKG, which held all the purchased assets, and (2) a holding company EWG, which held a 99.5% p'ship interest in TKG. Electro held a 99% p'ship interest in EWG, as well as the remaining .5% p'ship interest in TKG.

•As an S Corp and 2 general p'ships, Electro, EWG and TKG were flow-through entities.

•In 1994 and 1995, Petitioners received flow-through income from Electro, which included Electro's distributive share of p'ship income from TKG.

•Petitioner's reported this income by treating Electro, TKG as a unitary business and combined their apportionment factors.

•Dept audited and asserted that UBP did not apply to individuals under ITA, and that Petitioners were required to apply Electro's apportionment factors to Electro's income alone and independently of TKG.

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ROUND UP OF RECENT STATE TAX CASES

Income Tax Cases

***Wheeler* - UBP (cont'd)**

•MTT held that UBP applied to individuals and that Electro and TKG were a UB entitled to combining apportionment factors for tax puposes.

•CoA Held: Aff'd MTT.

- In order to distinguish between multistate businesses that can allocate their income to specific geographic areas and mutlistate businesses that can't, the US Supreme Court in *Allied-Signal, 504 US 768, 778 (1992)* has recognized the value of the UBP.
- Under UBP, for a business or individual to exercise multistate apportionment, there must "be some sharing or exchange of value not capable of precise identification or measurement beyond the mere flow of funds arising out of a passive investment or a distinct business operation – which renders formula apportionment a reasonable method of taxation.

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ROUND UP OF RECENT STATE TAX CASES

Income Tax Cases

Wheeler (cont'd)

•*Preston* – Taxpayer sole member in Tennessee ltd p'ship LCA II, that owned 99% share in 22 lower level Ltd Pships.

•One of those lower-level pships owned a pair of nursing homes that operated in Michigan, while remaining 21 pships had no Michigan business activities.

•All 22 pships distributed gains and losses to LCA II, which in turn distributed the combined income to the taxpayer. When reporting Michigan income, taxpayer offset gains produced by pship operating Mich nursing homes with losses suffered by other pships.

•*Preston* Court concluded – LCA II operated the lower-level pships as a unitary business and that taxpayer was entitled to apportion the income he received from LCA II.

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ROUND UP OF RECENT STATE TAX CASES

Income Tax Cases

Wheeler (cont'd)

•Contrast ***Malpass*** – CoA, while acknowledging that S Corps had many characteristics of a UB, rejected taxpayers' application of UBP because the S Corps were "separate and legally distinct business entities . . ."

•Other distinguishing facts in *Malpass* (from *Preston* and *Wheeler*) – although each of the 22 pships in *Preston* was a separate legal entity, all were joined by LCA II, which owned 99% of each of the 22 pships.

•By Contrast, taxpayers in *Malpass* received business income from 2 separate businesses.

- Per CoA in *Wheeler,* "given this distinction, it appears that Michigan law does not allow separate entities to be treated as unitary business in absence of some common ownership at entity level and that being owned by the same individual taxpayers is insufficient to trigger this relationship requirement."

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ROUND UP OF RECENT STATE TAX CASES
Income Tax Cases

Wheeler (cont'd)

•*Wheeler* Holding: Facts in case more analogous to those of *Preston* than *Malpass.*

- TKG is 99% owned by EWG, which is in turn 99.5% owned by Electro. Electro and TKG are not "separate and legally distinct business entities," but stand in what amounts to a parent/subsidiary relationship.
- Like *Preston,* the income to Petitioners flowed through one source, Electro, and not through 2 separate sources as in *Malpass.*
- Therefore, Electro and TKG permitted to avail themselves of multistate apportionment under the ITA.

