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STATE OF MICHIGAN
IN THE SUPREME COURT

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

Plaintiff-Appellee,

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

vs.

MICHIGAN DEPARTMENT OF TREASURY,

Defendant-Appellant.

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PLAINTIFF-APPELLEE'S SUPPLEMENTAL BRIEF ON MOAA

ORAL ARGUMENT REQUESTED

RECEIVED by MSC 5/25/2022 8:51:59 PM

TABLE OF CONTENTS

INDEX OF AUTHORITIES iv

COUNTER-STATEMENT OF QUESTIONS PRESENTED iii

INTRODUCTION 1

SUMMARY OF FACTS AND PROCEEDINGS 2

STANDARD OF REVIEW 8

ARGUMENT 9

I. MLI Has Provided Clear and Cogent Evidence that the Business Activity Attributed to Michigan by the Statutory Formula is Disproportionate and Creates a Grossly Distorted Result. 9

A. The Evidence Establishes a Grossly Distorted Result 9

B. Evidence Presented 11

II. The Application of the Statutory Formula Results in Unconstitutional Taxation under both the Due Process Clause and the Commerce Clause. 15

A. The Due Process Clause 15

B. The Commerce Clause 15

C. The Unique Facts and Circumstances Contribute to Unconstitutional Taxation. 17

D. The Inclusion of the Revenue in the Tax Base, but not in the Apportionment Formula Creates Further Distortion. 21

III. The Remand does not Conflict with MCL 208.1309(2). 22

A. Revenue Administrative Bulletin 2018-28 23

B. This Court has the Authority to Direct Treasury to Engage in Alternative Dispute Resolution 24

CONCLUSION AND REQUESTED RELIEF 26

RECEIVED by MSC 5/25/2022 8:51:59 PM

RECEIVED by MSC 5/25/2022 8:51:59 PM

INDEX OF AUTHORITIES

Page(s)

Federal Cases

Asarco, Inc v Idaho State Tax Comm,
458 US 307; 102 S Ct 3103; 73 L Ed 2d 787 15

Complete Auto Transit, Inc v Brady,
430 US 274; 97 S Ct 1076; 51 L Ed 2d 326 15

Container Corp of America v Franchise Tax Bd,
463 US 159; 103 S Ct 2933; 77 L Ed 2d 545 .....8, 10, 17

Exxon Corp v Wisconsin Dep't of Revenue,
447 US 207; 100 S Ct 2109; 65 L Ed 2d 66 9

Hans Rees' Sons, Inc v North Carolina,
283 US 123; 51 S Ct 385; 75 L Ed 879 .....8, 10, 11, 15, 16

Mobil Oil Corp v Comm'r of Taxes of Vermont,
445 US 425; 100 S Ct 1223; 63 L Ed 2d 510 14

Moorman Mfg Co v Bair,
437 US 267; 98 S Ct 2340, 2344; 57 L Ed 2d 197 17

N Carolina Dep't of Revenue v Kimberley Rice Kaestner 1992 Family Tr.,
__ U.S. __;139 S Ct 2213; 204 L Ed 2d 621 14

Oklahoma Tax Comm'n v Jefferson Lines, Inc,
514 US 175; 115 S Ct 1331; 131 L Ed 2d 261 17

Trinova Corp v Michigan Dep't of Treasury,
498 US 358; 111 S Ct 818; 112 L Ed 2d 884 .....14, 17

Underwood Typewriter Co v Chamberlain,
254 US 113; 41 S Ct 45; 65 L Ed 165 9

State Cases

Cardinal Mooney High School v MHSAA,
437 Mich 75; 467 NW2d 21 8

Detroit Edison Co v Dep't of Treasury,
498 Mich 28; 869 NW2d 810 .....24, 25

RECEIVED by MSC 5/25/2022 8:51:59 PM

GMC v Dep't of Treasury,
290 Mich App 355; 803 NW2d 698 14

In re Rovas Complaint,
482 Mich 90; 754 NW2d 259 23

Manufacturers Nat'l Bank v Director of Dep't of Natural Resources,
420 Mich 128; 362 NW2d 572.....23

McQueen v Black,
168 Mich App 641; 425 NW2d 203 9

Paye v Grosse Pointe,
279 Mich 254; 271 NW2d 826 24

People v Benton,
294 Mich App 191 817; NW2d 599 (2011).....16

People v Sierb,
456 Mich 519; 581 NW2d 219 14

State Tax Assessor v Kraft Foods Grp, Inc,
2020 ME 81, 235 A3d 837.....18

Vectren Infrastructure Services Corp v Dep't of Treasury,
506 Mich 964; 950 NW2d 746 .....**7**

Vectren Infrastructure Servs Corp v Dep't of Treasury,
331 Mich App 568; 953 NW2d 213 11

Federal Statutes

IRC 338(h)(10).....5

State Statutes

MCL 205.22.....6

MCL 205.94*o*(2) 24

MCL 208.1115.....21

MCL 208.1115(1) 7

MCL 208.1303.....14

MCL 208.1303(1) 20

MCL 208.1309.....1, 2, 5, 7, 22, 24

MCL 208.1309(1) 23

MCL 208.1309(1)(c) 2

MCL 208.1309(2) 2, 6, 22, 24

Other Authorities

MCR 2.114(D) 16

MRE 803(6) 13

Erikson, *Judicial Administrative Review*, Michigan Bar J. (2002) 23

Murphy, *Michigan Business Tax Apportionment and Sales Sourcing Provisions*, 53 Wayne L. Rev. 1395 (2007) 21

RAB 2018-28, *Alternative Apportionment for the Michigan Business and Income Taxes* 22

RECEIVED by MSC 5/25/2022 8:51:59 PM

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COUNTER-STATEMENT OF QUESTIONS PRESENTED

This Court's March 23, 2022 order requested the parties to brief the following three questions:

1. Whether the taxpayer establish by clear and cogent evidence that "the business activity attributed to it 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'" under MCL 208.1309(3) of the Michigan Business Tax Act, MCL 208.1101 *et seq.*?

   Plaintiff-Appellee answers, "Yes."

   Defendant-Appellant answers, "No."

   The Court of Claims answered, "No."

   The Court of Appeals answered, "Yes."

