AN ALERT FROM THE BDO STATE AND LOCAL TAX PRACTICE

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SUBJECT
2014 MICHIGAN STATE AND LOCAL TAX IN REVIEW: RECENT SIGNIFICANT MICHIGAN DEVELOPMENTS, MOST OF WHICH ARE TAXPAYER-FRIENDLY

SUMMARY

During 2014, many significant, taxpayer-friendly developments occurred in Michigan, including the decisions in *Thomson-Reuters Inc. v. Department of Treasury*, *Auto-Owners Insurance Co. v. Department of Treasury*, and *Fradco, Inc. v. Department of Treasury*, as well as several legislative developments. Together, these developments begin to provide guidance regarding the treatment of software as a service ("SaaS") for sales and use tax purposes, and improve the fairness and administration of Michigan taxes. While the decision in *International Business Machines Corp. v. Department of Treasury* was also considered a taxpayer win, the flurry of activity in the second half of the year has only made the availability of the Multistate Tax Compact (the "Compact") three-factor apportionment formula election (the "MTC Election") more uncertain for Michigan taxpayers.

DETAILS

Legislative developments[1]

S.B. 658 and S.B. 659, 97th Legis., Reg. Sess. (Mich. Public Act 553 of 2014) – Michigan Enacts Affiliate and Click-Through Nexus Provisions for Sales/Use Tax. On December 15, 2014, the Michigan legislature enacted, and Michigan Governor Rick Snyder subsequently signed into law, changes to the provisions

[1] Note that this document identifies the most recent Michigan legislative developments. Please see prior BDO State and Local Tax Alerts for details on earlier legislative developments: *Michigan Corporate Income Tax: New Law Allows a Taxpayer to Elect to Include Non-Unitary, Controlled Entities in a Combined Group*, dated January 2014, and *Michigan Corporate Income Tax: Passage of Bills Result in Exemption of DISCs, Modification of Sales Factor Eliminations, and Various Other "Clean-Up" Items*, dated March 2014. These documents may be accessed at www.bdo.com/insights/tax/state-and-local-tax/michigan-corporate-income-tax-new-law-allows-a-tax and www.bdo.com/insights/tax/state-and-local-tax/mi-passage-of-bills-result-in-exemption-of-discs.

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identifying the activities that constitute doing business in Michigan for purposes of Michigan sales and use tax collection requirements. The changes address when an affiliate can create a collection requirement for a related party and when an unrelated party can create nexus for a remote seller if business is referred to the remote seller.

Affiliate Nexus Provision

A seller will be presumed to be doing business in Michigan for purposes of sales and use tax collection if any one or more of the following activities are conducted by the seller or an affiliate:

- The affiliate sells a similar line of products as the seller and does so under the same business name as the seller or a similar business name as the seller.
- The seller uses its employees, agents, representatives, or independent contractors in Michigan to promote or facilitate sales by the seller to purchasers in Michigan.
- The seller or an affiliate maintains, occupies, or uses an office, distribution facility, warehouse, storage place, or similar place of business in Michigan to facilitate the delivery or sale of tangible personal property sold by the seller to the seller's purchasers in Michigan.
- An affiliate uses, with the seller's consent or knowledge, trademarks, service marks, or trade names in Michigan that are the same or substantially similar to those used by the seller.
- An affiliate delivers, installs, assembles, or performs maintenance or repair services for the seller's customers in Michigan.
- An affiliate facilitates the sale of tangible personal property to customers in Michigan by allowing the seller's customers to pick up or return tangible personal property sold by the seller to an office, distribution facility, warehouse, storage place, or similar place of business maintained by the affiliate in Michigan.
- An affiliate shares management, business systems, business practices, or employees with the seller, or the affiliate and the seller have intercompany transactions related to the activities with the seller that assist the seller with establishing or maintaining the seller's market in Michigan.
- An affiliate conducts any other activity within Michigan that is significantly associated with the seller's ability to establish and maintain a market in Michigan for the seller's sales of tangible personal property to purchasers within Michigan.

The statute also states that, in addition to an affiliate, an independent third party can trigger a collection requirement if the third party is performing any of the activities described above. The existence of any of the above activities creates a presumption of doing business. The statute states that the presumption can be rebutted by the seller if the seller can demonstrate that the existence of the above activities is not "significantly associated with the seller's ability to establish or maintain a market in the state". In addition to the above activities the statute also contains a "click-through" nexus provision.

