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COURT OF APPEALS: TAXPAYERS MAY NOT INCREASE BASIS OF ASSETS PURCHASED UNDER SBT AND SOLD UNDER MBT/CIT BY AMOUNT OF FEDERAL DEPRECIATION DEDUCTION DISALLOWED UNDER SBT

Michigan Bell Telephone Co v Dep't of Treasury, ___ Mich App ___, (No. 36515) and *Republic Services of Michigan Holding Co v Dep't of Treasury,* ___ Mich App ___,(No. 366164), both issued for publication on August 22,2024, involved the same substantive tax issue. The main question in each case was whether the Taxpayer could increase its basis in assets purchased under the Single Business Tax (SBT) and sold under the Michigan Business Tax (MBT)/Corporate Income Tax (CIT) by the amount of depreciation it was required to add back to its tax base under the SBT. Treasury argued that neither the MBT nor the CIT allowed such a basis adjustment, and the Court of Claims agreed, granting Treasury's motion for summary disposition in each case. Both Taxpayers appealed, and the Court of Appeals affirmed the lower court decisions. (Note: While the cases addressed the same substantive tax issue, *Republic Services* only involved asset sales under the CIT.)

The SBT was a value-added tax and quite different from both the MBT and CIT. Among its unique provisions, it required a taxpayer to add back to its tax base the amount of asset depreciation the taxpayer had claimed as a deduction on its federal return. When those assets were sold, the taxpayer's federal gain (which accounted for the assets' federal depreciation) was included in the taxpayer's federal taxable income and flowed through to its state return.

The MBT and CIT both allow a taxpayer that sold a depreciable asset during the tax year to adjust the amount of federal taxable income flowing through to its state return by the amount of federal bonus depreciation that had been disallowed with respect to that asset under the MBT/CIT but not by the amount of any federal depreciation that the taxpayer had been required to add back to its tax base under the SBT. Thus, an MBT/CIT taxpayer could be taxed on federal gain that had been calculated, at least in part, based on federal depreciation deductions for which the taxpayer received no benefit under the SBT.

In an effort to avoid this outcome, the Taxpayers in the two cases claimed basis adjustments on their MBT/CIT returns for the tax years at issue for assets sold under those tax regimes that were purchased under the SBT. Specifically, each Taxpayer increased its basis in such assets *for state tax purposes* by the amount of federal depreciation it had been required to add back to its tax base under the SBT. These adjustments resulted in the Taxpayers reporting federal taxable income on their state returns that was lower than the amount reported on their federal returns.

The Taxpayers were subsequently audited, and these adjustments were

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disallowed. After informal conferences resulting in decisions and orders upholding Treasury's position, each Taxpayer sued in the Court of Claims, arguing that its adjustments were supported by Michigan statute and caselaw. The Court of Claims disagreed, finding that the only allowed adjustments to federal taxable income are those expressly outlined in the two tax statutes (such as the adjustment for federal bonus depreciation) and that neither the MBT nor the CIT allowed the Taxpayers' claimed tax treatment. It further found that the cases cited by the Taxpayers, *Sturrus v Dep't of Treasury*, 292 Mich App 639 (2011), an individual income tax case, and *Maxitrol Co v Dep't of Treasury*, 217 Mich App 366 (1996), did not support their positions.

The Taxpayer in *Michigan Bell* filed a motion for reconsideration, which was denied. Both Taxpayers subsequently appealed.

The Court of Appeals affirmed the Court of Claims decisions based on the plain language of the statutes at issue and the relevant caselaw. Regarding the statutory language, the Court of Appeals noted the express carveouts in Michigan's definition of "federal taxable income" for bonus depreciation and the domestic production activities deduction, which it determined indicated the legislature did not intend to grant similar treatment to general depreciation. The court also noted that while the MBT included several transition rules to facilitate and clarify the transition from the SBT, neither the MBT nor the CIT contained a transition rule regarding depreciation that would support the Taxpayers' positions.

Both Taxpayers have sought leave to appeal to the Michigan Supreme Court.

RECENTLY ISSUED GUIDANCE FROM TREASURY

Revenue Administrative Bulletins

RAB 2024 - 13 Sales and Use Tax – Food for Human Consumption, Approved August 20, 2024

RAB 2024 - 18 Sales and Use Taxes – Lessors, Approved November 13, 2024

RAB 2024-21 Sales and Use Tax - The Prescription Drug and Over-the-Counter Drug Exemptions

RAB 2024-23 Federal Taxable Income - Net Operating Loss and Business Loss Under Part 2 of the Michigan Income Tax Act

