

Enacted Michigan Law Retroactively Repeals the Multistate Tax Compact and Provides Retroactive MBT Changes

September 12, 2014

Overview

On September 11, 2014, Michigan Governor Snyder signed Senate Bill 156 ("SB 156"), repealing retroactively MCL §§ 205.581 to 205.589, the Multistate Tax Compact ("Compact") provisions of Michigan law, and adopting various retroactive amendments to the Michigan Business Tax ("MBT") Act.¹ This new law comes on the heels of the July 14, 2014, Michigan Supreme Court decision in *International Business Machines v. Michigan Department of Treasury* ("IBM"). In *IBM* the court held that the taxpayer could elect to compute both the Modified Gross Receipts Tax and the Business Income Tax components of its 2008 MBT liability using the Compact election (Compact Article III) in lieu of the 100% sales-weighted apportionment formula under the MBT Act.² By application of the Compact election, the taxpayer was allowed to use an equally-weighted, three-factor apportionment formula (property, payroll and sales).³

In this Tax Alert we summarize the retroactive repeal of the Compact and certain retroactive MBT amendments contained in SB 156. We also provide taxpayer considerations in light of these law changes.

Retroactive Legislation

Following the *IBM* decision, the Michigan Department of Treasury ("Treasury") stated in its Motions filed with the Supreme Court⁴ that the cost of the *IBM* decision would be a "budget-busting aggregated refund . . . to mostly out-of-state corporations" in excess of \$1 billion.⁵ While no basis was provided for this estimated refund, the specter of such a budgetary result had the anticipated effect on the Michigan legislature. With unusual speed, the Michigan House and Senate passed SB 156 with few votes in opposition. Governor Snyder signed the bill two days later.

Unlike previous action by the Michigan legislature to limit the scope of the Compact election,⁶ SB 156 provides for an outright repeal of all elements of the Compact, which were originally enacted into Michigan law in 1969. And, of greatest significance, the Compact provisions are "repealed retroactively and effective beginning January 1, 2008[.]" with "the intent . . . that the repeal . . . is to express the original intent of the legislature regarding the application of section 301 [providing for the 100% sales-weighted apportionment formula] of the Michigan business tax act"⁷

Due Process Considerations

Significant questions exist regarding whether retroactive tax legislation,⁸ reaching back over six years, would survive scrutiny under the Due Process Clause of the U.S. Constitution. In *United States v. Carlton*, the U.S. Supreme Court upheld a retroactive amendment to the Internal Revenue Code that reached back slightly more than one year. In doing so, the Supreme Court concluded that the amendment's retroactive application met the requirements of due process because Congress' purpose in enacting the amendment was neither illegitimate nor arbitrary, and

¹ Public Act 282 of 2014, repealing MCL §§ 205.581 to 589; signed by Governor Snyder on Sept. 11, 2014, and filed with the Secretary of State on Sept. 12, 2014.

² *International Business Machines v. Michigan Department of Treasury*, Mich. Supreme Court Docket No. 146440 (Jul. 14, 2014).

³ The background, judicial history and implications of the *IBM* decision were discussed in detail in the [Deloitte Tax Alert dated July 16, 2014](#).

⁴ In response to the *IBM* decision, Treasury filed two motions with the court on August 4, 2014: a Motion for Rehearing, requesting that the court reconsider its decision; and a Motion to Stay, asking that the court suspend the effects of the case pending the outcome of the Motion for Rehearing. The Michigan Supreme Court has yet to rule on these Motions.

⁵ *International Business Machines v. Michigan Department of Treasury*, Motion for Rehearing of Appellee Department of Treasury of the State of Michigan (Aug. 4, 2014).

⁶ See PA 40 of 2011, which disallowed the Article III Compact election "beginning January 1, 2011."

⁷ PA 282 of 2014, enacting Section 1 (at 39-40).

⁸ Many other questions and uncertainties are raised by seeking to withdraw Michigan from membership in the Compact nearly six years in the past. Michigan's involvement in Multistate Tax Commission ("Commission") committees or participation in Commission audits since January 1, 2008, may potentially be invalidated, with unknown consequences for all parties.

because “Congress acted promptly and established only a modest period of retroactivity.”⁹ By comparison, in upholding an unfavorable retroactive tax law change, a Michigan appellate court found that a relatively lengthy period of retroactivity withstood Due Process scrutiny. However, the facts addressed by that appellate court may be distinguishable from the facts generally applicable to many taxpayers that are challenging Treasury’s disallowance of the Compact election on previously filed MBT returns.

Taxpayer Considerations

To date, taxpayers that have challenged Treasury’s disallowance of the Compact election on previously-filed MBT returns have requested an Informal Conference at the administrative hearing level or pursued an appeal before the Michigan Tax Tribunal or the Michigan Court of Claims. In nearly all instances, these protests or appeals have been held in abeyance. While it is unclear whether Treasury will seek to move these matters to some sort of unfavorable resolution as a result of retroactive repeal of the Compact provisions, the high likelihood of additional litigation regarding the constitutionality of SB 156 suggests that any Treasury action on pending hearings or protests may be premature.

Retroactive MBT Changes

SB 156, as originally proposed in February 2013, sought only to address a number of technical deficiencies in the MBT Act. These proposed changes were retained in the enacted version of SB 156, and provide for the following amendments to the MBT Act (effective for tax years beginning “on and after January 1, 2010”¹⁰):

- Addition of a specific exclusion from the definition of gross receipts for amounts attributed to a taxpayer pursuant to discharge of indebtedness as described under IRC § 61(a)(12), including forgiveness of a nonrecourse debt.¹¹
- Revisions to the manner in which a taxpayer located and conducting business activity in a Renaissance Zone prior to December 1, 2010, computes its Renaissance Zone Credit.¹²
- Addition of language to the Investment Tax Credit recapture provisions to provide for a tax benefit-type rule upon the disposition of Michigan-sitused assets acquired during MBT tax years.¹³

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⁹ *United States v. Jerry Carlton*, 512 US 26, 114 S Ct 2018 (1994).

¹⁰ PA 282 of 2014, enacting Section 2 (at 40). Note that it is unclear whether the legislature may have meant “on or after January 1, 2010” as the applicable effective date.

¹¹ PA 282 of 2014, adding MCL § 208.1111(1)(ff).

¹² PA 282 of 2014, amending MCL § 208.1433.

¹³ PA 282 of 2014, amending MCL § 208.1403(3).