Click-Through Nexus Provision

A seller will be presumed to have nexus in Michigan for sales and use tax collection purposes if the seller enters into an agreement with a "resident" of Michigan whereby the resident refers purchasers to the remote seller for a commission or other consideration. In order for the provision to apply, both of the following must be present:

- The cumulative gross receipts of the seller during the immediately preceding 12 months that are the result of referrals from all residents within Michigan must exceed $10,000; and
- The remote seller's total gross receipts to customers within Michigan must exceed $50,000 during the same twelve-month period.

As with the affiliate activities outlined above, the statute also states that if the above two factors are present relating to a referral agreement, then the remote seller is presumed to have nexus in Michigan and thus a collection requirement. The statute outlines how the presumption can be rebutted by the remote seller.

S.B. 156, 97th Legis., Reg. Sess. (Mich. Public Act 282 of 2014) ("S.B. 156") – Adds several Michigan Business Tax ("MBT") technical corrections, and purportedly retroactively repeals the MTC Election. On September 11, 2014, Gov. Snyder signed into law S.B. 156, the provisions of which are effective, in the case of the technical corrections, for years other than 2008 and 2009. The MTC Election repeal is effective January 1, 2008. Any amended returns resulting from S.B. 156 must be filed during 2015. Taxpayers will receive refunds over a six-year payout period. In addition, the statute of limitations is extended beyond the normal time frame for the items that relate to the S.B. 156 issues.

MTC Election Repeal

At the last minute, a provision was added in the enacting section of this bill (originally intended to include only MBT technical corrections), which served to retroactively repeal the MTC Election effective January 1, 2008. The provision's intended effect was to undo the result in *International Business Machines Corp. v. Department of Treasury*. More discussion on this issue is set forth below.

Cancellation of Indebtedness Income

With the enactment of S.B. 156, cancellation of indebtedness ("COD") income and discharge of nonrecourse debt is excluded from the modified gross receipts tax base under the MBT to avoid a deemed receipt where no actual receipt existed. This taxpayer-favorable provision only applies to taxable years 2010 and 2011 (and potentially later years for MBT opt-in taxpayers). COD income is still considered a gross receipt for the 2008 and 2009 taxable years. Therefore, if a taxpayer has its 2008 and/or 2009 MBT taxable years still open under the statute of limitations and has COD income, then the issue of whether or not COD income is in fact a "gross receipt" must still be considered by the taxpayer for income tax examination and financial reporting (ASC 740) purposes.

Investment Tax Credit Recapture

With the enactment of S.B. 156, a "tax benefit" rule was enacted into the statute which prevents a taxpayer from being required to recapture an investment tax credit ("ITC") when certain assets are sold if the credit never provided a benefit to the taxpayer when those assets were originally purchased. This taxpayer-favorable provision limits ITC recapture to the extent the original credit actually produced a reduction in the taxpayer's tax liability (*i.e.*, "used") and applies to years other than 2008 and 2009. However, the term "used" is not defined in the statute. Accordingly, the tax benefit rule for MBT-era assets sold does not exist for 2008 and 2009 MBT returns. Note also that, earlier in 2014, H.B. 5011 (Public Act 16) created a tax benefit rule for MBT ITC-era assets required to be recaptured on corporate income tax ("CIT") returns that was retroactive to the start of the CIT regime.

Renaissance Zone Credit

With the enactment of S.B. 156, the credit calculation is revised to eliminate the arbitrary limit based on a taxpayer's prior single business tax ("SBT") credit amount and to give effect to the intended elimination of all MBT liability on activity within the Renaissance Zone for those taxpayers in a zone before December 1, 2002. This taxpayer-favorable provision is for years other than 2008 and 2009. The credit limitation is still in place on 2008 and 2009 returns.

Sales Apportionment of Dock Sales

Finally, the enactment of S.B. 156 corrected a grammatical error (the word "not" was in duplicate) in the prior statute that gave the opposite of the intended effect for sourcing sales of tangible personal property involving the ultimate destination determination of dock sales. This taxpayer-favorable provision is only for the 2010 and 2011 taxable years (and potentially later years for MBT opt-in taxpayers). Unfortunately, this grammatical error correction does not apply to 2008 and 2009 MBT returns and gives a result that is not intuitive. Note also that earlier in 2014, H.B. 5008 (Public Act 13) amended the apportionment statute to provide guidance relating to the determination of the ultimate destination, especially as it relates to dock sales and goods in transit, for CIT purposes. This provision was retroactive to the start of the CIT regime. In 2012, S.B. 1037 (Public Act 605) made similar changes to the MBT as described above for the CIT, except that the drafters left the duplicative word "not" in the guidance of dock sales, an action which prompted the S.B. 156 correction.