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ROUND UP OF RECENT STATE TAX CASES
"Procedural Issues" – Notice, SOL and Tolling

***SMK, LLC v Dept of Treasury, 828 NW2d 21* (March 27, 2013)*, order granting lv to appeal* CoA's Oct 30, 2012 decision, 2012 Mich App LEXIS 2199 (2012).**

•Parties ordered to address: "(1) whether the running of the 35-day time period in *MCL 205.22(1)* for an aggrieved taxpayer to file an appeal in the Tax Tribunal from a final assessment is triggered when the respondent Department of Treasury complies with the notice provision of *MCL 205.28(1)(a),* or is there an additional notice requirement under *MCL 205.8* when a taxpayer has filed a proper written request designating an official representative to receive copies of letters and notices; and (2) whether the tolling ruling adopted by the Tax Tribunal and the Court of Appeals is contrary to the finality language of *MCL 205.22(4)* and *(5)."*

•Ordered that this case be argued and submitted to the Court with *Fradco Inc v Dept of Treasury (Dkt No. 146333), 2013 Mich LEXIS 292.*

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ROUND UP OF RECENT STATE TAX CASES
"Procedural Issues" - SOL

***Asahi Kasei Plastics North America, Inc v Dept of Treasury,* Unpublished CoA Opinion, 2013 Mich App LEXIS 163 (dec'd January 29, 2013)**

•Plaintiff filed SBT returns and paid SBT taxes for 2003, 2004 and 2005. After audit, Dept determined that Plaintiff claimed an investment tax credit (ITC) for year 2003 when Plaintiff had actually generated that ITC in the year 2002.

•2002 tax year had closed for tax refunds under *MCL 205.27a(2),* under the 4-year SOL on "refunds."

•Dept argued that the excess ITC was a refund and barred by SOL.

•Plaintiff argued that the excess ITC did not entitle it to a refund; it could not be refunded; only available as a carry-forward as an offset on future tax liability under *MCL 208.35a(4).* Therefore, 4-year SOL not a bar.

• CoA Holding: Excess ITC not a "refund" subject to 4-year SOL. Plaintiff can carry forward its excess ITC from 2002 to offset its SBT liabilities for open tax years 2003,2004 and 2005.

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ROUND UP OF RECENT STATE TAX CASES
"Procedural Issues" – Calculating Interest on Refunds

***Ford Motor Company v Dept of Treasury,* On Reconsideration, 2013 Mich App LEXIS 397 (dec'd Feb 26, 2013)**

•CoA Holding: Statutory interest on refund does not begin to run when taxpayer, who has monies on account with Dept, notifies Dept that it disagrees with its audit determination because assessment excessive; or at time when taxpayer requests informal conference stating it disputes the assessment.

- Rather, per the CoA, Dept did not truly have notice that Taxpayer wanted its money back in the event the Courts agreed with it that assessment invalid (which Court did.)
- Per CoA, first time Dept really had notice was when taxpayer filed its Complaint seeking a refund.

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Corporate Officer Liability

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Corporate Officer Liability
Recent MTT Decision

Eric W Gaer v Dept of Treasury, MTT Docket No. 410947; dec'd May __, 2013) (Tax Tribunal Judge Steven Lasher presiding)

- FACTS:
  - Gaer was CEO and President of two companies during the tax periods at issue.
  - Companies failed to pay withholding taxes.
  - Treasury Issued Final Assessments to Gaer as a responsible officer.
  - Gaer never had responsibility for, supervision of, or control over the filing of tax returns or the payment of taxes and never signed a tax return or check for payment of taxes.
  - Gaer's duties included marketing, strategic direction, M&A, and raising capital.
  - The COO/CFO had sole responsibility for filing of tax returns and payment of taxes and reported directly to the Board not to Gaer.
  - Gaer signed an installment agreement to pay outstanding tax liabilities on behalf of one of the companies and signed some required corporate reports on behalf of both companies.

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Corporate Officer Liability
cont'd

***Gaer v Dept* (cont'd)**

- ISSUE:
  - Was Gaer, CEO and President of Solvis Group, a responsible officer liable for taxes under MCL 205.27a(5)
- HOLDING:
  - None of the testimony and evidence supported the Department's contention that Gaer's involvement in the companies was "tax specific."
  - Personal liability is imposed on a corporate officer for unpaid taxes only if the officer holds and exercises authority within the corporation with regard to the taxes at issue and no such authority was established.
  - The Department failed to prove that Gaer had control or supervision of, or [was] charged with the responsibility for, making the returns or payments.
  - Petitioner is not a responsible officer pursuant to MCL 205.27a(5)

