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STATE OF MICHIGAN
IN THE SUPREME COURT

VECTREN INFRASTRUCTURE SERVICES CORP., SUCCESSOR-IN-INTEREST TO MINNESOTA LIMITED, INC.,

Plaintiff-Appellee,

vs.

MICHIGAN DEPARTMENT OF TREASURY,

Defendant-Appellant

Supreme Court Docket No. 161422
Court of Appeals Docket No. 345462
Court of Claims Docket No. 17-000107-MT

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PLAINTIFF-APPELLEE'S BRIEF IN OPPOSITION TO APPLICATION FOR LEAVE TO APPEAL

RECEIVED by MSC 12/10/2021 6:07:44 PM

TABLE OF CONTENTS

INDEX OF AUTHORITIES 3

COUNTER-STATEMENT OF QUESTIONS PRESENTED 1

I. INTRODUCTION AND ABSENCE OF GROUNDS FOR REVIEW 2

II. COUNTER-STATEMENT OF FACTS AND PROCEEDINGS BELOW 2

A. The Company's Operations 2

B. The Sale of the Company 5

C. The Company's Tax Filing and Subsequent Audit by the Department 6

D. The Taxpayer's Request for Alternative Apportionment. 8

E. The Department's Denial of the Taxpayer's Request. 9

F. First Proceedings at the Court of Claims. 10

G. First Decision of the Court of Appeals 11

H. This Court Denies The Department's Application for Leave. 12

I. Court of Appeals' Remand to the Court of Claims 13

J. Second Proceeding at the Court of Claims 13

K. Second Decision of the Court of Appeals 14

III. STANDARD OF REVIEW 15

A. Standard for Granting Summary Disposition Under MCR 2.116(C)(10) 15

B. Tax Statutes are Construed in Favor of the Taxpayer and Against the Government 15

IV. ALLOCATION AND APPORTIONMENT OF BUSINESS INCOME AND THE STATUTES AT ISSUE 16

A. Basics of Apportionment 16

B. Income Subject to Apportionment 17

C. Alternative Apportionment 18

D. The MBT Taxable Base 19

E. Apportionment Under the MBT 19

F. Alternative Apportionment Under the MBT 20

V. ARGUMENT 21

A. The Court of Appeals Has Twice Found That the Statutory Formula, as Applied to MLI's Exceedingly Unique Circumstances, Led to a Grossly Distorted Result and Unconstitutionally Taxed Extraterritorial Activity 21

B. The Department Does Not Have the Exclusive Authority to Determine an Alternative Apportionment Method 26

VI. CONCLUSION 28

RECEIVED by MSC 12/10/2021 6:07:44 PM

RECEIVED by MSC 12/10/2021 6:07:44 PM

INDEX OF AUTHORITIES

CASES

Allied-Signal, Inc v Director, Div of Taxation, 504 US 768; 112 S Ct 2251; 119 L Ed 2d 533 (1992) 15

ASARCO Inc v Idaho State Tax Comm, 458 US 307; 102 S Ct 3103; 73 L Ed 2d 787 (1982). 16, 20

Briggs Tax Sery v Detroit Public Schools, 485 Mich 69; 780 NW2d 753 (2010) 14

Container Corp of America v Franchise Tax Board, 463 US 159; 103 S Ct 2933; 77 L Ed 2d 545 (1983) 16, 21

Detroit Edison Co v Dep't of Treasury, 497 Mich 873; 853 NW2d 380 (2014) 22, 23

Ford Motor Co v Dep't of Treasury, 496 Mich 382; 852 NW2d 786 (2014) 13

FW Woolworth Co v Tax'n and Rev Dep't of New Mexico, 459 US 961; 103 S Ct 274; 73 L Ed 213 (1982) 14

Hannay v Transp Dep't, 497 Mich 45; 860 NW2d 67 (2014) 21, 23

Hans Rees' Sons, Inc v North Carolina, 283 US 123; 51 S Ct 385; 75 L Ed 879 (1931) 21

Maiden v Rozwood, 461 Mich 109; 597 NW2d 817 (1999) 13

MeadWestvaco Corp v Illinois Dep t of Revenue, 553 US 16; 128 S Ct 1498; 170 L Ed 2d 404 (2008) 16

MidAmerican Energy Co v Dep't of Treasury, 308 Mich App 362; 863 NW2d 387 (2014) 14

Quinto v Cross & Peters Co, 451 Mich 358, 362; 547 NW2d 314 (1996) 13

TOMRA of North America v Dep't of Treasury, ___ Mich ___ (2020) 23

West v Gen Motors Corp, 469 Mich 177; 665 NW2d 468 (2003) 13

STATUTES

IRC 1031 5

RECEIVED by MSC 12/10/2021 6:07:44 PM

IRC 338(h)(10) 7, 8

MCL 205.22 9

MCL 205.94(o)(2) 23

MCL 208.1 16

MCL 208.69 16

MCL 208.1105 17

MCL 208.1111(1) 17

MCL 208.1115(1) 17

MCL 208.1303 ..... 2, 17

MCL 208.1303(1) 2

MCL 208.1309(1) 24

MCL 208.1309(2) 23

OTHER AUTHORITIES

All States Tax Guide (RIA) 16

Hellerstein & Hellerstein, State Taxation (3rd ed)……..……14, 15, 16

Revenue Adminstrative Bulletin 2020-XX, Alternative Apportionment for the Michigan Business and Income Taxes 21, 23

Revenue Adminstrative Bulletin 2018-28, Alernative Apportionment for the Michigan Business and Income Taxes 23

RULES

MCR 2.116(C)(10)……..…….2

MCR 2.116(G)(5) 3

MCR 7.305(B)(2) 2, 12

MCR 7.305(B)(3) 2, 11

MCR 7.305(B)(5) 2

REGULATIONS

MTC Reg IV.18(c)(1) 16

MTC Reg IV.18(c)(4) 16

Treas Reg 1.338(h)(10)-1(d) 7

RECEIVED by MSC 12/10/2021 6:07:44 PM

RECEIVED by MSC 12/10/2021 6:07:44 PM

COUNTER-STATEMENT OF QUESTIONS PRESENTED

1. Did the Court of Appeals properly rely on well-established legal principles to conclude the application of the statutory apportionment formula under the Michigan Business Tax Act ("MBTA"), as applied to the unique facts of the case at hand, would attribute business activity to Michigan out of proportion to the actual business activity transacted there?

   Plaintiff-Appellee answers, "Yes."

   Defendant-Appellant answers, "No."

   The Court of Claims did not address this question.

   The Court of Appeals answered, "Yes."

2. Did the Court of Appeals properly conclude that Plaintiff-Appellee presented clear and cogent record evidence to determine a reasonable alternative apportionment method, where the parties engaged in sweeping discovery, unearthing more than 1,200 pages of documentation, including business records, numerous depositions resulting in hundreds of pages of out-of-court oral testimony, and multiple third-party subpoenas?