S.B. 337, 97th Legis., Reg. Sess. (Mich. Public Act 3 of 2014) ("S.B. 337") – Adds audit timing and refund deemed denied provisions, and makes changes to statute of limitations, successor liability and responsible person provisions. On January 30, 2014, Gov. Snyder signed into law S.B. 337, the provisions of which are effective as of February 6, 2014.

Audit Timing and Process Changes

With the enactment of S.B. 337, for an audit commenced after September 30, 2014, the Department of Treasury (the "Department") must complete audit fieldwork and provide a written preliminary audit determination no later than one year after the four-year statute of limitations for the period at issue expires (unless the taxpayer otherwise agrees to extend the one-year period). The Department must also issue a final assessment within nine months of the date the Department provided the taxpayer with the preliminary audit determination (unless the taxpayer requests a reconsideration of the preliminary audit determination or an informal conference).

Statute of Limitations Changes

In addition, S.B. 337 changes the situations under which the four-year statute of limitations is "suspended" as to an issue that was the subject of a federal income tax or a Michigan tax audit, conference, hearing, or litigation. First, under S.B. 337, the statute of limitations is extended under the circumstances set forth below, but only if a period referred to exceeds the statutory four-year statute of limitations. Next, the four-year statute of limitations extension is limited to the following situations and extension periods:

- The period pending a final determination of *federal income tax* through audit, conference, hearing, and litigation, and for one year after that period, *but no longer as it relates to a Michigan tax*.
- With respect to Michigan tax audits:
  - For a period of 90 days after a decision and order from an informal conference or a court order that finally resolves an appeal of a decision of the Department in a case in which a final assessment was not issued before appeal;
  - The periods established by S.B. 337 relating to preliminary audit determinations and final assessments for audits commencing after September 30, 2014, or pending the completion of an appeal of a final assessment; and
  - The period for which the taxpayer and the Department have consented to an extension.

The changes did not alter the limitation that the extension of the statute of limitations applies only to the "items that were subject of the audit," but S.B. 337 did provide a definition of such items. These items are defined to be "items that share a common characteristic that were examined by an auditor even if there was no adjustment to the tax as a result of the examination. Items that share a common characteristic include items that are reported on the same line on a tax return or items that are grouped by ledger, account, or record or by class or type of asset, liability, income, or expense."

Deemed Denial Provisions on Certain Refunds

S.B. 337 also allows taxpayers, excluding individuals, to elect to treat a claim for refund as "denied" where the Department has not approved, denied, or adjusted the claim within one year of the Department's receipt of the claim. Upon such a deemed denial, a taxpayer may then seek an appeal with the Michigan Tax Tribunal or the Michigan Court of Claims as it pertains to the issue(s) raised in the claim or refund.

Successor Liability and Responsible Persons

Lastly, S.B. 337 amends the successor liability and responsible person provisions. Most notably, for purposes of meeting the escrow requirement as it relates to sales and use tax, income tax withholding, and certain other taxes, S.B. 337 now requires that within 60 days of receiving a request, the Department must provide to a purchaser of a business the amount of any known or estimated tax liability of the business. Additionally, S.B. 337 limits a purchaser's liability to the amount escrowed pursuant to the Department's tax disclosure, and extinguishes a purchaser's liability in the event the Department fails to comply with the known or estimated tax liability disclosure requirement. The purchaser, on the other hand, may be

held liable for the business's tax debts up to the fair market value of the business in the event it does not comply with the escrow requirement but the Department complies with the disclosure requirement.