Notices

- **Notice: Michigan Supreme Court Allows The Court Of Appeals Decision To Stand That Concluded The Reduction To The Income Tax Rate For Tax Year 2023 Was Temporary, Published September 23, 2024**
- **Notice of Tax Rate Calculation on Gross Premiums Attributable to Qualified Health Plans for Tax Year 2024, Published September 30, 2024**
- **Notice Regarding Rescission of Rule Governing Food for Human Consumption, Published October 10, 2024**
- **Notice: No Changes to City Income Tax Payments as Detroit Explores Cryptocurrency for Property Taxes, Published November 11, 2024**

Sales and Use Tax Exemption-Firearm Safety Devices, Published November 25, 2024

Statement of Acquiescence/Non-Acquiescence Regarding Certain Court Decisions

In each issue of the quarterly Treasury Update, Treasury will publish a list of final (unappealed), non-binding, adverse decisions issued by the Court of Appeals, the Court of Claims and the Michigan Tax Tribunal, and state its acquiescence or nonacquiescence with respect to each. "Acquiescence" means that Treasury accepts the holding of the court in that case and will follow it in similar cases with the same controlling facts. However, "acquiescence" does not necessarily indicate Treasury's approval of the reasoning used by the court in that decision. "Non-acquiescence" means that Treasury disagrees with the holding of the court and will not follow the decision in similar matters involving other taxpayers.

ACQUIESCENCE: None this issue.

NON-ACQUIESCENCE: None this issue.

MICHIGAN SUPREME COURT ALLOWS COURT OF APPEALS DECISION TO STAND — 4.05% TAX RATE FOR TAX YEAR 2023 IS TEMPORARY

In *Associated Builders and Contractors of Michigan v Eubanks*, a group of individual taxpayers and interested parties challenged Treasury's implementation of an opinion of the Attorney General (OAG Opinion No. 7320) which concluded the 4.05% tax rate as determined under Section 51(1)(c) of the Income Tax Act, MCL 206.51(1)(c), was temporary and effective for the 2023 tax year only. The Attorney General's interpretation was first upheld by the Michigan Court of Claims in an opinion issued on December 21, 2023, and, again, by the Michigan Court of Appeals in a published opinion issued on March 7, 2024. Plaintiffs filed an application for leave to appeal to the Michigan Supreme Court; however, by order entered on August 30, 2024, the Court unanimously denied that application.

The opinion of the Court of Appeals is published and therefore binding precedent. In accordance with that opinion, a rate reduction under Section 51(1)(c) is effective for one tax year only, with the rate under Section 51 reverting to 4.25% for each tax year in which a rate reduction is not triggered. It has previously been determined that a rate reduction under Section 51(1)(c) was not triggered for the 2024 tax year. Accordingly, the 4.05% income tax rate is effective for the 2023 tax year only, and the income tax rate effective for tax years beginning in 2024 is 4.25%. This rate will apply to individuals, fiduciaries, and flow-through entities paying the Michigan Flow-Through Entity Tax.

For more detailed information about the prior opinions from the Court of Claims and Court of Appeals, please see the prior coverage in the May 2024 edition of this newsletter.

RESCISSION OF RULE REGARDING "FOOD FOR HUMAN CONSUMPTION"

Effective September 17, 2024, Rule 86 of the Specific Sales and Use Tax Rules, R 205.136, has been rescinded from the Michigan Administrative Code. Rule 86 had elaborated on the statutory treatment of "food for human consumption." (For more on that treatment see RAB 2024-13, *Sales and Use Tax — Food for Human Consumption*.)

The recent rescission of Rule 86 follows the rescission of many rules in 2023, including rules that had been superseded by caselaw or that merely had restated a statutory provision. Rule 86 met both criteria: it had been superseded in part by *Emagine Entertainment v Treasury*, 334 Mich App 658 (2020), and it restated statutory provisions in the Use Tax Act and the General Sales Tax Act, after those acts were amended in 2023 by Public Acts 141 and 142. For these reasons, Treasury rescinded Rule 86.

The current General and Specific Sales and Use Tax Rules can be found by selecting Treasury's Bureau of Tax and Economic Policy under the administrative code search tool at: https://www.michigan.gov/lara/bureau-list/moahr/admin-rules.

TAXPAYER SEEKING TO REMOVE INCOME FROM TAX BASE MUST SEEK APPROVAL FROM TREASURY FOR ALTERNATIVE APPORTIONMENT

In MGM Grand Detroit, Inc v Dept of Treasury MI Ct of Claims, (No. 24-000009-MT)(July 9, 2024), one of the taxpayer's, unitary business group (UBG) members, MGM Elgin Sub Inc., sold its interest in a non-unitary partnership, Elgin Riverboat-Resort Casino during tax year 2018. MGM Elgin Sub's sale of its partnership interest generated a capital gain for federal tax purposes. The UBG included the gain on the sale in its 2018 unitary corporate income tax (CIT) filing and included the gain in the denominator of its apportionment factor.