   Plaintiff-Appellee answers, "Yes."

   Defendant-Appellant answers, "No."

   The Court of Claims did not address this question.

   The Court of Appeals did not address this question.

3. Did the Court of Appeals decision that mandates Plaintiff-Appellee and Defendant-Appellant collaborate and determine a reasonable alternative apportionment method, which the Defendant-Appellant, not Plaintiff-Appellee, has to ultimately approve, comport with the Defendant-Appellant's statutory authority to approve an alternative apportionment method?

   Plaintiff-Appellee answers, "Yes."

   Defendant-Appellant answers, "No."

   The Court of Claims did not address.

   The Court of Appeals answered, "Yes."

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I. INTRODUCTION AND ABSENCE OF GROUNDS FOR REVIEW

The case at hand deals with unique factual circumstances unlikely to ever be replicated. There was a sale of a 52-year old family business conducted primarily outside of Michigan; the sale occurred during the winter when the business was normally stagnant, but was conducting unusual activity in the state; and the sale resulted in a short tax year for state filing purposes. On these facts, the case has limited impact and poses a truly narrow question: whether the statutory apportionment formula of the Michigan Business Tax Act ("MBTA"), MCL 208.1303(1), as applied to Plaintiff-Appellee's unique circumstances, led to a grossly distorted result and unconstitutionally taxed extraterritorial activity. The Court of Appeals, in two unanimous published decisions, based on well-established legal precedent, answered yes.

Nonetheless, the Department's second Application for Leave to Appeal asserts this case "has significant public interest," "implicates legal principles of major significance to the state's jurisprudence," and results in "clear error" and "material injustice." These allegations are unfounded and merely parrot the standards for leave set forth under MCR 7.305(B)(2), (3) or (5). The Court of Appeals' decisions are unremarkable, and this case does not meet those standards. For these reasons and those discussed more comprehensively below, this Court should deny the Application for Leave to Appeal and affirm the decisions of the Court of Appeals.

II. COUNTER-STATEMENT OF FACTS AND PROCEEDINGS BELOW

A. The Company's Operations

Minnesota Limited ("MLI"), an S-corporation, was a family owned Minnesota business headquartered in Big Lake, Minnesota. Reuben Leines, the father of Christopher Leines and Paulette Britzius, started the Company in 1966. Leines Dep 59:1-60:14. MLI constructed oil and gas pipelines and performed maintenance activities on the pipelines. *Id*. The pipelines were

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constructed for customers engaged in the transportation of natural gas, crude oil and refined petroleum products. First Amended Complaint ¶4; Plaintiff-Appellee's App. No. 12. MLI also constructed pumping stations and tank farms for its pipeline customers. These services constituted the bulk of MLI's activities.

Reuben Leines was a hard worker who worked every day of the week. Leines Dep 59-:1-60:14. As a family business, all seven of the Leines siblings, including Chris and Paulette, had the opportunity to work in the family business. *Id.* Chris Leines began working for the company cleaning equipment when he was 14 years old. Leines Dep 7:23-8:12. Once he obtained his driver's license, he worked summers as a parts runner, delivering parts to work sites. *Id.* When Chris was 18, he worked during the summers as a laborer on the field construction crews. *Id.* In the early years, the Company had 20 to 30 employees. Leines Dep 59:8-23. By the time Chris and Paulette sold their shares in the Company, it had 500 to 700 employees. From the late 1970's to March 31, 2011 (when MLI was acquired by Vectren Infrastructure Services, Inc. ("Vectren")), MLI primarily performed its services in Minnesota and the upper Midwest (Wisconsin, Iowa, North and South Dakota). Leines Dep 59:8-21. Activities in these states constituted 50% - 70% of operations. Leines Dep 7:18-9:5. As MLI's customers expanded, its operations also expanded, as it followed its customers and performed its services in other states as needed. See Plaintiff-Appellee's App. No. 9, Offering Memorandum VEC000048-000143; Leines Dep 14:9-11. The company rarely performed work in Illinois or Michigan. *Id.*; Plaintiff-Appellee's Response to Treasury's First Discovery Request, Plaintiff-Appellee's App. No. 9, Response 7.

Chris obtained a degree in Civil Engineering. Leines Dep 7:9-17. After college, he worked for the company in various roles from project manager to overseeing fieldwork. Leines Dep 7:18-9:5. Much of the Company's business is seasonal, as the excavation work necessary for pipeline

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construction and repair work cannot occur when the ground is frozen. *Id*. In the winter months, when operations of the Company are minimal, Chris worked in the office where he prepared estimations for project bids. *Id*. In the mid-1990's, Chris became Vice President of Operations. His responsibilities included the day-to-day running of office operations, bid estimating, organizing resources, labor and equipment, dealing with clients, etc. *Id*. In 1998, Chris became President when Reuben retired. *Id*. At this time, Chris and Paulette equally owned MLI.

While MLI's headquarters and most of its facilities were in Minnesota, MLI had minor facilities in Wisconsin and Illinois. Plaintiff-Appellee's Response to Treasury's Third Discovery Requests; Plaintiff-Appellee's App. No. 10, Response 7. MLI did not have any facilities in Michigan. Plaintiff-Appellee's App. No. 9, Response 5.

In July 2010, MLI was selected for a hazardous material clean-up project for Enbridge Inc., which operated a crude oil pipeline transportation system in Michigan. First Amended Complaint ¶8-9. A crude oil spill had occurred in the Kalamazoo River from a pipeline owned by Enbridge, and Enbridge hired a number of pipeline repair companies to clean up the spill, including MLI. MLI brought ten employees and five pieces of equipment into the state for the project. *Id*. The rest of the needed equipment was rented on a temporary basis, with additional laborers hired from the local union shop. *Id*. Plaintiff-Appellee's App. No. 10, Response 7. At the end of the two-year project, MLI returned the rental equipment and the temporary employees were released. This contract represented the largest contract MLI had ever performed in Michigan and the work was performed during MLI's off-season months. *Id*. Fortuitously, the project afforded MLI to earn revenue during the off-season. At the time the business was sold, the only Michigan work outstanding was the remainder of the Enbridge contract.