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HIGHLIGHTS IN MICHIGAN LEGISLATIVE DEVELOPMENTS

- Offer-In-Compromise
- Officer Liability
- Affiliate and Click-Through Nexus – Sales and Use Tax

Offer-In-Compromise ("OIC")

- Tax Section Policy Position 2004
- OIC Considerations
  - Bad debts – reality
  - Fresh start
  - Revenue without new tax or fee
  - Eliminate need for gimmicks
- Bill pending HB 4003 of 2013

1

OIC Provisions

Doubt as to collectability

Doubt as to liability

Interest of fair and efficient administration of tax

- More than 40 other states
- IRS – recent expansion
- Good policy contrasted with the Michigan absolute prohibition against any compromise of "final" tax – whether correct or not

2

Officer Liability Reform

SB No. 64 of 2013 Currently Pending

Should collect actual amount of tax due

Applicable only to officer proven actually responsible for taxes

- Aligns Michigan with general principles of limited liability structures/entities
- Aligns Michigan with other states
- Aligns Michigan with Federal government
- Address perception of Michigan as a place to operate a business

Limit to trust fund taxes

- Similar to federal treatment
- Logical

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CLICK-THROUGH / AFFILIATE NEXUS

HB 5004 AND 5005

Sales and Use Tax Bills

Creates Presumption of Making Retail Sales if

I. Seller has an Affiliate in Michigan - or -

II. 1. Seller has a <u>contact</u> with Michigan resident

2. for direct or indirect referrals of customers

3. via a link or in person (oral or other)

4. for a commission or consideration

5. AND sales of > $10,000 during preceding 12 months

4

CLICK-THROUGH / AFFILIATE NEXUS

Approximately 25 other states, including NY, CA, TX and AR

Contrast Federal Legislation

Quill

5

ROUND-UP OF SELECT RECENT PROPERTY TAX CASES

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Transfer of Real Property Ownership, Uncapping of Taxable Value and Real Estate Transfer Tax

***Michigan Properties, LLC v Meridian Township, 491 Mich 518 (2012), Rehearing den* by *Mich Props, LLC v Meridian Twp,* 492 Mich 859 (2012)**
MI Supreme Court.

FACTS:

- In December 2004 Mich Properties purchased 3 apartment complexes located in Meridian Township
- In January 2005 Mich Properties timely filed the required affidavit notifying Meridian's assessor of the transfers of ownership
- Meridian's assessor failed to "uncap" the taxable values of the property for tax year 2005
- 2007 was the only tax year at issue in this case
- The total pretransfer taxable value of the properties was $10,376,535, by including the uncapping based on the 2004 transfers the March Board of Review adjusted the assessments for 2007 to a total taxable value of $14,905,107

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Transfer of Real Property Ownership, Uncapping of Taxable Value and Real Estate Transfer Tax cont'd

***Mich Props v Merridian Twp* (cont'd)**

- 2007 was the only tax year at issue in this case
- The total pretransfer taxable value of the properties was $10,376,535, by including the uncapping based on the 2004 transfers the March Board of Review adjusted the assessments for 2007 to a total taxable value of $14,905,107

- ISSUE:
  - Whether a tax assessor's failure to "uncap" the taxable value of real property in the year immediately following its transfer (in accordance with MCL 211.27a(3)) precludes a March Board of Review from adjusting the taxable value in a later year

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Transfer of Real Property Ownership, Uncapping of Taxable Value and Real Estate Transfer Tax cont'd

***Mich Props v Merridian Twp* (cont'd)**

- HOLDING:
  - The failure to adjust the taxable value in the year immediately following the transfer produced an erroneous taxable value because the taxable value was not in compliance with the GPTA
  - The GPTA does not preclude a March Board of Review from correcting an erroneous taxable value that resulted from the failure of an assessor to adjust a property's taxable value in the year immediately following its transfer
  - A March Board of Review may adjust the erroneous taxable value in a subsequent year in order to bring the current taxable value into compliance with the GPTA

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Transfer of Real Property Ownership, Uncapping of Taxable Value and Real Estate Transfer Tax

cont'd

***Toll Northville Ltd Pship v Northville Twp,* 491 Mich 518 (2012), *Rehearing den by Mich Props, LLC v Meridian Twp,* 492 Mich 859 (2012)**

