

# PUBLICATION

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## Spotlight on SALT: Income Apportionment and the Multistate Tax Compact's "Taxpayer Option" – Uncertainty for Corporate Taxpayers in Michigan

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A state's corporate tax income apportionment formula is at the heart of determining a business's multistate income tax liability. As we previously reported on California and *The Gillette Company v. Franchise Tax Board* (decided July 24, 2012 and reaffirmed October 2, 2012) (see our August 7, 2012 Tax Alert, "[California's Gillette Decision Raises a Host of Potentially Significant Taxpayer Opportunities Nationally](#)" and our October 9, 2012 Tax Alert, "[California Appeals Court Reaffirms Its Gillette Decision and FTB Issues Warning as to Gillette Reliance](#)"), multistate businesses may have at their option an election to apply a different income apportionment formula in those states that have enacted the Multistate Tax Compact (Compact). Under the Compact's "Taxpayer Option," a taxpayer may elect to use the Compact's equally-weighted three-factor formula to apportion its income or use the state's standard formula set forth in a separately codified corporate income tax statute.

On June 6, 2013, the Michigan Court of Claims in *Anheuser-Busch, Inc. v. Dept. of Treasury*, sustained the taxpayer's right to elect the Taxpayer Option for purposes of the Michigan Business Tax. However, *Anheuser-Busch* may conflict with an earlier (but unpublished) Michigan Court of Appeals decision in the case of *International Business Machines Corp. v. Dept. of Treasury*.

Given the California and Michigan developments, multistate businesses filing tax returns in one of the 18 member states of the Multistate Tax Commission (MTC) should consider whether protective refund claims should be filed for open years.

### History and Background

The Compact was drafted and adopted in 1964. Among other things, the Compact established the MTC, adopted the income apportionment and related provisions of the Uniform Division of Income for Tax Purposes Act (UDITPA), provided that the MTC could audit corporate taxpayers on behalf of multiple states, and included the "Taxpayer Option." Michigan adopted the Compact in 1970 and became a member of the MTC.

For years prior to January 1, 2008, Michigan imposed its Single Business Tax (SBT) on businesses. The Taxpayer Option only applies if the taxpayer is subject to an income tax. The Michigan Supreme Court held that the SBT was not an income tax (*The Gillette Company v. Dept. of Treasury* (1993)). As a result, the Taxpayer Option did not apply for years prior to 2008.

From 2008 through 2011, Michigan imposed the Michigan Business Tax (MBT), which was comprised of two components: a corporate income tax component and a gross receipts tax component. When Michigan adopted the MBT, the separately codified Compact was not repealed. Effective for tax years beginning on or after January 1, 2012, Michigan again changed its business tax statute and enacted the Michigan Corporation Income Tax (MCIT).

As part of the MCIT, the Taxpayer Option provisions of the Compact were amended and could not be elected by a taxpayer after January 1, 2011.

Unlike the Compact's Taxpayer Option formula, the MBT and MCIT both apply a single-factor formula based on sales. Such a formula will increase income apportioned to Michigan by out-of-state businesses making sales into Michigan and, conversely, will decrease income apportioned to that state by Michigan businesses making sales to customers outside Michigan.

### **International Business Machines Corp. v. Dept. of Treasury**

IBM filed an amended MBT return for its 2008 tax year that claimed a refund based on the Compact's Taxpayer Option, instead of the MBT's standard single factor formula based on sales. In the Michigan Court of Claims, the Court held that the Taxpayer Option was only available if a taxpayer first requested permission from the Department of Treasury (Department) to use the Taxpayer Option as an alternative apportionment formula. On appeal, the Michigan Court of Appeals initially agreed with the taxpayer that it was irrelevant that IBM did not first request permission from the Department to use the Taxpayer Option under the MBT's alternative apportionment provision. Next, the Court of Appeals found that the Compact and MBT were irreconcilable. Since the two Michigan statutes could not be harmonized, usually a later-enacted statute controls over the earlier, unless that earlier statute is a binding contract. The Court of Appeals held on November 20, 2012 that the Compact was not a "binding contract," because it could be repealed by a state and the Compact provided that provisions in the Compact that conflict with a member state's constitution are severable from the Compact. As a result, according to the Court of Appeals the Taxpayer Option did not survive enactment of the MBT.

On July 3, the Michigan Supreme Court granted IBM's application for leave to appeal and will now review the IBM case.

### ***Anheuser-Busch, Inc. v. Dept. of Treasury***

As an unpublished decision, *IBM* is not (yet) precedent. Notwithstanding the Court of Appeals' decision in *IBM*, the Court of Claims held in favor of the taxpayer in *Anheuser-Busch*. Like *IBM*, *Anheuser-Busch* (A-B) filed refund claims for its 2008 and 2009 taxable years seeking a refund of MBT using the Taxpayer Option to apportion its income to Michigan instead of the MBT's single sales factor formula. Unlike the Court of Appeals, the Court of Claims held that the Compact was a binding contract. Persuaded by some of the same factors as influenced the Court of Appeals' *IBM* decision, the Court of Claims found the Compact binding because it limited a member state's ability to withdraw from the MTC only by enacting a repealing statute (that is, a state cannot unilaterally modify the language of the Compact) and the Compact's arbitration provisions continued to apply to a member state that repealed the Compact for arbitrations covering years while the state was an MTC member. As a result, the court ruled that A-B could use the Taxpayer Option to apportion its income for the business income tax component of the MBT, but not the gross receipts tax component.

### **Uncertainty, Yet Potential Opportunity**

With *IBM* pending before the Michigan Supreme Court, the effect of *Anheuser-Busch* may be short-lived. Although the revenue departments of some member states of the MTC (e.g., Texas) are resisting the Taxpayer Option, others are at least accepting protective refund claims until controversies surrounding the Taxpayer Option in those states are resolved (e.g., Oregon). The Supreme Courts of California and Michigan now appear positioned to finalize the issue in their respective states and to be persuasive arbiters of the availability of the Taxpayer Option to apportion income in other MTC member states.

In the meantime, multistate businesses having filed corporate income tax returns with MTC member states for prior open years should consider whether protective refund claims are appropriate under their particular facts and circumstances.

If you have questions about the Taxpayer Option, or the case law and other developments in California, Michigan and other MTC member states, please contact one of the attorneys in the Firm's Tax Department.