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In the regular course of its business, MLI sold its used and surplus business equipment, usually on an annual basis. From 2004 through 2010, the Company sold construction, transportation and office equipment it used in its business. Plaintiff's Supplemental Response to Treasury's First Discovery Requests, Plaintiff-Appellee's App. No. 11, Response 5, VEC000379 to 000818. The number of assets sold during any given year ranged from ten to 346.[1] MLI regularly used an auction house to facilitate these sales. MLI also utilized the federal treatment afforded under IRC 1031, which allowed businesses and individuals to defer gain on the sale of equipment if they purchased replacement equipment.[2]

B. The Sale of the Company

In early 2010, Chris and Paulette began to explore the sale of MLI. Leines Dep 16:12-23. Paulette, 14 years older than Chris, was experiencing significant health issues and desired to leave the business. *Id*. Plaintiff-Appellee's App. No. 10, Response 3. Together, the siblings determined that the best option for the family and employees was to sell MLI. *Id*. MLI engaged a third-party consultant, Greene, Holcomb and Fisher, to prepare an Offering Memorandum to help sell the business and solicit interest from prospective buyers. Offering Memorandum, Plaintiff-Appellee's App. No. 9, VEC000048-000143; Leines Dep 19:4-20:10. As noted in the Offering Memorandum, MLI was recognized as one of the premier firms in the pipeline construction and services market and had built a strong reputation based on quality and safety since its founding in 1966. Plaintiff-Appellee's App. No. 9 (Offering memo, p 1).

---

[1] Asset disposals were as follows: 2004 – 10 assets (VEC000431-000432); 2005 – 16 assets (VEC000435); 2006 – 27 assets (VEC000437); 2007 – 58 assets (VEC000499-000501); 2008 – 96 assets (VEC000536, 000570-000571); 2009 – 10 assets (VEC000607); and 2010 – 396 assets (VEC000641-000647). Plaintiff-Appellee's App. No. 11, Tab H.

[2] Under IRC § 1031, a taxpayer may defer tax on the gain from sales of certain assets, if the proceeds from such sales are used to purchase similar type assets.

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In response to circulation of the Offering Memorandum, MLI received several inquiries of interest, which led to two bids. Leines Dep 27:1-25. In March 2010, Chris and Paulette reached an agreement in principle to sell their shares to Vectren. *Id*. The sale of MLI represented thousands of hours of their family's hard work and perseverance over several decades. The value inherent in MLI represented the development of the employee work force, the high safety rating the company had obtained in a hazardous profession and the monetary worth MLI had created with their family legacy. The sales transaction closed on March 31, 2011 (the "Sale"). Leines Dep 11:9-22; Plaintiff-Appellee's App. No. 9; Purchase Agreement[3] at VEC000221-000378.

When Vectren acquired MLI, it allocated the purchase price as follows: approximately $34.4 million to tangible assets (construction, transportation, and office equipment and certain buildings), approximately $22.8 million to intangible assets[4], and approximately $16.6 million to goodwill that existed at the time of the Sale. Plaintiff-Appellee's App. No. 9, KPMG Study, Schedule 1, VEC000172; Purchase Agreement VEC000221-000378.

C. The Company's Tax Filing and Subsequent Audit by the Department

Chris and Paulette reported their gain on the sale of their MLI stock and paid federal and state income taxes due on the full amount of the gain. At Buyer's request, the siblings executed an IRC 338(h)(10) election to calculate their gain on the stock sale for federal tax income tax purposes as a deemed asset sale. Under this election, the entity whose stock is sold is "treated as transferring all of its assets" in a "deemed sale." Treas Reg 1.338(h)(10)-1(d). Both the governing

[3] Under the terms of the Purchase Agreement, Minnesota law governs the sale transaction. The closing took place in Minneapolis, MN. Plaintiff-Appellee's App. No. 9.

[4] The intangible assets were valued as follows: $14,588,000 for customer relationship, $287,000 in backlog (work in process and/or committed to), $4,241,000 for the trade name, and $3,670,000 for the assembled workforce. Plaintiff-Appellee's App. No. 9, KPMG Study, Sch 1, VEC 000172.

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IRC statutes and regulations clarify that the treatment is for a fictional asset sale. Treas Reg 1.388(h)(10)-1(d)(9).

The federal election did not affect the federal taxation of the S-Corporation because S-Corporations are not taxed at the federal level. For its MBTA filing, MLI was required to file a short-period return from January 1 to the date of sale (March 31, 2011) (the "Short Year"). MLI included all of the income from the Sale in the tax base apportionable to Michigan (consistent with the federal treatment under IRC 338(h)(10) as a deemed sale of assets) and included all of the income from Sale of MLI assets in the sales factor. The sales factor was determined by sourcing the assets based on their location at the time of the Sale. At that time, almost all of the assets were located outside of Michigan, except for approximately $268,000 in rental property. Plaintiff-Appellee's App. No. 11, VEC000910-000913. Under the statute, this resulted in a sales factor of 14.99%.

The Department audited MLI for the calendar tax year ending December 31, 2010 and the Short Year. Based on the audit, the Department adjusted the computation of the sales factor for the Short Year. The sales factor is expressed as a fraction, the numerator of which is sales in the state, and the denominator is sales everywhere.[5] The Department excluded all the revenue from the Sale from the sales factor. Plaintiff-Appellee's App. No. 9, VEC000001-8. The removal of the Sale revenue from the sales factor increased the sales factor from 14.99% to 69.96%. *Id*. While the Department characterized this adjustment as increasing the sales factor by 54.9711%, such increase was almost a 400% increase.

[5] This fraction may also be expressed as a percentage by dividing the numerator by the denominator.

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The Department did not remove the gain from the Sale from the tax base apportionable to Michigan. *Id*. Instead, the Department apportioned the gain on the Sale to Michigan using the increased sales factor. *Id*. The Department did not assess any penalty at the conclusion of the audit. *Id*.

On April 20, 2016, the Department issued a Bill for Taxes Due (Intent to Assess) No. UO71593 assessing tax in the amount of $2,262,994 and interest in the amount of $465,615.86. The Bill for Taxes Due added penalty of $678,727.50 for a total purported amount due of $3,407,337.36.

D. The Taxpayer's Request for Alternative Apportionment.

On June 16, 2016, MLI timely requested penalty relief based on reasonable cause. Plaintiff-Appellee's App. No. 9, VEC000029-38. On June 24, 2016, MLI timely requested the use of an alternative apportionment method under MCL 208.1309 for the Short Year ("the Letter Request"), Plaintiff-Appellee's App. No. 12, Ex A to Plaintiff's First Amended Complaint. At the same time, MLI requested an informal conference contesting all assessed amounts.

In the Letter Request, MLI explained its filing methodology, and requested the use of an alternative apportionment method on the basis that the standard method was distortive and taxed extraterritorial values. MLI proposed several alternative apportionment methods for the Department's review and consideration. These included:

> 1. Include the gain from the Sale in both the taxable base and the apportionment formula; or
>
> 2. Consistent with the IRC 338(h)(10) election, treat the gain on the Sale as a sale of assets and apportion the gain based on the location of tangible assets; or
>
> 3. Report the gain on the Sale attributable to goodwill as allocable to the shareholder's state of residence and location of the

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> Company's headquarters and adopt the audit adjustment for the gain attributable to other identifiable intangibles and tangible assets; or
>
> 4. Report the gain on the Sale using a historical 10-year average sales factor average; or
>
> 5. A combination or variation of any of the above as the Department deemed reasonable.