2. Whether application of the statutory formula in this case conflict with the Due Process and Commerce Clauses incorporated into the statute, because it does not fairly determine the portion of income from the sale of a business attributed to in-state activities?

   Plaintiff-Appellee answers, "Yes."

   Defendant-Appellant answers, "No."

   The Court of Claims answered, "No."

   The Court of Appeals answered, "Yes."

3. Whether remand for the parties to determine an alternate method of apportionment conflicts with MCL 208.1309(2), which vests exclusive authority to approve an alternate method of apportionment in the Department of Treasury?

   Plaintiff-Appellee answers, "No."

   Defendant-Appellant answers, "Yes."

   The Court of Claims did not address this question.

   The Court of Appeals answered, "No."

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INTRODUCTION

The Michigan Business Tax Act (MBTA)—codified at MCL 208.1309—permits a taxpayer to petition for the use of an alternative method of apportionment when the statutory formula, as applied, leads to a grossly distorted result. The questions presented are whether MLI met its burden of proof in demonstrating that the statutory formula attributed an amount of business activity to the state "out of all appropriate proportion to the actual business activity transacted in the state," and whether the resulting distortion resulted in unconstitutional taxation under the protections of the Due Process Clause and Commerce Clause of the U.S. Constitution. Further raised is whether the Court of Appeals' Order on Remand conflicted with the statutory language of MCL 208.1309 which vests authority to approve an alternative method of apportionment with the Department of Treasury. The Department of Treasury does not contest any of this.

Treasury's position is that MLI failed to meet its evidentiary standard as well as the constitutional standard of gross distortion. Yet, the record evidence demonstrates that MLI firmly established by clear and cogent evidence, that the constitutional standard of gross distortion was manifested due to the unique facts of 1) the history of the Company's operations, 2) the use of a three-month Short Year return filing, 3) the performance of an unusual contract during a normally idle period, and 4) the latent inconsistency of the statutory formula due including the gain in the tax base, while excluding the factors associated with the gain from the statutory formula. Combined together, these facts resulted in the apportionment of gain to the state "out of all appropriate proportion" to the activities conducted in the state over the 52 year history of the Company.

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SUMMARY OF FACTS AND PROCEEDINGS

MCL 208.1309

MCL 208.1309 provides taxpayers with the option to petition Treasury to make "use of any other method to effectuate an equitable allocation and apportionment of the taxpayer's tax base," MCL 208.1309(1)(c), when "the apportionment provision of this act do not fairly represent the extent of the taxpayer's business activity in this state." MCL 208.1309(2) imposes a requirement that "An alternate method may be used only if it is approved by the department." MCL 208.1309(2).

MLI's Business Operations

During all relevant times, Minnesota Limited (MLI) was a family-owned business headquartered in Minnesota, where most of its facilities were located. Appellant's App'x Vol I, pp 122a–216a (Offering Memorandum). Reuben Leines, the father of Christopher Leines and Paulette Britzius, started the Company in 1966. Appellee's App'x Vol I, pp 1–14 (Deposition of Christopher Leines 59:1–60:14). MLI constructed oil and gas pipelines to transport natural gas, crude oil, and petroleum products. Appellant's App'x Vol I p 60a-78a (First Amended Complaint ¶4). MLI primarily performed its services in Minnesota and the upper Midwest (Wisconsin, Iowa, North and South Dakota). Appellee's App'x Vol I, pp 1–14 (Leines Dep 59:8–21). The company rarely performed work in Illinois or Michigan. Appellant's App'x Vol I, pp 122a–216a (Offering Memorandum); VEC000048–000143; Appellee's App'x Vol I, pp 1–14 (Leines Dep 14:9–11); Appellant's App'x Vol I, pp 122a–216a (Offering Memorandum). MLI did not have any facilities in Michigan. Appellant's App'x Vol I, pp 122a–216a (Offering Memorandum).

MLI was engaged to clean up an oil spill for Enbridge Inc., which operated a crude oil pipeline transportation system in Michigan. Appellant's App'x Vol I, pp 60a–78a (First Amended

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Complaint ¶8–9). The Enbridge contract represented the largest contract MLI had ever performed in Michigan and the performance occurred during MLI's off-season months. *Id*. At the time of the sale, the only Michigan work outstanding was the remainder of the Enbridge contract.

Chris and Paulette began to explore the sale of MLI, primarily due of Paulette's health problems. Appellee's App'x Vol I, pp 1–14 (Leines Dep 16:12–23). To facilitate a potential sale, MLI engaged a third-party consultant to prepare an Offering Memorandum to assist in the sale of the business and solicit interest from prospective buyers. Appellant's App'x Vol I, pp 122a–216a (Offering Memorandum); VEC000048-000143; Appellee's App'x Vol I, pp 1–14 (Leines Dep 19:4–20:10). As noted in the Offering Memorandum, MLI had built a strong reputation based on quality and safety since its founding in 1966. Appellant's App'x Vol I, pp 122a–216a (Offering Memorandum). The sales transaction closed on March 31, 2011. *Id.*

Buyer, Vectren Infrastructure Services, Inc. (VISCO) hired KPMG to prepare a valuation report of MLI's intangible assets. The study allocated the purchase price as follows: $34.4 million to tangible assets (construction, transportation, and office equipment and certain buildings), $22.8 million to intangible assets, and approximately $16.6 million to goodwill (which includes $3,670,000 for assembled workforce). The intangible assets were composed of, and valued at, $14,588,000 for MLI's existing customer relationships, $287,000 for MLI's backlog of work in process and/or committed to, and $4,241,000 for MLI's trade name. Appellant's App'x Vol II, pp 826a–865a (KPMG Study, Sch. 1); VEC 000172; Appellee's App'x Vol II, pp 1094–1105

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(Deposition of Bradley Hirsch 22:6–25:19); Appellant's App'x Vols I–II, pp 440a–597a) (Purchase Agreement), VEC000221-000378[1]).

