

Michigan – Trial court rules MTC is a binding compact, apportionment election applicable to business income tax base of the MBT

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In brief

On June 6, 2013, a Michigan trial court held that the Multistate Tax Compact (MTC) is a binding compact that cannot be repealed by a conflicting statute. Accordingly, the business income tax base of the Michigan Business Tax (MBT) may be apportioned pursuant to the MTC. However, because the MBT's modified gross receipts tax base is not an 'income tax,' it cannot be apportioned according to the MTC. This decision represents a departure from the Michigan appellate court's recent opinion holding that the MTC election is not available to MBT taxpayers. Michigan taxpayers should consider protective refund claims under the MBT consistent with the rationale in this opinion. [*Anheuser-Busch, Inc. v. Michigan Department of Treasury*, Michigan Court of Claims, No. 11-85-MT (6/6/13)].

In detail

MTC history

In its decision, the Michigan trial court found it instructive to review a brief history of the MTC. The court acknowledged that development of the MTC stemmed from Congress' attempt to enact legislation, following the 1959 US Supreme Court decision in *Northwestern Cement Co. v. Minnesota*, to establish uniform standards for states to tax the income of interstate businesses. In response to the developing Congressional legislation, the MTC was drafted with the purpose of promoting

uniformity and compatibility in state tax systems.

Article III of the MTC allows a taxpayer to elect to apportion income taxes according to the member state's laws or according to an equally-weighted three-factor formula of sales, property, and payroll. Article X of the MTC permits any member state to withdraw at any time by enacting a statute repealing the MTC. Michigan adopted the MTC by statute effective July 1, 1970.

Facts

During the 2008 to 2010 tax years, Michigan imposed the Michigan Business Tax, which

consisted of two tax bases: (1) the business income tax (BIT); and (2) the modified gross receipts tax (MGRT). Anheuser-Busch filed its original MBT returns computing liability according to the three-factor apportionment provisions of Article IV of the MTC for both the BIT and the MGRT bases.

The Multistate Tax Compact is a binding compact

The court observed that a statute may be deemed to be a binding contract when the statutory language (1) plainly provides that the Legislature intended it to be a binding contract and (2) demonstrates

an intent to surrender legislative power and bind future Legislatures.

The court, citing a 1976 District Court Case, *Hellmuth v. Washington Metropolitan Area Transit*, recognized that the effect of a state entering into an interstate compact functions as follows:

“Upon entering into an interstate compact, a state effectively surrenders a portion of its sovereignty; the compact . . . is superior to both prior and subsequent law. Further, when enacted, a compact constitutes not only law, but a contract which may not be amended, modified, or otherwise altered without the consent of all parties.”

The court found that the MTC plainly states an intent to enter into a binding contract by referring to itself as a “compact.” The court referred to Black’s Law Dictionary to define “compact” as an “agreement or contract between persons, nations or states,” thereby demonstrating a clear intent to enter into a contractual relationship.

Additionally, the court found that the MTC demonstrates an intent to limit the Legislature’s power by providing that a state may only withdraw from the MTC by “enacting a statute repealing the same.” As a result, the court found that “enactment of the MBT cannot impair the election provision of the MTC.”

The court agreed with a recent Michigan appellate court decision, *Int’l Business Machines, Corp. v. Dep’t of Treasury*, which held that the MTC’s apportionment election and the

MBT’s apportionment provision could not be reconciled. However, while the appellate court resolved the conflict in favor of the MBT’s apportionment, the trial court here determined that the MTC “controls and functions as an exception to the mandatory language of the MBT.”

The BIT base is an income tax subject to the MTC’s election provision

The MTC’s election applies only to taxes “imposed on net income.” The MTC defines an “income tax” as “a tax imposed on or measured by net income including any tax imposed on or measured by an amount arrived at by deducting expenses from gross income, 1 or more forms of which expenses are not specifically and directly related to particular transactions.”

The court found that the MBT’s BIT base is a tax imposed on a taxpayer’s business income after allocation or apportionment, which qualifies as a “tax imposed on net income” under the MTC.

The MGRT base is not an income tax, the MTC’s election provision does not apply

For a tax to qualify as an income tax under the MTC, the tax must provide deductions for expenses that are “not specifically and directly related to particular transactions.” The court determined that such deductions reflect value derived by the taxpayer from the economy.

The court found that the MGRT was not an income tax because its ‘purchases from other firms’ deduction represents the value added

to goods by the taxpayer related to particular transactions, which ultimately reflects the value the taxpayer has added to the economy – not the value derived by the taxpayer from the economy. Accordingly, the court held that the MTC apportionment election does not apply to the MGRT base.

Additional reading

[Click here](#) for our summary of the Michigan Appellate Court’s *Int’l Business Machines, Corp.* decision.

[Click here](#) for our article titled, *The impact of Multistate Tax Compact withdrawals on the joint audit program.*

The takeaway

While the *Anheuser-Busch* decision is a taxpayer victory, both parties have 21 days from the date of the decision to file a motion for reconsideration with the trial court. To the extent reconsideration is not granted or it does not provide the relief requested the Department is likely to appeal, and the Taxpayer may appeal the MGRT ruling.

Michigan enacted legislation effective January 1, 2011, that purports to preclude taxpayers from apportioning income under the MTC. However, it remains questionable whether Michigan’s attempt to override the MTC’s apportionment election would be valid under the rationale expressed in *Anheuser-Busch*. Michigan taxpayers should consider protective refund claims under the MBT applying the MTC’s equally-weighted three-factor apportionment formula for open years.

Let's talk

For more information on the *Anheuser-Busch* decision, or how the MTC apportionment election may affect your business, please contact:

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