S.B. 337 adds the term "responsible person" to the statute, and limits a responsible person's liability to sales and use tax, income tax withholding, and certain other taxes for which he/she was responsible during the period of default. The new provisions require willful failure of a responsible person regarding the filing of a return or the payment of a tax in order to impose a liability on the responsible person. In addition, the statute applies more favorable provisions to assessments issued after December 31, 2013, regarding the types of taxes involved in connection with the liability of responsible persons. S.B. 337 also imposes a four-year statute of limitations on the Department to assess a responsible person, shifts the initial burden of establishing that a person is a "responsible person" to the Department, allows a responsible person to challenge an assessment to the same extent the business could have, and creates a right of recovery from another responsible person. In addition, S.B. 337 requires the Department to notify a responsible person of amounts collected from another responsible person or a business purchaser that is attributable to the assessment, assess a purchaser of the business before assessing a responsible person under certain circumstances, and disclose documents that the Department considered in its audit or investigation in determining that a person is a "responsible person" and is personally liable.

H.B. 4291, 97th Legis., Reg. Sess. (Mich. Public Act 35 of 2014) ("H.B. 4291") – Requires the Department to provide copies of audit work papers and promulgate administrative rules related to audit standards. On March 20, 2014, Gov. Snyder signed into law H.B. 4291 which, effective March 20, 2014, requires the Department to provide a taxpayer under audit with a complete copy of audit work papers and the audit report of findings upon request. In addition, H.B. 4291 requires the Department to perform an audit in accordance with administrative rules, which it must promulgate within one year of the enactment of H.B. 4291 (*i.e.*, March 20, 2014). Such rules are required to address, but are not limited to, confidentiality, technical training, due professional care, planning, supervision, understanding of the entity under audit, audit evidence documentation, sampling, and elements of the audit in the report. On October 1, 2014, the Department issued Proposed Administrative Rules Regarding Audit Standards for Field Audits. A public hearing was held on December 1, 2014, regarding the proposed rules.

H.B. 4288, 97th Legis., Reg. Sess. (Mich. Public Act 108 of 2014) ("H.B. 4288") and H.B. 4292, 97th Legis., Reg. Sess. (Mich. Public Act 109 of 2014) ("H.B. 4292") – Limits the ability of the Department to use indirect audit procedures for sales and use tax purposes. On April 7, 2014, Gov. Snyder signed into law H.B. 4288 and H.B. 4292, effective April 10, 2014. Taken together, the legislation limits the ability of the Department to conduct indirect audit procedures for sales and use tax purposes to those situations where a taxpayer does not file a return or maintain "sufficient" (previously "proper") records, or if the Department considers the taxpayer's records or returns to be inaccurate. Further, H.B. 4288 and H.B. 4292 require the Department to conduct an indirect audit in accordance with the administrative rules to be promulgated as required by H.B. 4291 and establish the required elements of an indirect audit, including: (1) a review of the taxpayer's books and records; (2) evaluation of the credibility of evidence and the reasonableness of the conclusion; (3) use of reasonable methods to construct income, deductions, or expenses; and (4) an investigation of reasonable evidence by the taxpayer refuting the computation.

H.B. 4003, 97th Legis., Reg. Sess. (Mich. Public Act 240 of 2014) ("H.B. 4003") – Creates an offer-in-compromise program. On June 21, 2014, Gov. Snyder signed into law H.B. 4003, which, effective June 27, 2014, creates an offer-in-compromise program beginning January 1, 2015. Under the program, the State Treasurer (or an authorized representative) may compromise a liability if:

- Doubt as to liability exists (*i.e.*, evidence shows that the taxpayer would have prevailed in a contested case if the taxpayer's appeal rights had not expired),
- Doubt as to collectability exists (*i.e.*, the amount offered is the most that the Department could collect from the taxpayer's assets and income), or
- A federal offer-in-compromise has been granted for the same taxable years.

To be eligible under the program, there must be an assessment and all opportunities to contest the assessment must have expired. There must also be no open bankruptcy proceedings and all applicable tax returns must be filed. Under the

program, rejections are not subject to review or appeal (except through an independent administrative review process if requested within 30 days). In addition, the taxpayer must submit the greater of $100 or 20% of the offer in contemplation of the compromise which is applied to the outstanding liability (which will not be refunded if the offer is rejected or reduced). The State Treasurer is to publish on the Department's Web site a written report of a compromised tax liability which contains, at a minimum, a statement regarding each of the following: the basis for the compromise, the amount of tax assessed, the terms of the compromise, the amount actually paid, and the grounds for compromise. Finally, within 180 days after the effective date of H.B. 4003, the State Treasurer must establish administrative guidelines for the program.