MLI's Tax Filing and Subsequent Treasury Actions

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. For its Michigan Business Tax Act (MBTA) filing, MLI was required to file a short-period return from January 1, 2011 through the date of sale (March 31, 2011) (Short Year) and was taxed on both the gross receipts as well as the gain associated with sale. The impact of the Short Year return apportioned the gain by a formula of only a three-month period, rather than a full twelve months. MLI included the gain from the sale in the tax base apportionable to Michigan, as well as in the sales factor denominator, and included gain in the numerator to the extent of the Company's property in the state assets at the time of the sale. On the day of the sale, the majority of the Company's assets were located outside of Michigan. Appellee App'x Vol II, p 957–86 (MLI Personal Property Tax Reports); VEC000910–000913. This resulted in a sales factor of 14.99%.

Treasury audited MLI for the tax year ending December 31, 2010 and the Short Year. Treasury adjusted the sales factor for the Short Year and excluded all the gain from the sale from the sales factor. Appellant's App'x Vol III, pp. 884a–892a (Audit Report of Findings). The removal of the gain from the sales factor increased the sales factor from 14.99% to 69.96%. *Id*. Treasury characterized this adjustment as an increase in the factor of 54.9711%, although such increase was almost a 400% increase. This increase was due to not only the removal of the gain

[1] Note, as confirmed by Mr. Hirsch of KPMG, valuation is not performed on a state-by-state basis. Contrary to Appellant's allegations, MLI has not sought, nor has it proposed as an alternative, the use of geographical accounting Appellee's App'x Vol II, pp 1094–1105 (Hirsch Dep 22:6–25:19).

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from the sales factor, but also a result of the Short Year, during which MLI was engaged in a large contract in Michigan when the majority of its operations in other states were idle. Appellee's App'x Vol I, pp 1–14 (Leines Dep 14:9–11). Treasury issued a Bill for Taxes Due (Intent to Assess) No. UO71593 assessing tax in the amount of $2,262,994 plus statutory interest, and imposed penalties of $678,727.50.

MLI requested the use of an alternative apportionment method pursuant to MCL 208.1309 prior to filing an amended return. Appellee's App'x Vol I, pp 15–51 (Ex A to Plaintiff's First Amended Complaint). In its 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. The request proposed several alternative apportionment methods for Treasury's review and approval. 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 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 provided supplemental information to support its request. Appellee's App'x Vol I, pp 52–224 (December 14, 2016 Gursky Letter and Information); VEC000039–000211. Treasury rejected MLI's request for alternative apportionment, concluding that MLI had failed to meet its burden of proof to demonstrate distortion. Based on this conclusion, Treasury declined to review

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the proposed alternatives for reasonableness. *Id.*; Appellee's App'x Vol I, pp 15–51 (Ex B. to Plaintiff's First Amended Complaint); Appellee's App'x Vol I, pp 225–29 (Deposition of Lance Wilkinson 18:3–13). Under MCL 205.22, a taxpayer may appeal Treasury's decision to deny a request for alternative apportionment.

Lower Court Decisions

MLI sued in the Court of Claims to challenge the denial of its request for alternative apportionment. On cross-motions for summary disposition, the Court of Claims granted Treasury's motion and denied MLI's request for alternative apportionment. The Court of Claims failed to address Count 1 of Plaintiff's First Amended Complaint, Appellant's App'x Vol I, pp 13a–26a (Michigan Court of Claims, Opinion and order issued August 14, 2018), regarding the appropriate calculation of the sales factor under the statutory methodology.

MLI appealed to the Court of Appeals, which found that the application of the statutory formula, based on the specific and 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." Appellant's App'x, Vol I, p 31a (Court of Appeals March 12, 2020 Opinion at 4). The Court of Appeals found that MLI 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.

In accordance with the approval requirement of MCL 208.1309(2), the Court of Appeals returned the matter to Treasury and encouraged collaboration with the taxpayer to determine a reasonable alternative method. The Court of Appeals noted that an alternative method that does

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continues to attribute out-of-state revenue to Michigan will not cure the constitutional defect. *Id*. at 9.

In response, Treasury filed an Application for Leave with this Court. In lieu of granting leave, this Court issued an order on November 5, 2020, vacating the Court of Appeals' decision 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 Infrastructure Services Corp v Dep't of Treasury*, 506 Mich 964; 950 NW2d 746 (2020). This Court concluded that "This foundational issue must be addressed before determining that MCL 208.1309 requires application of an alternative method of apportionment." *Id*.

The Court of Appeals in turn remanded the case to the Court of Claims, by an Order directing the Court of Claims to address whether the sale of the business should have been included in the sales factor of the statutory formula. The Order directed proceedings on remand to commence in 56 days and gave priority to the proceedings. The Order directed the parties to file copies of all papers filed on remand, as well as to file with the Court of Appeals copies of all orders and/or opinions entered on remand within 7 days. Appellant's App'x Vol I, p 51a (Michigan Court of Appeals, Opinion issued September 30, 2021).

Subsequent to supplemental briefing, the Court of Claims issued its opinion on remand and held that the definition of "sale" under MCL 208.1115(1) would not include the sale of the business in the sales factor.

Having retained jurisdiction, the Court of Appeals issued an opinion after remand on September 30, 2021. Appellant's App'x Vol I, pp 49a–52a (Michigan Court of Appeals, Opinion issued September 30, 2021). While the Court of Appeals upheld the Court of Claims' analysis as to Count I, it stated that the statutory definitions and formula as interpreted by the Court of Claims,

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"reaffirms the conclusion that we reached in our original opinion: that the application of the statutory formula to this case constitutes a constitutional violation." *Id.* at 51a. The Court of Appeals emphasized that the differing definitions of "business activity," "business income," and "sales" resulted in the revenue from the sale being included in the tax base, while being excluded from the statutory formula. The result of such asymmetry contributed to the finding that "to apply the statutory formula . . . to the circumstances of this case would result in the imposition of a tax in violation of the Commerce Clause." *Id*.

By footnote, the Court of Appeals addressed MLI's argument that the statutory regime was impermissibly inconsistent, and noted, "that is a large contributing factor, at least in the context of this case, to our conclusion that this represents a constitutional violation." Appellant's App'x Vol I, p 51a (Michigan Court of Appeals, Opinion issued September 30, 2021). In explicitly limiting its findings to this specific case and its unique facts, the Court of Appeals reiterated that, "An alternate method of apportionment *must* be adopted." *Id*. (emphasis added), and remanded the case to the Court of Claims this time "with directions to determine an appropriate apportionment method if the parties are unable to agree upon one." *Id*. Treasury's Application for Leave to Appeal followed, and this Court's Order granting oral argument on the application.