MLI also proposed to tax income from pipeline activities for the Short Year in accordance with the statutory formula while taxing the gain on the Sale using an alternative apportionment method. Plaintiff-Appellee's App. No. 9, VEC000039.

E. The Department's Denial of the Taxpayer's Request.

On December 14, 2016, MLI provided supplemental information to support its request for alternative apportionment in response to the Department's request. Plaintiff-Appellee's App. No. 9, VEC000039-000211. On July 8, 2017, the Department rejected MLI's request for alternative apportionment, improperly concluding that Plaintiff-Appellee had not met the first part of the statutory test (establishing the existence of distortion). Based on this improper conclusion, the Department declined to review the proposed alternatives for reasonableness (the "Gursky Letter"), Plaintiff-Appellee's App. No. 12, Ex B. to Plaintiff's First Amended Complaint. Under MCL 205.22, a taxpayer may appeal the decision of the Department to deny the alternative apportionment request.

On March 23, 2017, the Department issued a Bill for Taxes Due (Final Assessment) No. UO71593 (the "Final Assessment") assessing tax in the amount of $2,262,994, interest in the amount of $550,792.07 and penalty in the amount of $112,979.00 for a total purported amount due of $2,926,765.07. Plaintiff-Appellee's App. No. 12, Ex C to Plaintiff's First Amended Complaint. Plaintiff-Appellee filed this suit.

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F. First Proceedings at the Court of Claims.

The procedural history in this case is as complex as the tax calculation methods at issue. In the Court of Claims, the parties filed cross-motions for summary disposition. The court disagreed with Appellee's argument that apportionment was at issued, and solely addressed the taxation of gain. Additionally, the Court of Claims disagreed with Appellee's argument that the sale of stock of MLI was the business activity of the shareholders, and found that the gain on the sales was business activity of MLI. However, the Court of Claims failed to apply this holding consistently. The Court of Claims noted that the "sale was expressly reported to the shareholders as a sale of the S-Corp's assets," *Vectren v Dep't of Treasury*, unpublished opinion of the Court of Claims, issued August 14, 2018 (Docket No. 17-107-MT) (attached as Exhibit A), p 5, Plaintiff-Appellee's App. No. 1 and that "the §338(h)(1) election controls the outcome of this case." *Id.* at 7. However, the Court of Claims failed to apply this finding to both the determination of the tax base and the sales factor.

Further, the Court of Claims committed an error when it disregarded Count 1 of Plaintiff's First Amended Complaint, Plaintiff-Appellee's App. No. 12, and failed to rule on the appropriate calculation of the sales factor. The Court of Claims inaccurately stated "while plaintiff generally frames its argument in this manner [that the apportionment formula as applied to the sale was out of all appropriate proportion to the business and activities conducted in Michigan], the crux of plaintiff's contention is really with the computation of its tax base." *Id.* This misconstruction of Plaintiff-Appellee's pleadings was further emphasized by the Court of Claims when it summarized ". . . this type of argument is not concerned with the result or constitutionality of the apportionment formula, but it is simply a disagreement with the computation of [Plaintiff's] tax base." *Id.* Summarily, Plaintiff-Appellees request for alternative apportionment was dismissed. *Id.* at 8. The

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Court of Claims also found penalty abatement was not warranted, holding that Plaintiff-Appellee had not satisfied its burden by a clear and convincing standard to demonstrate the Plaintiff-Appellee exercised reasonable care and not willful neglect.[6]

G. First Decision of the Court of Appeals

The Court of Appeals agreed in part with Plaintiff-Appellee and reversed the Court of Claims. In doing so, the Court of Appeals acknowledged that the case presented the complex question of how gain on the sale of an out-of-state business, which conducts some business activity in Michigan, should be taxed under the MBT. The Court of Appeals found that the application of the statutory formula, based on the very unique circumstances of the case, "would result in the imposition of a tax in violation of the Commerce Clause", and that the use of an alternative formula ". . . would be necessary to avoid the constitutional violation." Court of Appeals Opinion at 4 (attached as Exhibit B). In doing so, the Court of Appeals affirmed the following well-established principles of when alternative apportionment is required:

> 1. An apportionment formula must determine the portion of income "fairly attributed to in-state activities;"
>
> 2. Fairness "must actually reflect a reasonable sense of how the income is generated;"
>
> 3. A state may not tax more than its fair share of interstate commerce; and
>
> 4. A taxpayer may rebut the presumption that the statutory apportionment is fair by showing by "clear and cogent evidence" that the business activity transacted in this state leads to a grossly distorted result, or alternatively, the apportionment formula would operate unconstitutionally to tax the extraterritorial activity of the taxpayer.

[6] Lurie, LLP, a certified public accounting firm had prepared the Company's tax returns.

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The Court of Appeals found that Plaintiff-Appellee had "presented clear and cogent evidence that the statutory formula, as applied, attributed business activity to Michigan "out of all appropriate proportion to the actual business actively transacted in the state" and led to a grossly distorted result and also operated to unconstitutionally tax extraterritorial activity. *Id.* at 5. The Court of Appeals acknowledged, and based its conclusion on, the fact that "the value of the business and its assets was built up over many years and attributable to activity in many states." *Id.* Indeed, the Court of Appeals noted, "[M]uch of the activity and assets involved in the Sale never had any connection to Michigan." *Id.* It was the combination of these facts, "compounded when the Sale occurred in a time period (the Short Year) in which an unusually large percentage of the business activity occurred in Michigan" attributed to Michigan under the statutory formula an unreasonably large portion of the Sale which violated constitutional principles. In concluding that "this was an exceptional case" and the taxpayer had met its evidentiary burden, the Court of Appeals acknowledged that the "majority of the activities making up MLIs fair market value at the time of the Sale had occurred outside Michigan's borders. *Id.* at 7.

H. This Court Denies the Application for Leave.

The Department filed an Application for Leave. In lieu of granting leave, this Court issued an order vacating *Vectren Infastructure Services Corp v Dep't of Treasury*, 331 Mich App 568; 953 NW2d 213 (2020) and remanded the case to the Court of Appeals "to address the plaintiff's arguments regarding the proper method for calculating the business tax due under the statutory formula." *Vectren Infastructure Services Corp v Dep't of Treasury*, __ Mich __; 950 NW2d 746 (2020), *slip op* at 1 (attached as Exhibit C). Additionally, this Court concluded that this "foundational issue must be addressed before determining that MCL 208.1309 requires application

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of an alternative method of apportionment." *Id*. Thus, once again, the case returned to the Court of Appeals.

I. Court of Appeals' Remand to the Court of Claims

In response to this Court's remand, the Court of Appeals issued its April 19, 2021 order remanding the case to the Court of Claims. The Court of Appeals stated:

> The parties agree that the Court of Claims never ruled on Count I of plaintiff's first amended complaint and that the issue had been properly preserved. Given the complicated nature of the issue involved, and our view that it is typically preferred that a trial court be given the opportunity to address an issue before this Court does.