Case Developments

Thomson-Reuters Inc. v. Department of Treasury, Michigan Court of Appeals No. 313825 (May 13, 2014). In *Thomson-Reuters Inc.*, the Michigan Court of Appeals held that the taxpayer's sale of Checkpoint online subscriptions did not constitute the sale of taxable pre-written software. The court reasoned that the JavaScript computer code that was sent from the taxpayer's server to a customer's computer (which constituted less than one percent of the transaction) was incidental to the true object of the transaction – the expert knowledge of Checkpoint's content creators in synthesizing, compiling, and organizing materials to make researching more efficient, which is a service. As an unpublished case, this Court of Appeals decision is not precedential. The Department has appealed the matter to the Michigan Supreme Court.

***Auto-Owners Insurance Co. v. Department of Treasury*, Michigan Court of Claims, No. 12-000082 (March 20, 2014).** In *Auto-Owners Insurance Co.*, the Michigan Court of Claims held that accessing a third party's computer systems for the purpose of Web conferencing, Web hosting, processing payments, and conducting online research, risk analyses, and property valuations involved a non-taxable service, rather than a taxable transfer of tangible personal property, for use tax purposes. In so holding, the court reasoned that the seller transferred information and data that were processed using the third-party provider's software, hardware and infrastructure, but the software itself was not transferred. The court further reasoned that, even if tangible personal property was transferred: (1) the taxpayer only had a right of control constituting a taxable use over the outcomes arising from the inputting of certain data to be analyzed – not the software itself; and (2) any tangible personal property transferred was merely incidental to the services provided. The Department has appealed the matter to the Michigan Court of Appeals.

Rehmann Robson & Co., P.C. v. Department of Treasury, Case No. 12-000098-MT (November 26, 2014). Rehmann Robson & Co., P.C., a large accounting firm headquartered in Michigan, subscribed to Checkpoint, an online information database offered by Thomson Reuters. Access was obtained through Checkpoint's main Web site on the Internet. However, no software was downloaded by Rehmann employees. Upon audit, the Michigan Department of Treasury assessed Michigan use tax on the transactions asserting the use of Checkpoint constituted the sales of tangible personal property in the form of "prewritten computer software".

The Michigan Court of Claims held that the transactions are not subject to Michigan use tax as they were non-taxable services rendered through an online information service. In its opinion the court held that: (1) the transactions did not involve "tangible personal property" as there was no delivery of prewritten computer software effectuated by giving up possession or control of the software; (2) even if prewritten computer software was delivered, there was no "use" as evidenced by exercising a right or power incident to ownership in the software, noting that "access" does not equate to "use", and (3) even if prewritten computer software was delivered and used, any such use was merely "incidental" to the services pursuant to the "incidental to services" test adopted by the Michigan Supreme Court in *Catalina Marketing Sales Corp. v. Department of Treasury*, 470 Mich. 13, 678 N.W.2d 619 (2004).

It is worth noting that the opinion was written by the same judge who ruled on another Court of Claims case earlier this year on the same issue and which contained a very similar analysis (see *Auto-Owners Insurance Co. v. Department of Treasury*, discussed above).

***Fradco, Inc. v. Department of Treasury*, 495 Mich. 104, 845 N.W.2d 81 (2014).** In *Fradco, Inc.,* the Michigan Supreme Court held that where a taxpayer has appointed a representative, the Department must issue a notice to both the taxpayer and its representative to trigger the running of the appeal period. The court reasoned that both MCL §§ 205.28 and 205.8

require that the Department send notice – the former to the taxpayer and the latter to the taxpayer's appointed representative. In addition, the two notice requirements are of equal weight in relation to the appeal procedures under MCL § 205.22 because the statute does not refer to either MCL § 205.28 or MCL § 205.8 and neither MCL § 205.28 nor MCL § 205.8 refers to MCL § 205.22. The court found that, because the two notice requirements have equal weight and "statutes that relate to the same subject matter or share a common purpose must be read together as constituting one law[,]" it follows that the both notices are required to trigger the running of the appeal period where the taxpayer has appointed a representative.

***International Business Machines Corp. v. Department of Treasury*, 496 Mich. 642, 852 N.W.2d 865 (2014).** In *International Business Machines Corp.*, the Michigan Supreme Court reversed the Michigan Court of Appeals judgment in favor of the Department and held that, for purposes of computing its business income tax and modified gross receipts tax ("MGRT") under the MBT, the taxpayer could elect to use the MTC apportionment provisions in lieu of the single sales-factor apportionment required under the MBT Act on its 2008 MBT return. In its decision, the court addressed whether: (1) the MBT Act repealed the availability of the MTC Election; and (2) the taxpayer could make the MTC Election to apportion the MGRT base of its MBT. The court determined that it did not need to address contractual or constitutional issues raised by IBM because it determined that IBM should prevail on statutory construction grounds.