STANDARD OF REVIEW

Questions of law are reviewed de novo. *Cardinal Mooney High School v MHSAA*, 437 Mich 75, 80; 467 NW2d 21 (1991).

"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." *Container Corp of*

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America v Franchise Tax Bd, 463 US 159, 170; 103 S Ct 2933; 77 L Ed 2d 545 (1983); *Hans Rees' Sons, Inc v North Carolina*, 283 US 123, 135; 51 S Ct 385; 75 L Ed 879 (1931).

ARGUMENT

I. MLI Has Provided Clear and Cogent Evidence that the Business Activity Attributed to Michigan by the Statutory Formula is Disproportionate and Creates a Grossly Distorted Result.

This Court's first question posed to the parties on remand requests them to address whether the clear and cogent evidentiary standard was satisfied in proving a grossly distorted result from the application of the standard apportionment formula. Instead of responding to this question, Appellant Primarily addressed whether the evidentiary standard had been satisfied as to the alternative apportionment proposals presented by MLI. In lieu of a response to Appellant's arguments, MLI will address the question posed by the Court, as the alternative apportionment proposals suggested by MLI have yet to be considered by Treasury as they did not believe MLI had met its burden of proof on providing distortion. Appellee's App'x Vol I, pp 225–29 (Wilkinson Dep 18:3–13). Indeed, the reasonable alternative was the subject of the remand.

A. The Evidence Establishes a Grossly Distorted Result

The Court of Appeals has opined on the definition of clear and cogent evidence, ultimately determining that "clear and cogent evidence is more than a preponderance of evidence . . . the standard is much like clear and convincing evidence." *McQueen v Black*, 168 Mich App 641, n 2 646; 425 NW2d 203 (1987). MLI has met this standard.

MLI agrees that apportionment can be difficult. Appellant's Brief p 26. Nevertheless, "[i]t has long been settled that the entire net income of a corporation, generated by interstate as well as intrastate activities, may be fairly apportioned among the States for tax purposes by formulas

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utilizing in-state aspects of interstate affairs." *Exxon Corp v Wisconsin Dep't of Revenue*, 447 US 207, 219; 100 S Ct 2109; 65 L Ed 2d 66 (1980) (internal quotation marks and citation omitted). Indeed, the very case Treasury cites for the proposition that apportionment can be challenging, *Underwood Typewriter Co v Chamberlain*, 254 US 113, 120–21; 41 S Ct 45; 65 L Ed 165 (1920), also provides that, despite those difficulties, the legislature "adopted a method of apportionment which, for all that appears in this record, reached, and was meant to reach, only the profits earned in this state."

An apportionment formula must be fair. Fairness, in part, requires that the choice of "factors used in the apportionment formula must actually reflect a reasonable sense of how [the business activity] is generated." *Container Corp of* America, 463 US at 169. In determining whether apportionment is fair, the Supreme Court considers whether an apportionment formula produces an unreasonable result. See *Hans Rees' Sons*, 283 US at 131. In *Hans Rees'*, the Supreme Court clarified that "when a state has adopted a method not intrinsically arbitrary, it will be sustained until proof is offered of an unreasonable and arbitrary application in particular cases." *Id*. at 133. The Court observed that the record evidence demonstrated that "for the years 1923, 1924, 1925, and 1926, the average income having its source in the manufacturing and tanning operations within the State of North Carolina was seventeen per cent, while under the assessments in question there allocated to the state of North Carolina approximately 80 per cent, of the appellant's income." *Id*. at 134. The taxpayer submitted an analysis showing the percentage of income attributable to North Carolina "for the years in question, did not in any event exceed 21.7 per cent." *Id*. The Court determined the statutory formula was unreasonable, as "the statutory method, as applied to the appellant's business for the years in question operated unreasonably and arbitrarily, in attributing to North Carolina a percentage of income out of all proportion to the business transacted by the

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appellant in that state. In this view, the taxes as laid were beyond the state's authority." *Id*. at 135–136 (internal citation omitted).

B. Evidence Presented

Treasury alleges that MLI has failed to provide any documentation supporting the finding that the application of the statutory apportionment formula results in gross distortion. For example, on p 21, Treasury contends MLI ". . . what assets, how the assets were valued, or the value of those assets in Michigan compared to assets everywhere." The record demonstrates otherwise. The record contains the Michigan Personal Property Tax Returns, as well as the MBTA Return, which would indicate property reported in Michigan and everywhere as well as the value of the property. Appellee's App'x Vol II, pp 957–86 (MLI Personal Property Tax Reports). These tax returns, which are business records, and were filed under penalties of perjury, were audited by Treasury.

As in *Hans Rees'*, the statutory formula when applied in this case operates "so as to reach profits which are in no just sense attributable to transactions within its jurisdiction." *Vectren Infrastructure Servs Corp v Dep't of Treasury*, 331 Mich App 568, 578; 953 NW2d 213, vacated 506 Mich 964; 950 NW2d 746 (2020). Apportioning by a Short Year and ignoring the history of the Company fails to reasonably reflect how the revenue from the sale was generated. As summarized in the chart below, the evidence substantiates the gross distortion that results from the application of the statutory formula:

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Document	Citation	Proof Demonstrated
Report of Green, Holcomb & Fisher, Confidential Memorandum	Appellant App'x Vol I, pp 122a–216a; VEC 000047–143	History and development of the industry, detailed descriptions of the Company, including primary locations of business, sales growth, assets and facilities, management and workforce and a financial overview with historical information including capital expenditures. Audited financial statements were included.
KPMG 8/30/2011 Valuation Report prepared to comply with Accounting Standards Codification 805, Business Combinations[2]	Appellant's App'x Vol I, pp 826a–865a; VEC 0000144–183	Value of the tangible assets, the intangible assets consisting of existing customer relationships, work in process and/or committed to, value of trade name and assembled workforce, as well as goodwill accumulated over the life of the Company
Vectren Purchase Agreement	Appellant's App'x Vols I and II, pp 440a–597a	Terms and conditions of the sale; monies paid and liabilities assumed; real estate and tangible personal property transferred; list of service contracts and annual estimated cost; working capital schedules; MLI's sale price allocation; intellectual property transferred; customer list with prior two years of revenue by customer; contracts transferred;
MLI's State Tax Returns, including Michigan	Appellee's App'x Vol I, pp 230–706	Location of property in each state for the Short Period; wages paid in each state for the Short period; income sourced to each state, including the revenue and net income on the sale for the Short Period (based on each state's particular tax regime in effect for the Short Period); proof that MLI was subject to tax other states

[2] Purpose of the report was to determine the fair value of the intangible assets. See Appellee's App'x Vol II, pp 1094–1105 (Hirsch Dep 18:18–19:17).