- FACTS:
  - Residential Developer Toll installed public-service improvements to a "parent parcel" that was to be divided into "child" parcels
  - The value of the improvements (infrastructure e.g. primary access road, streetlights, sewer, water, electrical, natural gas and phone service and sidewalks) which were legally defined as "additions" per MCL 211.34(d)(1)(b)(viii) was included in the taxable value for the parent parcel for tax year 2000
  - The inclusion increased the taxable value of the property from $4,701,861 to $23,395,587
  - The parent parcel was divided into child parcels by tax year 2001

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Transfer of Real Property Ownership, Uncapping of Taxable Value and Real Estate Transfer Tax
cont'd

***Toll Northville* (cont'd)**

- For 2001 the assessor proportionately split the addition to the taxable values among the child parcels
- The property division did not trigger "uncapping" as Toll remained the owner of the child parcels
- MCL 211.34(d)(1)(b)(viii) was held unconstitutional by the Michigan Supreme Court as the mere installation of public service improvements on public property or utility easements does not constitute a taxable "addition"
- The Tax Tribunal prospectively amended the taxable value of the properties by removing the value of the public-service improvement additions from the parcels' taxable values for tax year 2001 and subsequent years (tax year 2000 had not been timely appealed and was not at issue)

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Transfer of Real Property Ownership, Uncapping of Taxable Value and Real Estate Transfer Tax
cont'd

***Toll Northville* (cont'd)**

- ISSUE:
  - Whether the Michigan Tax Tribunal has the same powers and duties as a March Board of Review to adjust previously entered erroneous taxable values for purposes of bringing the current tax rolls into compliance with the GPTA

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Transfer of Real Property Ownership, Uncapping of Taxable Value and Real Estate Transfer Tax
cont'd

***Toll Northville* (cont'd)**

- HOLDING:
  - The Tax Tribunal does have the authority to reduce an unconstitutional previous increase in taxable value for purposes of adjusting a taxable value that was timely challenged in a subsequent year
  - The Tax Tribunal Act sets forth the Tax Tribunal's jurisdiction, once properly invoked the Tax Tribunal possesses the same powers and duties assigned to a March Board of Review under the GPTA, including the duty to adjust erroneous taxable values to bring the current tax rolls into compliance with the GPTA

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Transfer of Real Property Ownership, Uncapping of Taxable Value and Real Estate Transfer Tax
cont'd

***Sebastian Mancuso Family Trust v City of Charlevoix,* Published Opinion, __ Mich App ___ (dec'd Feb 5, 2013)**

- FACTS:
  - The trustees of Petitioner trust are also trustees of Alice Mancuso Family Trust.
  - By warranty deed the trustees conveyed a condominium from the Alice Trust to the Petitioner Trust.
  - Following the conveyance City of Charlevoix uncapped property's taxable value and reassessed the property, increasing TV.
  - Trustees claimed conveyance was between commonly controlled legal entities and therefore a transfer of ownership did not occur under the exception in MCL 211.27(a)(7)(l).

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Transfer of Real Property Ownership, Uncapping of Taxable Value and Real Estate Transfer Tax

cont'd

Sebastian Mancuso Family Trust (cont'd)

- ISSUE:
  - Where a trust acquires real property from a different trust and both trusts have the same trustees is the acquisition a transfer of ownership that uncapped the taxable value of the property under the GPTA or does the exception for a transfer between commonly controlled legal entities apply?
- HOLDING:
  - Although the trustee has extensive control over the trust, he/she is ultimately liable to the beneficiaries. The statute does not look to a change in the property manager, it looks to a change in the ownership of the property. The trusts do not fall within the definition of commonly controlled legal entities by virtue of having the same trustees, and the exception in MCL 211.27(a)(7)(l)does not apply.