On the first issue, the court reversed the Michigan Court of Appeals in holding that the enactment of the MBT did not repeal the availability of the MTC Election. The court reasoned that, although there was a way to repeal the MTC Election, it could not be repealed by implication by the enactment of the MBT. Even though the MBT Act contained its own apportionment provisions, the MTC Election statute has been in place through periods of application of several different taxes that also provided apportionment provisions different from the Compact. Inasmuch as the court found that the MTC Election's availability was a matter of statutory construction, it did not address the issue of whether Michigan's membership in the Compact required that taxpayers be allowed the option of making the MTC Election with respect to income taxes.

On the second issue, the court held that the MGRT portion of the MBT met the MTC definition of an "income tax" – a prerequisite to making the MTC Election. Thus, the taxpayer could apportion that tax base using the Compact apportionment provisions. The court reasoned that the MTC defines "income tax" as a tax that "measures net income by subtracting expenses from gross income, with at least one of the expense deductions not being specifically and directly related to a particular transaction." For purposes of calculating the MGRT base, a taxpayer determines its gross receipts, which the court found met the Internal Revenue Code and *Black's Law Dictionary* definitions of "gross income," and then deducts therefrom several expenses, including deductions for purchases of materials and supplies. The court found that the enumerated deductions available under the MGRT are not specifically and directly related to particular transactions and thus the MGRT met the MTC definition of an "income tax".

On August 4, 2014, as anticipated, the Michigan Office of Attorney General filed a Motion for Rehearing, as well as a Motion to Stay the decision, with the Michigan Supreme Court. The motions focused on the fact that if left unaltered, the impact of the *IBM* decision would cost the state over $1 billion in refunds, plus interest, mostly to out-of-state businesses. On August 11, 2014, IBM filed its response.

Shortly after these motions were filed, legislators moved quickly to pass legislation, S.B. 156 (discussed above), repealing MCL §§205.581-205.589 (the Compact provisions) retroactively to January 1, 2008. Although the language of the bill states that the intent of the repeal was to express the intent of the legislature in drafting the original MBT Act, that a single sales factor be required, it is unclear whether this law change will withstand constitutional challenges, given a six-year retroactive application.

On the heels of the new legislation, the Department filed a Statement of Supplemental Authority with the Michigan Supreme Court on September 18, 2014, requesting that the retroactive statute be applied in the case and that the court reverse its judgment, disallowing IBM from utilizing the MTC Election. IBM filed a response on October 7, 2014, indicating that the decision should hold, and that the lower courts can subsequently address the applicability of the retroactive legislation.

On November 14, 2014, the Michigan Supreme Court denied both motions, remanding the case back to the Court of Claims for immediate consideration.

On December 19, 2014, the Michigan Court of Claims upheld the retroactive legislation enacted by the Michigan Legislature.[2] The court ruled that the retroactive appeal of the MTC Election did not violate the United States or Michigan constitutions and that the MTC was not a binding interstate compact under federal law. The decision has been appealed to the Michigan Court of Appeals.

Andrie Inc. v. Department of Treasury, 496 Mich. 161, 853 N.W.2d 310 (2014). In the one case highlighted in this alert that was not decided in favor of the taxpayer, *Andrie Inc.*, the Michigan Supreme Court reversed the Michigan Court of Appeals and held that the exemption from the use tax for sales tax paid requires that the taxpayer actually pay the sales tax because the statute "unambiguously" provides that the exemption applies "if the tax was due and paid[.]" The court also held that a taxpayer must prove that it paid the sales tax and was not entitled to a presumption that it paid the tax because the burden of proving entitlement to an exemption rests on the party asserting the right to the exemption.

BDO INSIGHTS

- The enactment of S.B. 658/659 represents a series of changes to the doing business statute within Michigan which are very similar to changes that have been made by other states related to click-through nexus. In addition, the affiliate nexus provision simply codifies specific activities that will create nexus. The codification of these affiliate-nexus-creating activities may have been unnecessary because courts in other states have often held that these types of activities conducted by an affiliate within a state on behalf of a remote seller can trigger collection requirements.