Unpublished order of the Court of Appeals, entered April 19, 2021 (Docket No. 345462) (attached as Exhibit D). Accordingly, the Court of Appeals remanded the case to the Court of Claims to "decide the issue raised in Count I of plaintiff's first amended complaint." *Id*.

J. Second Proceeding at the Court of Claims

The Court of Claims, without a hearing, issued its opinion on remand on May 25, 2021, attached as Exhibit E. As instructed, the Court of Claims limited its opinion to MLI's Count I, entitled, "Apportionment Without Factor Representation Under MCL 208.1309 Unconstitutionally Violates the Commerce and Due Process Clause." Unpublished opinion of the Court of Claims, entered May 25, 2021 (Case No. 17-000107-MT), at *2-3. In other words, "[t]he issue on remand [was] whether the sale of MLI should be included in the denominator of the sales factor." *Id*. at *7. The Court of Claims performed an extensive statutory analysis of the MBT provisions at issue, delving into the relevant statutory definitions, and determining that the plain language of the MBT supported the Department's position.

The Court of Claims stopped short of analyzing whether their interpretation of the definitions would have an unconstitutional effect on MLI, which was at the heart of MLI's initial

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count. The very title of the claim references the Commerce and Due Process Clauses. As instructed by the Court of Appeals in its remand Order, copies of all filings, as well as the Court of Claims decision on remand was submitted to the Court of Appeals, which had retained jurisdiction.

K. Second Decision of the Court of Appeals

On September 30, 2021, the Court of Appeals issued its opinion after remand, attached as Exhibit F. While the Court of Appeals upheld the Court of Claims' analysis at to Count I, the Court of Appeals reaffirmed its earlier decision that found the application of the MBTA's standard apportionment formula was unconstitutional when applied to the unique facts at hand. The Court of Appeals stated that the statutory definitions and formula, as interpreted by the Court of Claims, "reaffirms the conclusion that we reached in our original opinion: that the application of the statutory formula to *this case* constitutes a constitutional violation." Court of Appeals Opinion 2, at *3 (emphasis added). In support of that conclusion, the Court of Appeals relied heavily on the reasoning outlined in its original opinion, summarized *supra*, which went well beyond mere statutory interpretation. It painstakingly reviewed whether the statutory formula, as applied to the facts at hand as supported by the record evidence, created an unconstitutional result for MLI. The Court of Appeals explicitly limited its findings to this specific case and these unique facts. Ultimately, the Court of Appeals explicitly reiterated that, "An alternate method of apportionment *must* be adopted." *Id*. (emphasis added).

The Court of Appeals remanded the case to the Court of Claims "with directions to determine an appropriate apportionment method if the parties are unable to agree upon one." *Id*. The Department's Application for Leave to Appeal followed.

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III. STANDARD OF REVIEW

A. Standard for Granting Summary Disposition Under MCR 2.116(C)(10)

A motion for summary disposition under MCR 2.116(C)(10) is properly granted if: (1) there is no genuine issue of material fact, and (2) the moving party is entitled to judgment as a matter of law. MCR 2.116(C)(10). A trial court may grant a motion for summary disposition under MCR 2.116(C)(10) if the pleadings, affidavits, and other documentary evidence, when viewed in a light most favorable to the nonmovant, show that there is no genuine issue with respect to any material fact. *Quinto v Cross & Peters Co*, 451 Mich 358, 362; 547 NW2d 314 (1996); MCR 2.116(G)(5). "A genuine issue of material fact exists when the record, giving the benefit of reasonable doubt to the opposing party, leaves open an issue upon which reasonable minds might differ." *West v Gen Motors Corp*, 469 Mich 177, 183; 665 NW2d 468 (2003). An appellate court "reviews the grant or denial of summary disposition de novo to determine if the moving party is entitled to judgment as a matter of law." *Maiden v Rozwood*, 461 Mich 109, 118; 597 NW2d 817 (1999).

B. Tax Statutes are Construed in Favor of the Taxpayer and Against the Government

Clear and unambiguous language in a tax statute should be interpreted and enforced as written. *Ford Motor Co v Dep't of Treasury*, 496 Mich 382, 389; 852 NW2d 786 (2014). "The primary goal of statutory interpretation is to give effect to the intent of the Legislature." *Briggs Tax Sery v Detroit Public Schools*, 485 Mich 69, 76; 780 NW2d 753 (2010). The first step in such analysis is to examine the plain language of the statute at issue. *Id.* "When construing statutory language, [the court] must read the statute as a whole and in its grammatical context, giving each and every word its plain and ordinary meaning unless otherwise defined." *MidAmerican Energy Co v Dep't of Treasury*, 308 Mich App 362; 863 NW2d 387 (2014) (citations and quotation marks

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omitted). The court should avoid a construction that would render any part of the statute surplusage or nugatory. *Id.* at 370. "If the language of the statute is unambiguous, the Legislature must have intended the meaning clearly expressed, and the statute must be enforced as written." *Id.* at 369-370.

IV. ALLOCATION AND APPORTIONMENT OF BUSINESS INCOME[7] AND THE STATUTES AT ISSUE

A. Basics of Apportionment

Unlike the federal government, states do not have nationwide taxing jurisdiction. Not all income of a multistate business that is present in a state is taxable by that state. The U.S. Supreme Court has held that only income that is part of the business activity with nexus with the state can be subject to tax. *FW Woolworth Co v Tax'n and Rev Dep't of New Mexico*, 459 US 961; 103 S Ct 274; 73 L Ed 213 (1982). Thus, states must limit their taxation to the appropriate share of income derived from the conduct of business activities within the state. *Id.* Apportionment must be fair. *Id.*

Apportionment is the methodology of taking all of the income of a multistate business and separating out the appropriate amount subject to tax by each state based on factors that represent the business activity within the state. *Id.* Thus, a multistate business is taxed by any given state based the apportioned share of income arising from the business activity carried on within the state. Under *Allied-Signal, Inc v Director, Div of Taxation*, 504 US 768, 778; 112 S Ct 2251; 119 L Ed 2d 533 (1992), in order for a state, such as Michigan, to impose a tax on an activity, there must be some connection between Michigan and the income producing activity it seeks to tax.

[7] For simplicity, the term "income" is used to address both business income and gross receipts, as the MBT imposes an income tax, a gross receipts tax, as well as a surcharge on both.