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Enbridge Contract Documents	Appellee's App'x Vol II, pp 707–873; VEC 000212–219; 000221–378; VEC 000220	Uniqueness of contract; evidenced performance during winter months when the Company was generally idle due to weather and ground conditions
MLI's U.S. Tax Returns	Appellant's App'x Vol III, pp 913a–959a	Documents revenue and net income; accumulated depreciation, goodwill, retained earnings, cash on hand, loans and liabilities, and total equity of the Company
MLI's Financial Statements	Appellee's App'x Vol II, pp 874–899; VEC 000925–950	Documents revenue and net income, accumulated depreciation, goodwill, retained earnings, cash on hand, loans and liabilities, total equity of the Company
MLI's Depreciation Schedules and Fixed Assets Expense Reports	Appellee's App'x Vol II, pp 900–930; VEC 000408–438	Confirm the existence and current book value of all the fixed assets of the Company; the state tax returns demonstrate the location of these assets during the Short Period
MLI Disposal Reports 2007 – 2010; Equipment Sales/Exchange Receipts 2010	Appellee's App'x Vol II, pp 931–956; VEC 000719–744	Demonstrated sale of certain fixed assets in the normal course of business that would provide a basis for the proposal to source the revenue and net income based on the sale of assets
Personal Property Tax Reports (Michigan)	Appellee's App'x Vol II, pp 957–986; VEC 000895–924	Evidences location of fixed assets (i.e., tangible personal property) during the Short Period in Michigan
Customer Contract List and Valuations	Appellee's App'x Vol II, pp 987–989; VEC 000951–953	Verifies existing customer list and valuation of such intangible asset
Lurie, LLP Audited Financial Statements	Appellee's App'x Vol II, pp 990–1013; VEC000927–963	Several years of audited balance sheets, income and loss statements, and shareholder's equity
MLI Alternative Minimum Tax Reports	Appellee's App'x Vol II, pp Vol II 1014–1033; VEC000009–028	Evidences existence of each fixed assets with placed in service date

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Deposition of Brad Hirsch	Specific excerpts provided in Appellee's Appendix Vol II, pp 1094–1105	Demonstrates the computation of the value assigned to the intangible assets of the Company, by category and type, at the time of the Sale
Deposition of Doug Banning	Specific excerpts provided in Appellee's Appendix. Appellee's App'x Vol II, pp 1034–1040	Demonstrated purpose and intent of Buyer, and which assets of MLI Buyer were most highly desired
Deposition of Christopher Leines	Specific excerpts provided in Appellee's Appendix. Appellee's App'x Vol I, pp 1–14	Demonstrated the historical growth and development of the Company, development of sales activity, and location of business activities performed by the Company
Deposition of Jeffrey Starbird	Transcript provided in Appellee's App'x Vol II, pp 1106–1124	Demonstrated the filing of multiple state tax returns for the Short Period. The state tax returns evidenced sales income reported, the location of property in each state, and the payroll reported in each state

The above documentation, which is only a portion of the over 1,200 pages of business records submitted, supports the clear and cogent evidentiary standard. See MRE 803(6). In addition, Treasury had just completed an audit of MLI and its own audit workpapers verified the financial information above.[3] Treasury's allegations regarding the lack of evidence must fail. MLI met its burden by establishing by clear and cogent evidence that the application of the statutory formula of MCL 208.1303 apportioned a distortive amount of revenue from the sale to Michigan (70%) in proportion to the actual business transacted in the state, and led to a grossly distortive result.

[3] For an overview of the information reviewed during the audit, see the Michigan Business Tax Audit Report of Findings, Appellant's App'x Vol III, pp 884a–892a, VEC 000001–8.

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II. The Application of the Statutory Formula Results in Unconstitutional Taxation under both the Due Process Clause and the Commerce Clause.

A. The Due Process Clause

The Due Process Clause guarantees, "that no state shall deprive any person of life, liberty or property, without due process of law." *People v Sierb*, 456 Mich 519, 522; 581 NW2d 219 (1998) (internal citation omitted). Substantively, the Due Process Clause "protects individual liberty and property interests from arbitrary government actions." *GMC v Dep't of Treasury*, 290 Mich App 355, 370; 803 NW2d 698 (2010) (internal citations omitted). In considering whether a tax runs afoul of the Constitution, this Court must ask whether the tax "violates the Due Process Clause by taxing extraterritorial values." See *Trinova Corp v Michigan Dep't of Treasury*, 498 US 358, 387; 111 S Ct 818; 112 L Ed 2d 884 (1991). The Due Process Clause requires (1) "some definite link, some minimum connection, between a state and a person, property or transaction it seeks to tax," and (2) "that the income attributed to the state for tax purposes . . . be rationally related to values connected with the taxing state." *N Carolina Dep't of Revenue v Kimberley Rice Kaestner 1992 Family Tr.*, __ U.S. __; 139 S Ct 2213; 204 L Ed 2d 621 (2019). Courts recognize that "a State has no power to impose a tax on income earned outside of the State." *Mobil Oil Corp v Comm'r of Taxes of Vermont*, 445 US 425, 451; 100 S Ct 1223; 63 L Ed 2d 510 (1980) (STEVENS, J., dissenting).

B. The Commerce Clause

The Commerce Clause provides "The Congress shall have Power . . . [t]o regulate Commerce with foreign Nations, and among the several States, and with the Indian Tribes. U.S. Const. art. 1, § 8, cl. 3. The U.S. Supreme Court has recognized this limitation on state taxation, noting a state may not tax more than its fair share of interstate commerce. See *Asarco, Inc v Idaho*

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State Tax Comm, 458 US 307, 315; 102 S Ct 3103; 73 L Ed 2d 787 (1982). To determine whether a tax is valid under the Commerce Clause, the Supreme Court has used the following four factors:

1) The tax must be applied to an activity that has a substantial nexus with the state;
2) The tax must be fairly apportioned to activities carried on by the taxpayer in the state;
3) The tax must not discriminate against interstate commerce; and
4) The tax must be fairly related to services provided by the state.

