

## Out-of-State Companies Might Be Owed Tax Refunds Under Michigan's Multistate Tax Compact Election Decision

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A Multistate Tax Compact (MTC) election is applicable to both the net income base and modified gross receipts base of the Michigan Business Tax (MBT), the Michigan Supreme Court ruled in *International Business Machines v. Michigan Department of Treasury*. Miller Canfield represented IBM in the dispute.

The court held that both MBT tax bases constituted an "income tax" as that term is defined in the MTC.

### How the election benefits a taxpayer

The MTC election involves the application of a three-factor formula consisting of the average of a taxpayer's property, payroll, and sales in Michigan (property + payroll + sales / 3). The MBT used only a sales ratio; therefore taxpayers with a greater proportion of their property and payroll outside of Michigan than their sales into the state would benefit from the election. Conversely, those taxpayers with a greater concentration of property and payroll within Michigan than sales would not benefit. Other differences exist in the items included in the sales formula and how services are sourced which can also benefit companies with their primary base of operations outside of the state.

### Decision rests on statutory, and not contractual or constitutional grounds

The Supreme Court determined, as a matter of statutory construction, the MTC election could not have been repealed by implication by the mere enactment of the MBT containing its own apportionment formula, because the MTC election always contemplated the existence of a tax with an apportionment scheme that deviated from the MTC model. Thus, the Court reversed the decision of the Court of Appeals that the election was implicitly repealed when the MBT was enacted in 2007 and took effect on January 1, 2008.

Because the election was found to apply as a mere matter of statutory construction, the court did not address the taxpayer's alternative arguments that the election was promised under a contractual commitment with other states when Michigan became a member of the compact in 1970, and that the unilateral repeal of the election violated the contracts clause of the constitution. These issues are currently being considered in other state tax litigation concerning the MTC election, notably, by the California Supreme Court in *Gillette v Franchise Tax Board*.

### Applicability of decision to other claims

IBM's case arose from an election made on an original return filed by the taxpayer in 2008. The multistate tax compact was amended in 2011 to provide that the election is no longer available beginning January 1, 2011, so the decision is directly applicable only to MBT tax years 2008–2010. The court did not settle the question of whether the amendment of the compact in 2011 violated the contractual commitments of the compact or the contracts clause of the Constitution; therefore the decision does not address the viability of refund claims for 2011 – the last year the MBT was in effect – or for years beginning in 2012 when Michigan enacted a corporate income tax to replace the MBT. The case also did not specifically address whether taxpayers can make the MTC election on an amended return as opposed to an original return.

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### Finality of decision

The decision of the Michigan Supreme Court is final, unless the court revises its opinion upon a motion for reconsideration. Such motions are often filed but rarely granted. Further review of the decision could be petitioned to the U.S. Supreme Court, but such a petition would not modify the binding effect of the decision. Review by the U.S. Supreme Court would be highly unlikely given that the case was decided on statutory grounds.

### Next steps for taxpayers

Since the decision is applicable to tax years 2008-2010, the focus will now be on refund claims for those years. Generally, refund claims not previously filed for 2008 would be barred by the four-year statute of limitations, which would have expired no later than December 31, 2013 unless held open by an audit or other event, but claims for 2009 and 2010 would be viable in many cases. Claims for years after the MTC statute was amended for 2011 under the MBT and in 2012 and later years under the corporate income tax are not necessarily precluded, but would rely on arguments not considered by the Court in *IBM*. The outcome of the California litigation in *Gillette*, which is expected to be decided by the California Supreme Court in late 2014 or early 2015, would be relevant to such claims.

Taxpayers may therefore wish to review their returns for prior periods and consider filing claims for refund if the MTC election is favorable. You can Contact Gregory Nowak, Miller Canfield's state tax services leader, or any Miller Canfield attorney for assistance.

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