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When income is "apportioned," it is divided among the states in which the taxpayer derives such apportionable income. Hellerstein & Hellerstein, State Taxation (3rd ed), ¶9.02. No specific apportionment formula is universally accepted. Historically, many states adopted an equally weighted three-factor formula that measured a taxpayer's property, payroll and sales in a state, as a fraction or ratio of a taxpayer's property, payroll and sales everywhere. *Id.* Over the past few decades, the trend has been to apportion business income using only the sales factor, apportioning the income of a multistate business enterprise based on its economic marketplace. *Id.* Michigan, like many other states, now employs an apportionment formula consisting solely of sales. The formula is represented as follows:

$$\frac{\text{Sales in Michigan}}{\text{Sales Everywhere}}$$

B. Income Subject to Apportionment

The U.S. Constitution limits the income that may be apportioned. The Due Process Clause of the Fourteenth Amendment and the Commerce Clause of the U.S. Constitution mandate that a state may not "tax value earned outside its borders." *ASARCO Inc v Idaho State Tax Comm*, 458 US 307, 315; 102 S Ct 3103; 73 L Ed 2d 787 (1982). The Due Process Clause demands that there be "'some definite link, some minimum connection, between a state and the person, property or transaction it seeks to tax,' as well as a rational relationship between the tax and the 'values connected with the taxing State.'" *MeadWestvaco Corp v Illinois Dep t of Revenue*, 553 US 16, 24; 128 S Ct 1498; 170 L Ed 2d 404 (2008) (citations omitted). The Commerce Clause "forbids the States to levy taxes that discriminate against interstate commerce or that burden it by subjecting activities to multiple or unfairly apportioned taxation." *Id.* The "broad inquiry" under both is "whether the taxing power exerted by the state bears fiscal relation to protection, opportunities and benefits given by the state." *Id.* at 25.

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States use a variety of apportionment formulas. Historically, states primarily utilized a three-factor formula comprised of payroll, property and sales. The sales or receipts factor (hereinafter the "sales factor") used to apportion business income includes receipts from services, rentals, royalties, sales of stock, and general business operations, in the absence of some specific statutory or regulatory limitation on its scope. Hellerstein ¶9.18. The universe of receipts included in the sales factor is defined by reference to the receipts that give rise to apportionable income. *Id.* In the few states whose laws purport to apportion all income, no limitation is ordinarily applicable. All the taxpayer's receipts taken into account in determining net income likewise are included in the receipts factor. *Id.*

In *Container Corp of America v Franchise Tax Board*, 463 US 159; 103 S Ct 2933; 77 L Ed 2d 545 (1983), the U.S. Supreme Court stated the Commerce Clause requirement of fair apportionment mandates that the "factor or factors used in the apportionment formula must actually reflect a reasonable sense of how income is generated." *Id.* at 169. Professor Hellerstein, the leading authority on state taxation, states:

> The factors that are employed to apportion income among the states should reflect the factors that produce the income being apportioned. This virtually axiomatic proposition is also a principle of constitutional law. [Hellerstein, ¶9.15(1)].

C. Alternative Apportionment

To ensure that a state's apportionment formula will not exceed constitutional boundaries set by the Supreme Court (to tax only that income derived from business activity within the state), state statutes governing the division of the tax base allow for alternative apportionment methods. Alternative apportionment is required if the standard method does not fairly reflect the extent of the taxpayer's business activity within the state. Hellerstein ¶9.20. Currently, 42 states provide for alternative apportionment. *All States Tax Guide* (RIA) ¶223. Michigan adopted the use of

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alternative apportionment in 1975.[8] The Multistate Tax Commission (MTC) has adopted special rules pursuant to UDITPA's Section 18 equitable apportionment provision that provide variations from the standard sales factor in common situations. These include the exclusion of substantial amounts of gross receipts arising from an incidental or occasional sale of a fixed asset, see MTC Reg IV.18(c)(1); the exclusion of receipts from intangible property when the income cannot be attributed to a particular income-producing activity, see MTC Reg IV.18(c)(4); and the inclusion of net gain, rather than gross receipts, from assets held in connection with the taxpayer's treasury function, see *Id*.

D. The MBT Taxable Base

MCL 208.1105 defines "business income" to mean:

> [T]hat part of federal taxable income derived from business activity. For a partnership or S corporation, business income includes payments and items of income and expense that are attributable to business activity of the partnership or S corporation and separately reported to the partners or shareholders.

Gross receipts are defined as "the entire amount received by the taxpayer as determined by using the taxpayer's method of accounting used for federal income tax purposes . . ." MCL 208.1111(1).

E. Apportionment Under the MBT

A taxpayer whose business activities are subject to tax in multiple states must apportion its tax base solely by the use of a sales factor. The sales factor is a fraction, the numerator of which is the total sales of the taxpayer in this state during the tax year and the denominator of which is the total sales of the taxpayer everywhere during the tax year. MCL 208.1303. Under

[8] The Single Business Tax Act, MCL 208.1 *et seq*., enacted alternative apportionment in MCL 208.69. The language, which remains identical today, was incorporated into the MBT and the now imposed Corporate Income Tax. See MCL 208.1309; MCL 206.667. The Uniform Division of Income for Tax Purposes Act, adopted by National Conference of Commissioners on Uniform State Laws provides for alternative apportionment similar to Michigan in Section 18.

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MCL 208.1115 (1) "Sale" or "sales" means, the amounts received by the taxpayer as consideration from the following:

> (a) The transfer of title to, or possession of, property that is stock in trade or other property of a kind that would properly be included in the inventory of the taxpayer if on hand at the close of the tax period or property held by the taxpayer primarily for sale to customers in the ordinary course of the taxpayer's trade or business. For intangible property, the amounts received shall be limited to any gain received from the disposition of that property.
>
> (b) The performance of services that constitute business activities.
>
> (c) The rental, lease, licensing, or use of tangible or intangible property, including interest, that constitutes business activity.
>
> (d) Any combination of business activities described in subdivisions (a), (b), and (c).
>
> (e) For taxpayers not engaged in any other business activities, sales include interest, dividends, and other income from investment assets and activities and from trading assets and activities.

F. Alternative Apportionment Under the MBT

The MBT requires alternative apportionment when the standard formula would result in gross distortion or result in unconstitutional taxation as follows:

> (1) If the apportionment provisions of this act do not fairly represent the extent of the taxpayer's business activity in this state, the taxpayer may petition for or the treasurer may require the following, with respect to all or a portion of the taxpayer's business activity, if reasonable:
>
> (a) Separate accounting.
>
> (b) The inclusion of 1 or more additional or alternative factors that will fairly represent the taxpayer's business activity in this state.
>
> (c) The use of any other method to effectuate an equitable allocation and apportionment of the taxpayer's tax base.

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> (2) An alternate method may be used only if it is approved by the department.
>
> (3) The apportionment provisions of this act shall be rebuttably presumed to fairly represent the business activity attributed to the taxpayer in this state, taken as a whole and without a separate examination of the specific elements of either tax base *unless it can be demonstrated that the business activity attributed to the taxpayer in this state is out of all appropriate proportion to the actual business activity transacted in this state and leads to a grossly distorted result or would operate unconstitutionally to tax the extraterritorial activity of the taxpayer*. [MCL 208.1309][emphasis added].

