

June 11, 2013

Michigan Court Allows Multistate Tax Compact Election

On June 6, 2013, the Michigan Court of Claims became the second court in the country to hold that the Multistate Tax Compact (the Compact) is a binding multistate compact that cannot be repealed by a separate, subsequent statute. *Anheuser-Busch, Inc. v. Michigan Dep't of Treasury*, Case No. 11-85-MT (Order and Opinion, Mich. Ct. of Claims June 6, 2013) (Collette, J.). The taxpayer was thus entitled to apportion its income under the former Business Income Tax (BIT) component of the Michigan Business Tax (MBT) using the Compact's equally-weighted three factor formula rather than the statutory single sales factor formula.

The decision is significant because it represents the first court since the California Court of Appeal's seminal decision in *Gillette* to apply interstate compact law principles in upholding the Compact's election. See *Gillette Co. v. Franchise Tax Bd.*, 209 Cal. App. 4th 938 (2012), *review granted and opinion superseded sub nom.*, 291 P.3d 327 (Cal. Jan. 16, 2013).

Background

Michigan adopted the Compact effective July 1, 1970. Under Article III of the Compact, a taxpayer may elect, with respect to a state "income tax," to apply the Compact's equally-weighted three factor formula in lieu of the state's apportionment formula. The Compact remained largely dormant for nearly 40 years under the former Single Business Tax – a form of value added tax rather than an income tax – until the MBT became effective in 2008.

The MBT was comprised of two components, the BIT, a tax based on net income, and the Modified Gross Receipts Tax (MGRT), a tax based on gross receipts less certain deductions. Under the MBT, taxpayers elected to apportion their income using the Compact's equally-weighted three factor formula in lieu of the MBT's statutory single sales factor formula if it was advantageous to do so.

Anheuser-Busch filed its original returns claiming the Compact's apportionment election for the tax years 2008-2010, which resulted in refund claims of estimated taxes paid. Following the denial of its refund claims by the Michigan Department of Treasury (Department), Anheuser-Busch filed suit in the Court of Claims challenging the denials.

Many observers believed that the fate of the Compact election in Michigan would rest solely on a November 2012 Compact election decision by the Michigan Court of Appeals. See *Int'l Business Mach. Corp. v. Dep't of Treasury*, 2012 WL 6913772, Dkt. No. 306618 (Mich. App. Nov. 20, 2012) (unpublished) (hereinafter *IBM*), *application for leave to appeal filed*, Dkt. No. 146440 (Mich. Dec. 28, 2012) (application pending). *IBM*, however, was an unpublished – and thus non-binding – decision. The Court of Claims in *Anheuser-Busch*, left free to make an independent judgment on the merits of the case, reached a different conclusion than that of the Court of Appeals in *IBM*.

© 2013 Sutherland Asbill & Brennan LLP. All Rights Reserved.

This communication is for general informational purposes only and is not intended to constitute legal advice or a recommended course of action in any given situation. This communication is not intended to be, and should not be, relied upon by the recipient in making decisions of a legal nature with respect to the issues discussed herein. The recipient is encouraged to consult independent counsel before making any decisions or taking any action concerning the matters in this communication. This communication does not create an attorney-client relationship between Sutherland and the recipient.

Sutherland Observation: The Michigan Court of Appeals, following its decision in *IBM*, denied a request from the Michigan Attorney General’s Office to publish its November 20, 2012 decision – an act that would have rendered the opinion binding on the Court of Claims. The recent *Anheuser-Busch* decision may provide the Court of Appeals with another opportunity to consider the Compact election should the Michigan Supreme Court deny review in *IBM* and perhaps reach a different result than that reached in *IBM*.

The Compact Is a Binding Contract Among States

The Court of Claims first concluded, like the California Court of Appeal in *Gillette*, that the Compact “is a binding compact that cannot be repealed by a conflicting statute.” Applying Michigan case law, the court found that the language of the Compact plainly and unambiguously demonstrated an intent to bind future Legislatures. The court held that Section 1 of the Compact, which provides that “[t]he multistate tax compact is enacted into law and entered into with all jurisdictions legally joining therein,” “plainly states an intent to enter into a binding contractual relationship . . . [and] to limit the Legislature’s power.” *Anheuser-Busch* at 6-7.

The Court of Claims further ruled, agreeing with a portion of the Court of Appeals holding in *IBM*, that the plain language of the MBT Act (MCL 208.1301) purports to override the Compact’s election by providing that, “each tax base established under this act shall be apportioned in accordance with this chapter.” *Id.* at 8. As a binding multistate compact, the Michigan legislature’s subsequent enactment of the MBT Act’s single sales factor apportionment formula “cannot impair the election provision of the [Compact],” *Id.* at 7. Thus, the “the [Compact] controls and functions as an exception to the mandatory language of the MBT [Act].” *Id.* at 8.

