

STATE OF MICHIGAN
COURT OF APPEALS

OHIO SAVINGS BANK,

Plaintiff-Appellant,

v

DEPARTMENT OF TREASURY,

Defendant-Appellee.

UNPUBLISHED

October 13, 2009

No. 284656

Court of Claims

LC No. 07-000007-MT

Before: Talbot, P.J., and Wilder and M. J. Kelly, JJ.

PER CURIAM.

Plaintiff appeals as of right a Court of Claims order granting summary disposition to defendant under MCR 2.116(I)(2). The court held that, under the Michigan Single Business Tax Act (SBTA), MCL 208.1 to MCL 208.145,¹ plaintiff was required to pay a single business tax for business activities in Michigan that resulted in income even though the income was received at addresses outside of the state. The court also declined to waive a penalty assessed to plaintiff for failure to file and pay taxes. Because we conclude that there were no errors warranting relief, we affirm.

Plaintiff argues that MCL 208.65 was interpreted incorrectly to include interest income that was not received in Michigan, that a Revenue Administrative Bulletin (RAB) on the topic was invalid because it contravened MCL 208.65, and that the RAB at issue should not have been applied retroactively. Plaintiff also argues that an alternative statute applied for purposes of sourcing its income, and that it should not have been assessed a penalty for failure to file and pay taxes. This Court reviews de novo both a trial court's decision on a motion for summary disposition and questions of statutory interpretation. *Eggleston v Bio-Medical Applications of Detroit, Inc.*, 468 Mich 29, 32; 658 NW2d 139 (2003); *Maiden v Rozwood*, 461 Mich 109, 118; 597 NW2d 817 (1999).

Plaintiff is based in Cleveland, Ohio, and had branch offices in Arizona and Florida. During the relevant period, plaintiff's business activities included offering banking services, such as issuing loans and credit cards, and buying bundles of mortgages from loan brokers. After

¹ The SBTA was repealed in 2006. 2006 PA 325.

auditing plaintiff's business activities in Michigan for the period from October 1, 1998 to September 30, 2001, defendant assessed a tax on plaintiff in the amount of \$608,446. Defendant also billed plaintiff for \$226,394.56 in interest and \$152,115 as a penalty, for a total liability of \$986,955.56. During the relevant period, plaintiff received payments for loans that were secured by property located in Michigan, and received credit card payments from customers located in Michigan. None of the payments received by plaintiff were sent to a Michigan address. Plaintiff only had a single employee in Michigan, who purchased loan bundles from brokers. Defendant assessed the tax against these business activities.

Plaintiff first argues that, based on the language of MCL 208.65, only interest income received in Michigan was subject to the SBTA. A financial organization, such as plaintiff, apportions its income to Michigan sources based on MCL 208.65. MCL 208.65 provides:

The tax base of a financial organization attributable to Michigan sources shall be taken to be:

(a) The entire tax base of a taxpayer whose business activities are confined solely to this state.

(b) In the case of a taxpayer whose business activities are conducted partially within and partially without this state that portion of its tax base as its gross business in this state is to its gross business everywhere during the period covered by its return. Gross business includes the sum of:

(i) Fees, commissions, or other compensation for financial services.

(ii) Gross profits from trading in stocks, bonds, or other securities.

(iii) Interest charged to customers for carrying debit balances of margin accounts, without deduction of any costs incurred in carrying the accounts.

(iv) Interest and dividends received.

(v) Any other gross income resulting from the operation as a financial organization.

In this case, the parties dispute whether MCL 208.65(b)(iv) requires plaintiff to include, as single business tax gross business, interest payments it received at addresses outside of Michigan from loans made that were secured by property in Michigan or made to borrowers located in Michigan. Plaintiff argues that MCL 208.65 defines gross business as interest and dividends received, and that "in this state" modifies the first reference to "gross business" in MCL 208.65(b). Therefore, it argues, the plain reading of the statute in MCL 208.65(b) would be that plaintiff's tax base includes "interest and dividends received in this state" Thus, plaintiff concludes, its portion of gross business sourced to Michigan is zero because it received no interest in this state.

This Court has already addressed—and rejected—a similar argument. In *PNC Bank Nat'l Association v Dep't of Treasury*, ___ Mich App ___, ___; ___ NW2d ___ (2009), PNC

argued that, although it received interest income from loans that were secured by real property in Michigan and from unsecured loans made to Michigan customers, the interest from those loans could not be included when calculating its tax under the SBTA because it received payments from these transactions at an address outside Michigan. This Court stated that it was unconvinced that PNC's interpretation of MCL 208.65(b)(iv) was correct: "It seems illogical that the Legislature would intend to exempt from taxation interest income earned on loans secured by Michigan property or made to Michigan customers simply because the payments on these loans were sent to an out-of-state mailing address." *Id.* at _____. This interpretation, the Court noted, would "set up a perfect tax loophole" and was inconsistent with the clear purpose behind § 65(b), which was to determine what portion of a businesses' activities occurred within Michigan. *Id.* at _____. For these reasons, the Court held that § 65(b) did not exclude interest received at an address outside Michigan:²