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State Tax Commission Bulletin 5 of 2013
2012 PA 497 - Transfer of Ownership

- Beginning December 31, 2013 a transfer of residential real property is not a transfer of ownership if,
- The transferee is related to the transferor by blood or affinity to the first degree,
- AND
- The use of the residential real property does not change following the transfer of ownership.
- Definitions:
- Residential real property is defined as residential real property under MCL 211.34c,
  - (i) Platted or unplatted parcels, with or without buildings, and condominium apartments located within or outside a village or city, which are used for, or probably will be used for residential purposes

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2012 PA 497 – STC Bulletin 5 of 2013
cont'd

Definitions cont'd

- (ii) Parcels that are used for, or probably will be used for, recreational purposes, such as lake lots and hunting lands, located in an area used predominantly for recreational purposes.
- (iii) For taxes levied after December 31 2001, a home, cottage, or cabin on leased land, and a mobile home that would be assessable as real property under section 2(a) except that the land on which it is located is not assessable because the land is exempt.

- Transferee is defined as the person to whom the conveyance is made.
- Transferor is defined as one who conveys a title, right or interest in property.
- Affinity to the first degree includes the following relationships: spouse, father or mother, father or mother of the spouse, son or daughter, including adopted children and son or daughter of spouse.

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2012 PA 497 – STC Bulletin 5 of 2013
cont'd

- Assessor Responsibilities
- Provisions of Act only apply to residential real property
- However, provisions in the act ARE NOT limited to homestead property
- Meaning any residential real property regardless of residency, the application of a Principal Residence Exemption or how many residential real parcels the taxpayer owns
- Additionally the use of the property may not change
- Assessors should note any changes in the use of the property during their annual property classification review
- Any change in use should result in an immediate uncapping
- The Property Transfer Affidavit will be updated effective December 31, 2013 to include a checkbox under the exemptions, for relationship by blood or affinity in the first degree and a statement that the transferee will not change the use of the property and will notify the assessor should the use change

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Property Tax Exemptions

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Property Tax Exemptions

***Camp Retreats Foundation v Twp of Marathon,* Unpublished Court of Appeals Opinion, 2012 Mich App LEXIS 938 (dec'd May 15,2012)**

- FACTS:
  - Until June 2007, the property was owned by the Tau Beta Assoc. which sponsored summer camps for disadvantaged children and was granted an exemption from ad valorem taxation.
  - Camp Retreats, a Michigan nonprofit corporation, purchased the property with funds supplied by the Tawheed Institute, a nonprofit corporation that has tax exempt status of which Camp Retreats is a wholly owned subsidiary.
  - The parties agree that the Tawheed Institute is an Islamic organization even though its Articles of Incorporation focus on athletic pastimes as its purpose.

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Property Tax Exemptions
cont'd

***Camp Retreats* cont'd**

- The Property, which includes a lodge, dining hall, athletic facilities, pools, dorms, prayer hall and other buildings was adapted to Islamic living requirements.
- Tawheed's camping programs are open to people of all faiths, although camp requirements state all participants must observe Islamic laws.
- In 2008 Marathon Township classified the Property as commercial and rejected Camp Retreats' request for a tax exemption as a charitable institution.
- The Tax Tribunal rejected Camp Retreats' claim for an exemption and found that it had not been organized for charitable purposes and that even when analyzed along with the Tawheed Institute, Camp Retreats is chiefly organized for recreational purposes rather than for charitable purposes.

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Property Tax Exemptions
cont'd

***Camp Retreats* cont'd**

- ISSUE:
  - Is Camp Retreats entitled to the charitable exemption from ad valorem taxation because they provided a "gift" benefitting an indefinite number of people by "bringing their minds or hearts under the influence of… religion."
- HOLDING:
  - Camp Retreats is entitled to a charitable exemption from ad valorem taxation
  - Applying the *Wexford* Court factors for making an MCL 211.7o(l) determination, the court found the Property fulfills the requirements of charity because its primary use focuses on "bring[ing] people's minds or hearts under the influence of … religion," and it offers this charity on a nondiscriminatory basis and the Property was made "available to the general public" or "benefitted an indefinite number of persons."