Treasury later audited the UBG for tax years 2014-2018. Treasury removed the gain from the sales factor denominator, and litigation ensued.

The taxpayer asserted that the gain should have been allocated rather than apportioned and, in the alternative, that if the gain was subject to apportionment, then it must be represented in the sales factor to be constitutional. The taxpayer did not make a request for alternative apportionment, maintaining that one was not necessary.

The parties filed cross-motions for summary disposition. Treasury asserted that the taxpayer was not entitled to alternative apportionment because it failed to petition Treasury for application of an alternative method of apportionment as required by section 667 of the Corporate Income Tax Act. [1] Treasury established that the statute requires a request for alternative apportionment even where a taxpayer seeks to remove income from the tax base for allocation elsewhere not just when seeking to adjust the apportionment factor.

The taxpayer asserted that because Elgin Riverboat was not unitary with MGM Elgin Sub, the gain arising from the sale of MGM's interest in the Riverboat cannot be included in apportionable income. Alternatively, the taxpayer argued that if it were to be included in apportionable income, apportionment must be based on the business activity (sales factor) of Elgin Riverboat, which had no Michigan sales. Finally, the taxpayer asserted that a request for alternative apportionment was not needed because the state is required to adhere to constitutional limitations on its ability to tax income earned outside its borders where there is no connection to the activities conducted by the UBG.

The Court of Claims on its own motion dismissed the case without prejudice on procedural grounds.

The taxpayer filed a second complaint on the apportionment issue.

After rejecting several procedural arguments to the taxpayer's claim, the Court addressed the underlying apportionment issue raised in the taxpayer's first lawsuit and concluded that the CIT required the taxpayer to petition Treasury for approval before using an alternative apportionment method on its tax return. The Court cited the Michigan Supreme Court's decision in *Vectren Infrastructure Servs Corp v Dep't of Treasury*, 512 Mich 594, 601 (2023), as implicit support for its conclusion and also cited section 667(3) of the CIT, which requires a taxpayer to petition for alternative apportionment when the taxpayer contends that the default apportionment method would either lead to a grossly distorted result or, as asserted by MGM, would unconstitutionally tax a taxpayer's out-of-state activity. In the Court's opinion, the fact that the latter circumstance would require allocation rather than a different apportionment method, did not obviate the requirement that a taxpayer petition Treasury when seeking to avoid the default apportionment provision.

[1] MCL 206.667.

UNITARY BUSINESS GROUP OF INSURANCE COMPANIES MUST FILE A COMBINED PREMIUMS TAX RETURN AND RETALIATORY TAX RETURN[1]

In *Nationwide Agribusiness Ins Co v Treasury*, ___ Mich App ____ (No. 364790)(June 20, 2024), the Court of Appeals (COA), in a published decision, held that a unitary business group (UBG) of insurance companies must file a combined return for calculation of premiums tax and related credits under Chapter 12 of the Income Tax Act. Because the retaliatory tax under the Insurance Code is incorporated into Chapter 12 of the CIT, it also must be filed on a combined basis.

The Plaintiff originally filed separate premiums tax and retaliatory tax returns for each insurance company. Realizing that the insurance companies met the definition of a UBG, the Plaintiff filed amended combined returns with the other members seeking to aggregate tax liability and share credits on the premiums tax returns. Because there are no forms for insurance companies to file on a combined basis, the Plaintiff included a schedule aggregating premiums and credits to members of the UBG. Treasury initially accepted the amended returns and issued refunds. Later after reviewing the amended returns, Treasury rejected the combined returns on the grounds that the premiums tax and retaliatory tax are levied on each insurance company that had premiums on policies written covering risks and property in Michigan and assessed the insurance companies to reclaim the refunds.

The MTT held that while the insurance companies met the definition of a UBG, the definition of "taxpayer" in Section 611(5) was dependent on the specific chapter of the CIT and the tax the taxpayer was liable for under that chapter. Thus Chapter 12 included only insurance companies subject to the premiums and retaliatory tax and not standard corporations or financial institutions. The MTT then concluded that Chapter 12 does not provide for a UBG to file jointly and each insurance company must file individually.

The COA held the MTT's conclusion was in direct contradiction with the holdings in *D'Agostini* and *Soave*. The Court held that these cases make clear when a group of companies qualify as a UBG they must file a combined return. The COA concluded Section 691(1) requires that a UBG must file a combined return. Relying on *k*, the Court stated the MTT's conclusion was "exactly backwards", "the question is not whether the Legislature intended to include every subcategory of tax, but whether the Legislature intended to exempt any particular subcategory, which it did with the MBT credits." The COA also rejected the fact that Chapter 12 imposed a tax on "each insurance company. The Court then noted that a credit is provided for payments made by an insurance company to the Michigan Automobile Insurance Placement Facility (MAIPF). Since the Court held that a UBG must file a combined return, "[i]t logically follows . . . the calculation and application of the MAIPF credit must also be done on a unitary basis."