The Michigan statute, similar to the UDIPTA standard, contains a two-part test for the use of alternative apportionment. First, the taxpayer must show that the use of the standard formula does not fairly represent the extent of the taxpayer's business activity in the state. The taxpayer may meet this burden by showing that the business activity attributed to the state by the use of the standard formula is "out of all appropriate proportion to the actual activity transacted in the state" or, by showing the use of the standard formula would "operate unconstitutionally" to tax activity of the taxpayer conducted outside of the state. Second, once the taxpayer has demonstrated gross distortion or extraterritorial taxation, the test requires that the alternative method proposed by the taxpayer is reasonable. The Department is obligated to review the alternative formula for reasonableness. If the alternative is reasonable, the alternative method is permitted under the statute.

V. ARGUMENT

A. The Court of Appeals Has Twice Found That the Statutory Formula, as Applied to MLI's Exceedingly Unique Circumstances, Led to a Grossly Distorted Result and Unconstitutionally Taxed Extraterritorial Activity

As stated *supra*, the Court of Appeals has twice considered the issue of whether the statutory formula found in the MBT is unconstitutional when applied to the unprecedented facts of this case. In its second consideration of the constitutionality issue, the Court of Appeals

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reiterated the reasoning from its original opinion, finding "the application of the statutory formula in this case constitutes a constitutional violation." Court of Appeals Opinion 2 at 3. Additionally, it explicitly "adopt[ed] the analysis in [its] original opinion regarding the constitutional defect present in the case applying the statutory formula under the facts of this case to calculate the tax owed. An alternative method of apportionment must be adopted." *Id*. Accordingly, the arguments against the Supreme Court granting the Department's Application for Leave to Appeal are nearly identical to those MLI previously raised.

The Court of Appeals neither proclaimed a new legal standard, nor fundamentally altered or disregarded precedent. Instead, the Court of Appeals correctly recognized that based on the unique factual circumstances that existed, alternative apportionment was not only justified, but constitutionally required due to venerable legal principles related to the prohibition of state taxation of extraterritorial activity.

It is a well-established legal principle that "[a] state may not tax more than its fair share of interstate commerce." Court of Appeals Opinion 1 at 5[9] (citing *Asarco, Inc v Idaho State Tax Comm*, 458 US 307, 315; 102 S Ct 3103; 73 L Ed 2d 787 (1982)). Although "the United States Supreme Court has not required the use of a particular formula to the exclusion of others[,] . . . the formula must fairly determine the portion of income that can be 'fairly attributed to in-state activities.'" Court of Appeals Opinion 1 at 4 (citing *Container Corp of America v Franchise Tax Bd*, 463 US 159, 169; 103 S Ct 2933; 77 L Ed 2d 545 (1983)). "An apportionment formula will be struck 'if the taxpayer can prove by clear and cogent evidence that the income attributed to the State is in fact out of all appropriate proportion to the business transacted . . . in that State, or has led to a grossly distorted result." Court of Appeals Opinion 1 at 5 (citing *Container Corp of*

[9] Since the Court of Appeals second opinion explicitly incorporates the reasoning of its first opinion, MLI also references that first opinion in support of its argument.

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America, 463 US at 170; *Hans Rees' Sons, Inc v North Carolina*, 283 US 123, 135; 51 S Ct 385; 75 L Ed 879 (1931)).

More than thirty years ago, in accordance with the above precedent, the Michigan Legislature enacted the language now contained in MCL 208.1309, which allows for alternative apportionment when the standard formula does not fairly represent the taxpayer's business activity in Michigan. Contrary to Treasury's protestation that this case involves legal principles of major significance, see MCR 7.305(B)(3) ("The application must show that the issue involves a legal principle of major significance to the state's jurisprudence."), the concept of alternative apportionment in Michigan is far from novel, and the Legislature intended that alternative apportionment would be necessary in certain instances. *Hannay v Transp Dep't*, 497 Mich 45, 57; 860 NW2d 67 (2014) ("[C]ourts must give effect to every word, phrase, and clause in a statute and avoid an interpretation that renders nugatory or surplusage any part of a statute.").

In both unanimous published opinions, the Court of Appeals determined the statutory formula, as applied to MLI's exceedingly unique circumstances, attributed business activity to Michigan that ran "afoul of the Due Process and Commerce Clauses, incorporated in the statute, because it does not fairly determine the portion of income from the Sale that is reasonably attributed to in-state activities." Court of Appeals Opinion 2 at 1 (citing Court of Appeals Opinion 1). MLI had been in business for over 52 years at the time Chris and Paulette sold their shares in the family S-corporation in 2011. The resulting gain from the tangible and intangible assets and accumulated goodwill was generated over the course of half a century. There is no dispute that MLI conducted its business primarily in Midwestern states other than Michigan. Indeed, MLI's sales in Michigan in the ten years prior to the Sale averaged 6.782%, ranging from a low of 0% to a high of 39.28%. Serendipitously, MLI obtained the largest Michigan-based contract in MLI's

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history during the winter months in 2010, when its business operations were generally slow, due to weather. Accordingly, at the time of the Sale in March of 2011, MLI's Michigan-based sales were quite anomalous.

Due to these unique factual circumstances, in its first consideration of the issue, the Court of Appeals conducted an in-depth analysis into the proper tax allocation percentages when the statutory formula, thereby concluding that the result is grossly distortive. In its original opinion, the Court of Appeals noted, "[A]pplication of the statutory formula results in an allocation of 70 percent of the gain on the Sale to Michigan . . . . To impose a tax on 70 percent of the gain of the Sale is not commensurate with the 'protection, opportunities and benefits' that Michigan conferred on MLI, where the majority of the activities making up MLI's fair market value at the time of the Sale had occurred outside Michigan's borders." Court of Appeals Opinion 1 at 7. The Court of Appeals' conclusion is in line with well-established United States Supreme Court precedent, and it is neither contrary to law nor clearly erroneous.

Additionally, the Department argues "[t]he Court of Appeals' published decisions encourages unhappy taxpayers to claim, without evidence, that they have carried out most of their past business activities outside of Michigan's borders," and "the decision[s] could place a disparate tax burden on businesses with Michigan-only business operations." Application for Leave to Appeal at 19. Nothing could be further from the truth, and allegations of "unhappy taxpayers" hardly implicates issues of significant public interest. See MCR 7.305(B)(2) ("The application must show that the issue has significant public interest . . . ."). Nor has the Department explained the "disparate tax burden on businesses with Michigan-only business operations."