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Property Tax Exemptions
cont'd

***Boyne Area Gymnastics v City of Boyne City,* Unpublished Court of Appeas Opinion, 2012 Mich App LEXIS 514 (dec'd May 15, 2012)**

- FACTS:
  - Boyne Area Gymnastics is a nonprofit Michigan corporation and requested that its Property be given a charitable exemption from ad valorem taxation.
  - It's amended Articles of Incorporation state it's purposes is: (1) to cultivate and nurture the physical, mental, and emotional development of children and young adults, to educate, promote and advance the interest of physical fitness throughout one's life, and to provide the opportunity for self-expression and recreation through gymnastics and dance. (2) Said organization is organized exclusively for charitable, religious, educational, and scientific purposes, including for such purposes, the making of distributions to organizations that qualify as exempt organizations under section 501(c)(3) if the IRS Code.

99

Property Tax Exemptions
cont'd

***Boyne Gymnastics* cont'd**

- FACTS:
  - At the start of every year it provided scholarships to children who couldn't afford the standard tuition rate, eligibility was dependent on whether the child was enrolled in the public school lunch program
  - The scholarship policy was not in writing and no scholarships were provided to adults
  - A consent judgment was signed by Petitioner on June 30, 2008 and by the City on July 7, 2008 indicating that the City was not contesting the Petitioner's claim the it is a charitable institution exempt from ad valorem property taxes for specific years
  - In a December 22, 2009 letter, the Tax Tribunal indicated the consent judgment had not been entered because it was awaiting the Supreme Court decision as to whether it would grant leave to appeal in the Involved Citizens Case

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Property Tax Exemptions
cont'd

***Boyne Gymnastics* cont'd**

- ISSUE:
  - Is the Petitioner a charitable institution under the six-factor *Wexford* Court test?
- HOLDING:
  - Petitioner is not a charitable organization exempt from ad valorem taxation as it did not meet the six-factor test in *Wexford.*
  - As to the 2nd factor, the Petitioner was not organized chiefly or solely for charity, at most the waiving of fees to some members of the public is incidental to the primary purpose for organizing (to teach gymnastics, dance and physical fitness)
  - As to the 4th factor, Petitioner stated that its classes lessen the burden of the government by providing training outside of Michigan's strained public school system but failed to provide evidence that it is the government's burden to provide such classes, a party may not merely announce a position and leave it to the Court to discover and rationalize the basis for the claim

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Property Tax Exemptions
cont'd

***Boyne Gymnastics* cont'd**

- As to the 6th factor, Petitioner's charitable endeavors appear to be incidental to its recreational purposes so that it's overall nature is not charitable
- Even if the proposed consent judgment were viewed as a settlement agreement that might be enforceable, contracts that offend public policy should not be enforced
- The proposed consent judgment was contrary to both law and public policy
- Petitioner does not meet the six-factor test in *Wexford* to be classified as a charitable institution
- Allowing Petitioner consent to being a charitable institution when it does not qualify as a charitable institution under the law would violate the purpose of the uniformity clause to treat similarly situated taxpayers equally

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Property Tax Exemptions
cont'd

PRE

***Kevin and Arlyn Drew v Cty of Cass*, Published Opinion, ___ Mich App ___ (dec'd Feb 14, 2013)**

- FACTS:
  - The Property is located on an island, inaccessible by road and is less than 600 square feet in size.
  - Utility bills from 2009 and 2010 showed low utility usage.
  - Petitioners own 2 other residential properties, one of which is located within one minute of their children's school.
  - Petitioners sought a principal residence (homestead) exemption under MCL 211.7cc(l) for tax years 2007, 2008, 2009, 2010 and 2011, the Tax Tribunal affirmed the County of Cass' denial of the exemption.

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Property Tax Exemptions
cont'd

***Drew v Cass Cty* cont'd**

- ISSUE:
  - Is Property a principal residence entitled to a PRE
  - Principal residence defined by MCL 211.7dd(c) as "the 1 place where an owner of the property has his or her true, fixed and permanent home to which, whenever absent, he or she intends to return and that shall continue as a principal residence until another principal residence is established"
- HOLDING:
  - Denial of PRE affirmed
  - Deferred to MTT findings on witness credibility and weight of evidence
  - Support for MTT's conclusion that "the driver's licenses, voter registration, cars and tax returns were not dispositive for purposes of determining petitioners' principal residence"
  - Evidence that Petitioners used the Property as a seasonal home, rather than their one "true, fixed, and permanent home…"