Sutherland Observation: The court’s holding that the Compact is a binding multistate compact could have broad implications for the numerous Michigan taxpayers that have similar Compact election cases pending. According to the Michigan Attorney General’s Office, as of late 2012, there were roughly 60 to 70 cases held in abeyance either in the Court of Claims or the Michigan Tax Tribunal pending the outcome of cases like *Anheuser-Busch*, plus approximately 50 more at the informal conference stage before the Department of Treasury’s Hearings division.

Compact Election Applies to the BIT, But Not the MGRT Component of the MBT

Applying the Compact’s definition of an “income tax,” the court had no reservation in holding that the BIT component of the MBT is an income tax subject to the Compact’s election provision. *Id.* at 9.

As a matter of first impression, however, the court ruled that the MGRT component of the MBT is not an income tax and thus not subject to the Compact election. The court described the MGRT component as a modified “sales-subtraction value added tax.” While the computation of the tax base allowed for certain expense deductions, “the expenses that are deducted under the MGRT are related to particular transactions,” and thus “the MGRT is not imposed on or measured by net income” within the meaning of the Compact. *Id.* at 10-11.

Sutherland Observation: This case is the first judicial decision to address whether the MGRT component of the MBT is properly characterized as an “income tax” under the Compact’s definition of that term. Similar issues arise with the Texas Margins Tax, a different form of modified gross receipts tax, and whether it constitutes an “income tax.”

Conclusion

A split of authority now exists in Michigan regarding whether the Compact's apportionment election is available to taxpayers under the MBT, and the new *Anheuser-Busch* decision provides a welcome, taxpayer-favorable contradiction to the previous *IBM* decision. Taxpayers with pending refund claims in Michigan should closely monitor the Michigan Supreme Court's potential grant of review in *IBM*'s pending application, as well as the Department's likely appeal of *Anheuser-Busch*.



If you have any questions about this Legal Alert, please feel free to contact any of the attorneys listed below or the Sutherland attorney with whom you regularly work.

Michele Borens	202.383.0936	michele.borens@sutherland.com
Jonathan A. Feldman	404.853.8189	jonathan.feldman@sutherland.com
Jeffrey A. Friedman	202.383.0718	jeff.friedman@sutherland.com
Todd A. Lard	202.383.0909	todd.lard@sutherland.com
Carley A. Roberts	916.241.0502	carley.roberts@sutherland.com
Marc A. Simonetti	212.389.5015	marc.simonetti@sutherland.com
Eric S. Tresh	404.853.8579	eric.tresh@sutherland.com
W. Scott Wright	404.853.8374	scott.wright@sutherland.com
Douglas Mo	916.241.0505	douglas.mo@sutherland.com
Prentiss Willson	916.241.0504	prentiss.willson@sutherland.com
Pilar Mata	202.383.0116	pilar.mata@sutherland.com
Jack Trachtenberg	212.389.5055	jack.trachtenberg@sutherland.com
Mary C. Alexander	202.383.0881	mary.alexander@sutherland.com
Andrew D. Appleby	212.389.5042	andrew.appleby@sutherland.com
Zachary T. Atkins	404.853.8312	zachary.atkins@sutherland.com
Madison J. Barnett	404.853.8191	madison.barnett@sutherland.com
Todd G. Betor	202.383.0855	todd.betor@sutherland.com
Scott A. Booth	202.383.0256	scott.booth@sutherland.com
Christopher N. Chang	212.389.5068	christopher.chang@sutherland.com
Miranda K. Davis	404.853.8242	miranda.davis@sutherland.com
Timothy A. Gustafson	916.241.0507	tim.gustafson@sutherland.com
Sahang-Hee Hahn	212.389.4028	sahang-hee.hahn@sutherland.com
Saabir S. Kapoor	202.383.0819	saabir.kapoor@sutherland.com
Charles C. Kearns	202.383.0864	charlie.kearns@sutherland.com
Jessica L. Kerner	212.389.5009	jessica.kerner@sutherland.com
Shane A. Lord	404.853.8091	shane.lord@sutherland.com
Suzanne M. Palms	404.853.8074	suzanne.palms@sutherland.com
Kathryn E. Pittman	202.383.0826	kathryn.pittman@sutherland.com
David A. Pope	212.389.5048	david.pope@sutherland.com
Maria M. Todorova	404.853.8214	maria.todorova@sutherland.com