- The legislative developments in H.B. 4003, H.B. 4288, H.B. 4291, H.B. 4292, and S.B. 337 help to create a more taxpayer-friendly environment in Michigan. For example, S.B. 337 imposes a much needed one-year limit on the period of time during which the Department can delay the processing of a refund claim before a taxpayer has the right to litigate the issue by considering the claim to be deemed denied. However, it appears that the refund denial election under S.B. 337 limits a taxpayer's remedy to an appeal to the Michigan courts and does not provide the option of an informal conference. In addition, the refund denial election does not apply to individual income tax refund claims. The new offer-in-compromise program eliminates Michigan's absolute prohibition against any compromise of a final tax for any reason. The enacted legislation was modified substantially from its original version, but it is a major improvement. It gives the Department an opportunity to really make a difference, using the offer in compromise, in both poverty cases and in cases in which the taxpayers likely do not owe the tax. Caution should be used when considering making an offer in compromise to the Department due to the requirement to pay the greater of $100 or 20% of the offer, inasmuch as this amount is not refunded if the offer is rejected.

- The decision in *International Business Machines Corp.* brought the MTC Election one step closer to being available to Michigan taxpayers. However, given the retroactive legislation, taxpayers are once again in uncertain territory as to the availability of the MTC Election in Michigan. It is important to note that, even if the retroactive legislation is found to be unconstitutional, this case only directly applies to MBT taxable years 2008 through 2011, and separate litigation will likely be necessary for the following years. Additionally, litigation on this issue in California, Minnesota, Oregon, and Texas is ongoing. While the decision in *International Business Machines Corp.* technically has no precedential value in the other states, it could help to persuade the courts in the other states to decide in favor of the taxpayers.

- The decisions in *Thomson-Reuters Inc., Auto-Owners Insurance Company,* and *Rehmann Robson* should provide guidance to taxpayers regarding the treatment of certain online services for Michigan sales and use tax purposes. For taxpayers that are hoping that these cases will provide guidance related to the application of Michigan sales and use tax to SaaS transactions, there are two unfortunate aspects to these cases. First, none of these cases seem to deal with "true" SaaS transactions (*i.e.,* a software license granted to a remote user in Michigan whereby the user remotely

[2] *Yaskawa America, Inc. v. Department of Treasury*, Mich. Court of Claims, No. 11-77-MT, (Dec. 19, 2014).

uses the software code on the vendor's server). All of the services subject to litigation in these three cases either were information services or services sold by the vendor, whereby the service was provided by way of the operation of software code *used by the vendor*. Because none of the items under consideration were true SaaS transactions, it may require more litigation beyond these three cases to fully resolve the taxability of SaaS in Michigan. Second, even if the three cases could be used analogously to determine the taxability of SaaS transactions, none of the three cases are precedential because the Court of Claims cases are not precedential and the Court of Appeals case is unpublished. Inasmuch as none of the cases are precedential, taxpayers must be cautious with changing their approach on similar transactions. The Department has indicated that it believes the decisions in the three cases are wrong and thus the Department will not change its position on the taxability of these types of transactions. Given that these decisions are contrary to the Department's longstanding position that SaaS and SaaS "like" services are taxable, here, too, taxpayers should evaluate whether they have improperly paid use tax on purchases of these services and contemplate filing refund claims where it is beneficial. Sellers, on the other hand, should be cautious with changing their taxability approach related to these types of transactions given that these decisions are not precedential. A non-collecting vendor could be assessed by the Department for failure to collect tax because the vendor cannot look to these cases as precedents. Recognizing that these decisions are not precedential, coupled with the fact that the Department intends to "ignore" the decisions, vendors of these types of services are put in a very difficult position with respect to the decision to impose tax or not to impose tax on these types of services.

- The holding in *Fradco, Inc.* to require notice to the taxpayer as well as its appointed representative should provide those taxpayers that heavily rely on their tax representatives for assistance with an added level of protection. In that sense, *Fradco, Inc.*, together with the other recent legislative developments related to Michigan tax administration, is a big win for Michigan taxpayers.

- Michigan does not require a seller to separately state the sales tax paid on an invoice and a consumer might not have access to the seller's records necessary to prove that the seller paid sales tax on a purchase. Thus, the decision in *Andrie Inc.* is an unfortunate result because, as the dissent pointed out, it creates a risk of double taxation.