Complete Auto Transit, Inc v Brady, 430 US 274, 277–78; 97 S Ct 1076; 51 L Ed 2d 326 (1977). Under this Commerce Clause inquiry, MLI alleges, and the Court of Appeals twice found, that the statutory formula, *as applied to the facts of this case*, fairly apportions a tax on the gain from the sale of MLI to MLI's activities in Michigan.

MLI does not dispute that it owes *some* Michigan tax, as it acknowledges that it carried on business in Michigan and therefore, is subject to taxation. Its contention is that as in *Hans Rees'*, the statutory formula as applied, results in unconstitutional taxation by apportioning almost 70% of the gain on the sale to the state, despite MLI's historical Michigan apportionment ranging from 4% to 39.28%, with the average for the decade prior to the Short Year being 6.782%. A summary of its prior decade of apportionment, as filed on its Michigan tax returns, demonstrates:

YEAR	MICHIGAN SALES	EVERYWHERE SALES	APPORTIONMENT	TEN YEAR AVERAGE
2001	0	$19,577,034	0.0000	
2002	0	$25,255,248	0.0000	
2003	$522,713	$38,328,523	0.0137	
2004	$1,428,969	$42,391,279	0.0337	
2005	$1,101,714	$46,556,704	0.0222	
2006	$1,011,461	$48,270,114	0.0210	
2007	$957,516	$99,876,379	0.0096	
2008	$3,341	$155,164,472	0.00002	
2009	$3,136,684	$121,058,709	0.1852	

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2010	$43,352,830	$110,365,790	0.3928	.06782

Supplemental Submission to Treasury Appellee's App'x Vol I, pp 52–224 (Gursky Letter #2, December 14, 2016). The statutory formula results in an apportionment formula that exceeds a ten-fold increase of the average. This distortion far exceeds the level of gross distortion in *Hans Rees'*. Yet, Treasury alleges that MLI cannot show any distortion. Appellant's Brief p 22.[4] Never in the history of the Company, but for the three months of the Short Year, did MLI earn anywhere near 70% of its revenue from Michigan. As shown in the record, as well as in the chart above (Everywhere Sales), the majority of its revenue had been earned in states other than Michigan. Appellee's App'x Vol I, pp 1–14 (Leines Dep 59:8–21); Appellant's App'x Vol II, pp 826a–865a (KPMG Draft Valuation); Appellee's App'x Vol II, pp 874–899 (MLI Financial Statements (VEC 000925–950 in Plaintiff's Response to Department's Third Discovery Requests)).

C. The Unique Facts and Circumstances Contribute to Unconstitutional Taxation.

The underlying rational for formulary apportionment grew out of the difficulty of geographically identifying the source of income earned by a multistate business. *Trinova Corp*,

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[4] Treasury alleges that the Request for Alternative Apportionment (Appellant's App'x Vol III, p 866a–873a), along with the supplemental submission –Appellee's App'x Vol I, pp 52–224 (Gursky Letter December 14, 2016)—and its accompanying 165 pages of business records, lack foundation and, at best, "are an attorney prepared letter." Treasury's argument dismisses the magnitude of an attorney's signature on a document. *See* MCR 2.114(D) (An attorney's signature "constitutes a certification by the signer that (1) he or she has read the document; (2) to the best of his or her knowledge, information, and belief formed after reasonable inquiry, the document is well grounded in fact and is warranted by existing law or a good-faith argument for the extension, modification, or reversal of existing law; and (3) the document is not interposed for any improper purpose such as to harass or to cause unnecessary delay or needless increase in the cost of litigation."). Furthermore, Treasury's citation to *People v Benton*, 294 Mich App 191, 202 817 NW2d 599, 606 (2011) is unrelated to the proposition for which it was cited. *Benton* dealt with a Confrontation Clause issue, not the weight that should be given to a document prepared by an attorney.

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498 US at 373. Formula apportionment does not purport to identify the precise geographical source of a taxpayer's income, but is intended to be only a rough approximation of a taxpayer's income related to the activities conducted within a state. *Moorman Mfg Co v Bair*, 437 US 267, 273; 98 S Ct 2340, 2344; 57 L Ed 2d 197 (1978). There is both an internal consistency test and an external consistency test. Internal consistency looks at the structure of the tax and measures whether the apportionment formula, if adopted by all states would discriminate again interstate commerce in favor of intrastate commerce. The external consistency test looks at whether a state's tax reaches beyond that portion of value that is fairly attributable to a taxpayer's economic activity within the taxing state, so as to cause extraterritorial taxation. *Oklahoma Tax Comm'n v Jefferson Lines, Inc*, 514 US 175, 175–76; 115 S Ct 1331; 131 L Ed 2d 261 (1995).

No specific formula must be used, it is only required that ". . . the formula must fairly determine the portion of income that can be 'fairly attributed to in-state activities.'" *Container Corp of America*, 463 US at 169. As applied to the unusual facts of this case, the statutory formula does not "fairly determine the portion of income that can be fairly attributed to in-state activities", resulting in a "grossly distortive" or disproportionate apportionment of MLI's revenue to limited in-state activities.

MLI does not allege that the statutory formula, on its face, is unconstitutional as it is limited to a single sales factor. MLI concurs with Treasury that single-factor apportionment can be constitutional. Appellant's Brief p 29, n 3 (citing *State Tax Assessor v Kraft Foods Grp, Inc*, 2020 ME 81; 235 A3d 837 (2020)). The court in *Kraft Foods* found that, even if the sales factor varied by less than one percent, the apportionment formula could still be unconstitutional, if application of the sales factor formula would

> not fairly represent the extent of the taxpayer's business activity in [Maine], the taxpayer may petition for, or the tax assessor may

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> require, in respect to all or any part of the taxpayer's business activity, if reasonable . . . [t]he employment of any other method to effectuate an equitable apportionment of the taxpayer's income." M.R.S. § 5211(17).