Nor do the Court of Appeals' decisions have wide-reaching effects due to the unique factual circumstances of the case. Indeed, the Court of Appeals aptly "conclude[s] that this is an

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exceptional case." Court of Appeals Opinion at 7; see also Draft Revenue Administrative Bulletin ("RAB") 2020-XX, Alternative Apportionment for the Michigan Business and Income Taxes[10] (discussing the Court of Appeals' decision, stating "the court was careful to note that . . . *the gross distortion finding was only because of the unique facts applicable to this taxpayer*.") (emphasis added). On the facts, these decisions are limited to a transaction that involved the sale of a family business under circumstances that are unlikely to be repeated. The value of the decisions lie in the determination of what constitutes "gross distortion" and the Court of Appeals' decisions are in line with U.S. Supreme Court precedence. The decisions also deals with a one-time event under the MBTA, unlike other tax cases appealed to this Court, which have implications to ongoing operations for future tax years. *Cf. TOMRA of North America v Dep't of Treasury*, ___ Mich ___ (2020) and *Detroit Edison Co v Dep't of Treasury*, 497 Mich 873; 853 NW2d 380 (2014) (granting leave for appeal in sales/use tax cases that had implications for future tax treatment of tangible personal property in specific industries). The case at hand consists of facts unlikely to ever be replicated - it is an unremarkably one-off decision. Notably, the Department cites primarily to unpublished opinions of the Court of Appeals, or cases that have been resolved and dismissed by the parties. Application for Leave to Appeal pp 27-29, 21.

Second, the Department mischaracterizes the factual record by insinuating the taxpayer presented no evidence to support gross distortion, nor the use of an alternative apportionment method. That allegation misses the mark. The Taxpayer provided more than 1,200 pages of documentation in response to the Department's four extensive discovery requests. The Department conducted numerous depositions and issued multiple third-party subpoenas, resulting

[10] Draft RAB 2020-XX is intended to replace RAB 2018-28 and incorporates much of the same language.

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in hundreds of pages of out-of-court oral testimony. Specifically, MLI produced depreciation schedules, reports, valuation studies and financial records that established the value of its intangible assets, goodwill, other allocable items of income, as well as operational earnings. Moreover, MLI produced all of its state tax returns for the period under review, which established state-by-state income and assets. Also in the record are copies of MLI's Michigan personal property tax returns that further document MLI's assets in the state at the time of the sale. The Department had conducted a full audit of MLI and had access to its financial books and records. The allegations that little information has been provided to documents the financial information used to demonstrate gross distortion are false. The Department's argument, which the Court of Appeals has rejected twice, asks this Court to vacate two published opinions due to the Department's inability to analyze information that they themselves demanded. MLI has produced clear and cogent record evidence to permit the determination of a reasonable alternative apportionment. The Department's assertions ring hollow.

B. The Department Does Not Have the Exclusive Authority to Determine an Alternative Apportionment Method

The Department argues that "despite its exclusive statutory authority, [it will not] have unilateral discretion to approve the [alternative apportionment] method used, but will instead have to somehow work with [MLI] to do so." Application for Leave to Appeal at 19. This argument is flawed and baseless.

First, the Department's statutory authority is limited *to approving* an alternative apportionment method; it need not be the sole creator of such method.[11] MCL 208.1309(2) ("An

[11] MCL 205.94o(2) also deals with the concept of apportionment, albeit in the use tax context. There, tangible personal property that qualifies for an industrial processing exemption is limited "to the percentage of exempt use to total use determined by a reasonable formula or method approved by the department." Taxpayer's are not required to seek preapproval from the Department. *Id.* In *Detroit Edison Co. v. Dep't of Treasury*, this Court discussed MCL 205.94o(2),

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alternate method may be used only if it is approved by the department."). This is precisely what the Court of Appeals articulated in its original opinion, and incorporated in its second opinion. Indeed, in requesting the use of alternative apportionment, the taxpayer has the burden to proffer a reasonable alternative (the second part of the test), for the Department's review, once distortion has been proved. The Department's proposed guidance mandates that taxpayers submit a proposed alternative apportionment method with any request for alternative apportionment. According to Draft RAB 2020-XX, a taxpayer's request for alternative apportionment "must detail the proposed alternative apportionment method(s) and explain how it reflects the taxpayer's income attributable to Michigan and why it is a reasonable alternative." In drafting RAB 2020-XX, the Department undoubtedly contemplated whether taxpayers should submit alternative apportionment methods for review and approval pursuant to MCL 208.1309, and decided taxpayers have a vital role to play in devising an appropriate alternative apportionment method. Indeed, the Department, through Draft RAB 2020-XX, *instructs* taxpayers to submit alternative apportionment methods with any request for alternative apportionment. MLI submitted alternative apportionment methods for review and approval by the Department. Gursky Letter, Plaintiff-Appellee's App. No. 12, Ex B. to Plaintiff's First Amended Complaint. The Department, however, decided not to review the proposals, and now argues MCL 208.1309 requires taxpayers be cut out of the process completely, in opposite to Draft RAB 2020-XX.

Second, there is no reason, statutory or otherwise, that would prohibit the Department and the taxpayer to engage in good-faith efforts to review the multiple alternative methods previously

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concluding, "[T]he percentage must be determined on the basis of a 'reasonable formula or method *approved* by the [Department of Treasury]." 498 Mich 28, 56; 869 NW2d 810 (2015) (emphasis added). Notably, on remand, the Court of Claims ordered mediation to determine the appropriate formula, requiring the parties to work together to reach a reasonable formula.

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proffered by MLI. Similarly, there is no reason, statutory or otherwise, that would prohibit the Department and the taxpayer to collaborate to determine another alternative apportionment method, which could be a combination of the proffered alternatives. Such good-faith collaboration is the statutory basis for the use of alternative apportionment. Once the parties identify an alternative apportionment method, the Department can exercise its statutory authority *to approve* such method. Of course, any method ultimately approved by the Department must be "reasonable." MCL 208.1309(1).

This is precisely what the Court of Appeals articulated in both opinions. Originally, the Court of Appeals declined to ascertain an alternative apportionment method because "[t]he statute clearly directs that this must be settled between the parties; that is, the method must ultimately be approved by the Department." Court of Appeals Opinion 1 at 8. Quite reasonably, the Court of Appeals "encourage[d] the parties to engage in a good-faith collaboration to arrive at such a method," and reiterated that "just as the Department may not rely on the statutory formula in this case, neither can it insist on an alternate method that does not cure the constitutional defect by continuing to attribute out-of-state revenue to Michigan." *Id.* at 8-9. In its second opinion, the Court of Appeals emphasized that same approach, stating that the matter was remanded to the trial court "to determine an appropriate alternate apportionment method if the parties are unable to agree on one." Court of Appeals Opinion 2 at 3. Simply put, the Court of Appeals' order did not deprive the Department of its statutory authority, as the order comports with the plain language of MCL 208.1309.

VI. CONCLUSION

For the reasons set forth above, the Court of Appeals has twice properly concluded that the statutory formula, as applied to MLI's exceedingly unique circumstances, led to a grossly distorted

result and unconstitutionally taxed extraterritorial activity. The Department's Application for Leave to Appeal should be denied.

Respectfully submitted,

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