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Valuation Appeals

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Valuation Appeals

***Pontiac Country Club, et al v Waterford Twp,* Published Opinion, ___ Mich App ___ (dec'd Feb 12, 2013)**

- FACTS:
  - Tax years at issue: 2004-2006. Country Club challenged the assessed and taxable values of 9 parcels of real property
  - It uses 8 of the parcels as a golf course and the 9th as a used car lot
  - Value of used car lot not in dispute
  - The Country Club failed to respond to a request for admissions and the Tribunal deemed the statements admitted including that "[t]he property is properly assessed or assessed at below market value"

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Valuation Appeals
cont'd

***Pontiac Country Club,* cont'd**

- Petitioner's appraiser relied on income approach to value, resulting in estimates of TCV of $190,000 in 2004; $120,000 in 2005; and $90,000 in 2006.
- Alternatively estimated value of the land as if vacant and concluded property more valuable as vacant, resulting in total TCV of land for each year at $700,000.
- Respondent's appraiser also used income approach to value, resulting in TCV of $1,540,000 in 2004, $1,920,000 in 2005 and $$2,530,000 in 2006.
- Respondent's appraiser's highest and best use conclusion – as vacant property, zoned for residential or mixed commercial and residential developments. He considered the likelihood a zoning change could occur when determining HBU.
- Under this HBU, TCV estimates were $7,607,000 in 2004, $8,010,000 in 2005 and $6,910,000 in 2006.

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Valuation Appeals
cont'd

***Pontiac Country Club,* cont'd**

- HOLDING:
  - Competent and material evidence supported MTT's determination to reject Petitioner's appraisal as not credible and in rejecting Respondent's appraisal because based on "hypothetical property." Respondent's appraisal did not account for possible costs and time required to rezone the property.
  - The Tribunal's ultimate value conclusions - between the 2 appraisals, which resulted in finding that assessments on the roll for each year accurate.

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Valuation Appeals
cont'd

***Toll Northville Ltd Pship , et al v Twp of Northville,* 298 Mich App 41 (2012)**

- FACTS:
  - Supreme Court remanded the case to consider Northville's alternative argument that the adjusted valuation set by MTT did not comport with the parties' stipulation regarding valuation. The parties had stipulated to TCV of every parcel, of new construction additions made to 58 of the 353 lots in 2000.
  - Petitioners did not dispute Respondent's challenges to valuation conclusions based on the Tribunal failing to honor the stipulation.
  - No indication in the Tribunal's records that it had rejected the parties' stipulation.

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Valuation Appeals
cont'd

***Toll Northville,* cont'd**

- HOLDING:
  - MTT erred in calculating many of the properties TVs because it failed to account for the value of new construction additions made to 58 of the 353 properties even though the parties had stipulated to the cash value of the properties.
  - Regardless of reason for omission, MTT's valuation of properties should have comported with stipulation.
  - Reversed and remanded.

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Special Assessment Appeals – SOL/Tolling

Ashley Ann Arbor LLC v Pittsfield Twp, 2012 Mich App LEXIS (dec'd Dec 27, 2012)

- FACTS:
  - Special Assessment levied for drainage system up-grade.
  - Ashley filed petition with MTT on April 22, 2009, 29 days after the special assessment roll was confirmed.
  - Ashley filed a separate complaint in circuit court on December 13, 2010 raising the same issues.
  - On December 20, 2010 Ashley filed a motion in MTT to transfer matter to circuit court because MTT lacked subject matter jurisdiction.
- ISSUE:
  - Were Ashley's claims barred because it did not file its original circuit court complaint until December 13, 2010, almost 21 months after Pittsfield confirmed the assessment roll.

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Special Assessment Appeals – SOL/Tolling
cont'd

***Ashley Ann Arbor LLC,* cont'd**

- HOLDING:
  - Ashley's filing in MTT 29 days after assessment roll was confirmed tolled the 30 day SOL pursuant to MCL 600.5856 making circuit court filing timely.
  - Even if SOL not tolled by MCL 600.5856, period would be tolled as a matter of equity.
  - Alternatively, MTT could have transferred Ashley's petition circuit court once it discovered it lacked of jurisdiction pursuant to MCR 2.227(A)(1).

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