Id. Recognizing the flexibility the Maine legislature built into the statute for unusual cases, the court stated that, this provision was enacted to allow the tax assessor to depart from the statutorily prescribed apportionment method in "exceptional circumstances." *Id*. Nor has MLI advocated for the use of geographical accounting.

MLI had been in business for fifty-two (52) years prior to the sale. The gain from the sale was the result of the Company's activities over the course of more than half a century, and was attributable to the value of the tangible assets, the intangible assets, and the goodwill accumulated from the family's labor conducted primarily outside of Michigan during the Company's history. Headquartered in Minnesota, the operations of the business were primarily directed and managed from Minnesota. Chris Leines confirmed that at the time of the sale, MLI conducted operations in 24 states, which were "predominately in Minnesota, Wisconsin, Iowa, [and] [the] Dakotas." Appellee's App'x Vol I, pp 1–14(Leines Dep, 13:23–14:9.) When asked about activities in Michigan at the time of acquisition, Leines indicated that there was only the Enbridge contract. *Id*. at 39:4-14; 39:24-25 ("we weren't doing much work in Michigan"). This is verified by the Offering Memorandum, federal and state income tax returns, and audited financial statements.[5]

[5] Appellant devotes significant text to a discussion of the Antrim Shale Basin in an attempt to vaguely argue the location of this shale deposit as somehow relevant to the apportionment of almost 70% of the sale gain to Michigan. The Antrim Shale Basin might have offered future business opportunity, but it was not relevant to neither Vectren nor MLI at the time of the sale. See Appellee's App'x Vol II, pp 1034–1040 (Banning Dep 45:6–12; 47:21–24; 49:10–13); Appellee's App'x Vol I, pp 1–14 (Leines Dep 39:15–40:2.)

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This is history is reflected in KPMG's Valuation Report. On Schedule 1, KPMG noted that MLI believes that "Revenue growth attributable to existing customers [is] expected to be approximately 80.0% of total revenue growth." Appellant's App'x Vol II, n 1, p 861a (KPMG Draft Valuation). In short, a substantial portion of MLI's value stemmed from its existing customer base, a customer base that existed for work primarily in Minnesota, Wisconsin, Iowa, and the Dakotas. Treasury is attempting to tax revenue that was the result of activities, long time relationships and goodwill primarily derived from operations in states other than Michigan.

The record further substantiates that MLI's sales in Michigan in the decade prior to the sale averaged 6.782%, ranging from a low of 0% to a high of 39.28%. Appellee's App'x Vol I, pp 230–706 (MLI State Tax Returns.) It was only shortly before the sale that MLI was awarded the Enbridge contract. The contract was anomalous for several reasons. First, MLI commenced work on the contract in the winter months of 2010, when its business operations were generally slow due to weather conditions. Second, the contract created the appearance of greater Michigan sales in comparison to historical Michigan sales, as the Short Period represented only 3 out of the 624 months MLI had been in existence. As a result, MLI's Michigan business activities appeared much more extensive than they truly were.

The Court of Appeals appropriately summarized the impact of these factual circumstances, "[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." Appellant's App'x, Vol I, p 34a (Michigan Court of Appeals, Opinion issued September 30, 2021). The apportionment of almost 70% of the gain from the sale of the Company,

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when MLI's historical apportionment rate was 6.782%, demonstrates that the application of the statutory formula measured by the Short Year does not fairly determine the portion of income from the sale attributable to in-state activities.

D. The Inclusion of the Revenue in the Tax Base, but not in the Apportionment Formula Creates Further Distortion.

MCL 208.1303(1) provides that "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." The application of this statutory formula further exacerbated the unconstitutional result, as the inclusion of the gain in the tax base, while excluding the gain from the apportionment formula creates an asymmetry in the relationship of the tax base to the statutory formula. See Appellant's App'x Vol I, p 51a, n 2 (Michigan Court of Appeals, Opinion issued September 30, 2021). "As for plaintiff's additional argument that including the sale of the business in the tax base, but not in the sales factor, is impermissibly inconsistent, that is a large contributing factor, at least in the context of this case, to the conclusion that this represents a constitutional violation." *Id.* This asymmetry enhances the distortive result, as the resulting tax lacks factor representation in its computation.[6]

Treasury's MBTA Frequently Asked Questions page provides, "if a transaction is not a sale under MCL 208.1115, it will be excluded from both the numerator and the denominator of the sales factor. Sales under MCL 208.1115 may still be included in the business income and modified gross receipts tax bases. Appellee App'x Vol II, pp 1125–1301 (Michigan Business Tax

[6] MLI has asserted that there would be a due process violation as well, as the statutory formula would reach income earned outside of the state's borders, to which the state lacks the power to tax.

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Frequently Asked Questions). Michigan tax practitioners have discussed such asymmetry, often referenced as "factor representation," and the inconsistency of using different definitions in the tax base and the apportionment factor:

> This FAQ seems to indicate that items that are not "sales" may nonetheless be items of income or gross receipts that would be included in the respective bases without any kind of factor representation. The SBT provisions included a rule that excluded items from the sales definition if not included in the tax base for dividends, interest and royalties deducted from the tax base under MCL 208.9(7). The MBT Act provides no such rule for either the business income or modified gross receipts tax base. However, the limitation of "sales" to items derived from business activity and reference to that term in the business income definition may create a different result for that base than the seemingly expansive definition of gross receipts used for the modified gross receipts base.

Murphy, *Michigan Business Tax Apportionment and Sales Sourcing Provisions*, 53 Wayne L. Rev. 1395, 1403 (2007) (internal quotation omitted).

The concept is simple: if a state includes income in the apportionable base but excludes the receipts and related factors that generated that income from the apportionment formula, that inconsistency can cause distortion, as it has done here. Factor representation is a means of ensuring that the factors of an apportionment formula include representation of the factors related to the generation of that income. The factor should not be included in the base and excluded from the factor, nor vice versa. Here, the inconsistency of the statutory assisted in creating a grossly distortive result.

