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## *Michigan: Taxpayers may not elect to apportion income based on MTC three-factor formula*



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### **In brief**

On November 20, 2012, in a per curiam decision, the Michigan Court of Appeals denied a taxpayer's right to elect to apportion its income using the equally weighted three-factor formula provided in the Multistate Tax Compact. The Michigan Business Tax Act repealed by implication the election provision found in the Compact and the taxpayer did not seek permission to use an alternative apportionment method.

[[International Business Machines Corp. v. Department of Treasury](#), Mich. Ct. of App., No. 306618, 11/20/12]

### **In detail**

#### *IBM's Procedural History*

International Business Machines Corp. (IBM) filed its 2008 Michigan Business Income Tax and Modified Gross Receipts Tax returns using the equally weighted three-factor apportionment formula contained in the Compact, codified in Michigan law at MCL 205.581 et. seq. Based on its calculations, IBM was entitled to a tax refund of \$6M. However, using the single sales factor apportionment formula contained in the Michigan Business Tax Act (Act), the Department determined that IBM was only entitled to a \$1.3M tax refund.

The Court of Claims agreed with the Department and held that IBM was required to use the formula set forth in the Act, or to petition for approval for an alternate formula pursuant to the Act.



### *Compact election repealed by implication*

On appeal the Court noted that this case involved questions of statutory construction, namely, whether the Act mandated the use of an apportionment method. IBM contended that the calculation set forth in the Act is optional and that it was permitted to elect to apportion its income using the Compact.

MCL 205.581(1)(Art III)(1) provides that taxpayers may elect to apportion and allocate income in accordance with the Compact. However, under MCL 205.1301(1) and (2) taxpayers are required to apportion income in accordance with "this chapter" using a single sales factor formula specified in the Act. There is a facial conflict between the two provisions. The Act mandates single sales factor apportionment while the Compact mandates that taxpayers have an election.

[Note that MCL 205.851 was subsequently amended to explicitly provide that the election is unavailable after January 1, 2011. However, the Court deemed this amendment irrelevant to the case at hand.]

The Court noted that the Act contains a provision, MCL 208.1309(1), under which taxpayers may seek permission or may be required to use an alternate apportionment methodology when the statutory formula does not fairly represent the extent of the taxpayer's business in the state. In contrast, the Compact permits an "election of right" based on "pure whim." While the two provisions serve completely different purposes, they neither conflict with nor are rendered meaningless by each other.

The Court next turned to whether the Compact apportionment election was repealed. While it noted that repeals by implication are disfavored, there is "no way to harmonize" MCL 205.581 and MCL 208.1301 and if two statutes are in irreconcilable conflict, the later-enacted or more specific statute controls. In this case, the Act is not only newer in time, but also more specific. IBM argued that the Compact apportionment election remained dormant until Michigan enacted an income tax law providing a different apportionment method. However, the Court disagreed with this argument and held that the plain language of MCL 208.1301 which states "except as provided in this act", "absolutely precludes any other apportionment except by petition pursuant to MCL 208.1309."

### *The Compact is not a binding contract*

IBM further argued that the Compact is a binding contract. The Court found this unpersuasive, explaining that the Michigan Supreme Court has held that a statute will not be deemed a contract in the absence of "exceedingly clearly-expressed intent by the Legislature." This requires the Legislature to use specific words such as "contract" or "covenant" or to otherwise explicitly "surrender its power to make such changes." In this case, no such words were used. Additionally, the Michigan Constitution provides that the "power of taxation shall never be surrendered, suspended or contracted away."

Further, the Court found that, in general the Compact provides that any portion found in conflict with a state's constitution is severable. The Compact provides that party states may withdraw at any time by enacting a repealing statute. While the Court acknowledged that enacting a conflicting statute may be an improper way to repeal the Compact, it is not an impermissible one.

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## ***Let's talk***

If you have any questions about the *IBM* decision, please contact one of the following individuals:

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