Turning to the retaliatory tax assessed on an "authorized insurer" under the Insurance Code, the COA was dismissive of the fact that an authorized insurer is an individual insurance company. The Court simply stated the retaliatory tax was part of the CIT's tax structure and therefore, is calculated and imposed at the UBG level the same as the premiums tax.

On September 24, 2024, Treasury filed an Application for Leave to Appeal to the Michigan Supreme Court (Case No. 167608), which remains pending as of the publication date of this article.

[1] This article was updated on January 8, 2025, to correct an error describing the holding of the Court of Appeals and to include information about the status of this case.

ATTENTION ALL DATA CENTER OPERATIONS

Treasury is requesting that all data center operators who claimed a sales or use tax exemption for the sale or purchase of data center equipment submit form 5726 by January 31st. Sales and use tax exemptions play a large role in overall revenue allocation and exemptions taken by data centers are no exception as they directly affect the School Aid Fund, General Fund, and other revenue distributions. The Department must determine the amount of revenue lost to the School Aid Fund from claiming these exemptions under MCL 205.54ee and/ or MCL 205.94cc and has implemented a process to mandate certain reporting obligations on persons claiming these exemptions.

Public Acts 29 and 30 ("Acts") of 2020 became effective February 13, 2020. These Acts established certain reporting obligations on persons claiming sales or use tax exemptions regarding the sale or purchase of data center equipment. More specifically, the Acts require such persons to annually report the sales or purchase price of equipment sold to, or purchased by, them each calendar year in which the exemptions were claimed. The Acts also established that this reporting must be submitted on a form and at the time and in the manner prescribed by the Department. For the purpose of reporting the information required by the Acts, the Department has issued form 5726 (Report for Qualified Data Center Exemptions). This form must be filed no later than January 31st of the year immediately following the close of the calendar year. Keep in mind that the filing of this form is to fulfill the reporting obligations under the Acts and is not a means for claiming an exemption. If no Equipment was sold or purchased or an exemption was not claimed in a particular calendar year, the filing of form 5726 is not required. The form itself, and instructions on completing and submitting the form can be found under the Business Taxes (Sales and Use Tax) Forms and Instructions section at www.michigan.gov/taxes.

For more information regarding the data center exemptions, please refer to the Department's Notice Regarding Data Center Exemption which was updated on March 14, 2016. This will provide you with everything you need to know about what sales or purchases are exempt. For questions concerning the filing of Form 5726, please direct your inquiries to Tax Technical Services at 517-636-4357.

NEW TAX CREDIT FOR LIVE ORGAN DONATION[1]

More than 2,000 Michigan residents are currently waiting for organ donations, most of whom require kidneys. Nationally, 13 people die every day waiting for a kidney donation. Removing economic barriers that prevent live organ donations is considered key to increasing this lifesaving gift.

Beginning tax year 2025, Michigan taxpayers can take a new tax credit for up to $10,000 in unreimbursed expenses associated with donating a live human organ to another human for transplant. The new credit is a one-time, nonrefundable credit available to the taxpayer for donations made by themselves or any of the dependents claimed by the taxpayer. Expenses include, but are not limited to, any unreimbursed travel or lodging expenses, lost wages, or childcare expenses. Claimable expenses are those incurred in the tax year before the donation, the year of the donation, or the year following the organ donation. Because it is a one-time credit, a taxpayer may only take the credit for expenses incurred in one of those years. Additionally, because the credit is non-refundable, it may only be taken up to the amount of the taxpayer's tax liability for the year claimed even if the unreimbursed expenses exceed that amount.

For purposes of the new tax credit, live donations of human organs can include, as defined under the Public Health Code, a kidney, part of a liver, a lobe of a lung, a partial pancreas, part of an intestine, bone marrow, bone, or skin. Human organ does not include whole blood, blood plasma, blood products, blood derivatives, other self-replicating body fluids, or human hair.

Taxpayers are required to submit verification of the donation with the annual return on which the credit is claimed. Treasury may require reasonable proof of the donation expenses claimed.

[1] This article was updated on January 16, 2025, to provide accurate examples of human organs capable of live donation.

ABOUT TREASURY UPDATE

Treasury Update is a periodic publication of the Tax Policy Division of the Michigan Department of Treasury.

It is distributed for general information purposes only and discusses topics of broad applicability. It is not intended to constitute legal, tax or other advice. For information or advice regarding your specific tax situation, contact your tax professional.

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