III. The Remand does not Conflict with MCL 208.1309(2).

Treasury fails to cite authority for its suggestion that Treasury alone should *determine* the alternate method of apportionment. It cannot, as Treasury's statutory authority is limited *to approving* an alternative apportionment method; it need not be the sole creator or contributor of such method. MCL 208.1309(2) ("An alternate method may be used only if it is approved by the

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department."). The statute provides that the alternative must be reasonable, and "fairly represent the taxpayer's business activity in the state" and "effectuate an equitable allocation of apportionment of the taxpayer's tax base." *Id*. In its Opinion on Remand (Appellant's App'x Vol I, at 51a (Michigan Court of Appeals, Opinion issued September 30, 2021)), the Court of Appeals remanded to the Court of Claims to "determine an appropriate alternative apportionment method if the parties are unable to agree on one." There was no suggestion that Treasury would not have its statutory authority to approval the reasonable alternative. The remand anticipates that only if the parties be unable to reach consensus, would judicial intervention be appropriate.

A. Revenue Administrative Bulletin 2018-28

Treasury argues that MCL 208.1309(2) requires taxpayers be removed from the process. Such argument is contrary to the words and spirit of MCL 208.1309 as well as the language of RAB 2018-28, *Alternative Apportionment for the Michigan Business and Income Taxes,* issued December 19, 2018 (RAB). Appellee's App'x Vol II, pp 1073–1087 (RAB 2018-28). The RAB, which while not having the force of law, is afforded respectful consideration as guidance from an administrative agency. *In re Rovas Complaint*, 482 Mich 90, 105; 754 NW2d 259 (2008). It confirms that when requesting alternative apportionment, a taxpayer is involved in proposing alternatives, and indeed, instructs taxpayers to "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."[7] The RAB directs taxpayers to make their requests in writing, provide a statement of reasons why they believe the statutory method does not fairly represent the activities of the taxpayer in Michigan, attach documentation to explain the nature of the taxpayer's business,

[7] Note, the RAB was issued subsequent to the commencement of this litigation.

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as well as to justify the proposed alternatives. Appellee's App'x Vol II, pp 1073–1087 (RAB 2018-28, p 6). As noted in the RAB, the reasonableness of the proposed alternative looks to whether "the proposed method reflects the economic reality of the taxpayer's business activity in Michigan." *Id*. at p 9.

There is no reason, statutory or otherwise, that would prohibit the Department and the taxpayer to collaborate to determine a reasonable alternative apportionment method. Once the parties identify a reasonable alternative method, Treasury can exercise its statutory authority *to approve* such method. Of course, any method ultimately approved by Treasury must be "reasonable." MCL 208.1309(1).

B. This Court has the Authority to Direct Treasury to Engage in Alternative Dispute Resolution

Courts have the power to review decisions made by administrative agencies. See e.g., *Manufacturers Nat'l Bank v Director of Dep't of Natural Resources*, 420 Mich 128, 146; 362 NW2d 572 (1984) (finding that "To the extent that an administrative order conflicts with a statute, the order is void."). Indeed, "Even if a reviewing court gives deference to the expertise of the administrative agencies, courts must not abandon or delegate their responsibility to interpret legislative intent." Appellee's App'x Vol II, pp 1088-1093 (Erikson, *Judicial Administrative Review*, Mich Bar J. (2002)). Likewise, this Court has explicitly stated:

> It is the duty of courts to construe language of the statute and while the construction given to a statute by those charged with the duty of executing it is always entitled to the most respectful consideration and ought not to be overruled without cogent reasons, such construction is not binding upon the courts.

Paye v Grosse Pointe, 279 Mich 254, 259–60; 271 NW2d 826 (1937) (internal citation and quotation omitted).

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In this case, the Court of Appeals in its Opinion on Remand was simply exercising its authority to ensure that Treasury would appropriately bring to bear its authority contained within MCL 208.1309(2). It is not attempting to usurp Treasury's approval power under the statue. The Court was acknowledging that approval and determination are not interchangeable.

This Court has previously considered a case involving a request for a reasonable apportionment formula. In *Detroit Edison Co v Dep't of Treasury*, 498 Mich 28; 869 NW2d 810 (2015), this Court determined DTE was "entitled to the industrial-processing exemption based on the 'percentage of exempt use to total use determined by a reasonable formula or method approved by the department [of Treasury]' " under MCL 205.94*o*(2). *Id*. at 32. Although the use tax statute in *DTE* is not identical to MCL 208.1309, they are comparable in several ways. First, both MCL 205.94*o*(2) and MCL 208.1309 address the concept of apportionment. Second, both provisions outline the process for using a reasonable alternative method, which Treasury is to approve, rather than determine.

In *DTE*, this Court recognized the distinction between approval and determination, "To be clear, we do not purport to recite a formula that applies to this case or any other case. Rather, MCL 205.94o(2) is quite clear that the reasonable formula or method must be approved by the department of Treasury." *Id.* at 54. This Court noted that when an apportionment formula is at issue, it will "in many cases be a highly fact-specific inquiry that depends on a multitude of considerations." *Id*. at 51–52.

This Court again faces a question of how a reasonable apportionment formula can be determined. As anticipated in *DTE*, this inquiry will be a "highly fact-specific inquiry." For that very reason, directing the parties to collaborate on a reasonable alternative to be approved by Treasury is grounded in the language of the statute. As noted in the chart *supra*, allegations

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regarding a lack of information to determine a reasonable alternative is bewildering given the record evidence and Treasury's conduct of an audit for the Short Period. The record is sufficient to determine a reasonable alternative formula that would permit Michigan to tax the appropriate portion of the gain on the sale that is reasonably connected to MLI's activities in the state over its 52-year history.

CONCLUSION AND REQUESTED RELIEF

For the reasons set forth above, this Court should conclude that 1) MLI has met its clear and cogent evidence burden; 2) the application of the statutory apportionment formula runs afoul of the Commerce Clause and Due Process Clauses; and 3) the order for remand does not conflict with Treasury's power to approve the alternative apportionment formula. Appellee further requests that in the interests of judicial efficiency, this Court consider 1) identifying which of Plaintiff's proposed alternatives are reasonable; 2) ordering alternative dispute resolution to assist in determining a reasonable alternative; or 3) appoint a special master to hold proceedings as to a reasonable alternative, to be ultimately approved by Treasury.

Dated: May 25, 2022

Respectfully submitted,

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