We conclude that this statutory scheme requires that "gross business" income of whatever kind must be sourced to the state where a taxpayer engaged in "business activity" which resulted in that income. We further conclude that the Department of Treasury's reading of § 65(b)(v) fulfills this statutory scheme and purpose. Plaintiff received interest income as a result of business activity within Michigan. As a result, plaintiff must pay Michigan tax on that interest. Where plaintiff received that interest is irrelevant to the statutory scheme, and nothing within the language of the statute suggests that it must have been received in Michigan to be [properly] taxable. [*Id.*]

Plaintiff derived significant income from its business activities in Michigan and the Court of Claims correctly concluded that plaintiff's business activities were subject to the SBTA even though the payments were ultimately sent to addresses outside Michigan.

Plaintiff next argues that RAB 2002-14 contains many rules for sourcing interest income that are contrary to MCL 208.65. A Revenue Administrative Bulletin (RAB) is issued under MCL 205.3(f), which allows defendant to "issue bulletins that index and explain current department interpretations of current state tax laws." See *JW Hobbs Corp v Revenue Div, Dep't of Treasury*, 268 Mich App 38, 46; 706 NW2d 460 (2005). A RAB is only an interpretation of the applicable statute and does not have the force of law. *Catalina Marketing Sales Corp v Dep't of Treasury*, 470 Mich 13, 21; 678 NW2d 619 (2004). Notably, there are separate provisions for rule making issued by the Department: "After reasonable notice and public hearing, the department may promulgate rules consistent with this act in accordance with the administrative procedures act . . . , MCL 24.201 to 24.328, necessary to the enforcement of the provisions of tax and other revenue measures that are administered by the department." MCL 205.3(b); *Kmart Michigan Prop Services, LLC v Department of Treasury*, 283 Mich App 647, 654; 770 NW2d 915 (2009). Explanatory guidelines, such as a RAB, do not have the force of law and are not

² Given this Court's decision in *PNC Bank*, we decline to consider plaintiff's argument concerning the Legislative history of MCL 208.65 and its predecessors as irrelevant.

legally binding. *Id.* Nevertheless, defendant's interpretation of the statute at issue is entitled to respectful consideration. *Id.* at 654-655.

Defendant approved RAB 2002-14 in June 2002. It contains 20 guidelines for determining where the five categories of gross business outlined in MCL 208.65(b) are sourced. Defendant specifically disputes the RAB guidelines pertaining to MCL 208.65(b)(iv), interest and dividends received.

RAB 2002-14 provides that interest and loans secured by real property were sourced to Michigan as follows:

- a. property is located in Michigan
- b. the property is located both within Michigan and one or more other states if more than 50 % of the fair market value of the real property is located within Michigan
- c. if more than 50 % of the fair market value of the real property is not located within any one state, then if the borrower is located in Michigan [RAB 2002-14, p 4.]

RAB 2002-14 also provided that interest from loans not secured by real property was to be sourced to Michigan if the borrower was located in Michigan. The RAB additionally stated that receipts from credit card receivables were to be sourced to Michigan if the billing address of the cardholder was in Michigan.

Plaintiff argues that the plain language of MCL 208.65 reads, contrary to the guidelines of RAB 2002-14, that only interest and dividends actually received in Michigan are included in the taxpayer's gross business in the state. However, as previously stated, MCL 208.65(b)(iv) does not require that the interest be received in Michigan, but only that the gross business activity resulting in the interest income occur in Michigan.

Plaintiff also argues that RAB 2002-14 contravenes the statute because it contains detailed rules that were not legislated, including determining the source of income according to the type of loan, the location of property secured by a loan, and the location of the borrower or user of a credit card. Plaintiff points out that the statute makes no mention of determining the source of interest income by utilizing such an elaborate scheme. However, RAB's are interpretive guidelines, rather than legislated rules promulgated according to the Administrative Procedures Act. See *Kmart Michigan Prop Services, supra* at 654. As legally non-binding guidelines, the test of the validity of a RAB is whether it contravenes a pertinent statute or case law. *Id.*

There is no evidence that the explanations provided in RAB 2002-14 are contrary to the purpose or the language of the statute. That RAB 2002-14 is more expansive and detailed than MCL 208.65 is not evidence that it contradicts the statute, but is merely a function of its explanatory purpose. RAB 2002-14 details under what conditions interest income, and other items of gross business, are properly sourced to Michigan by elaborating on scenarios that are simply not addressed in the statute. RAB 2002-14 does not contravene MCL 208.65.

Plaintiff next argues that the Court of Claims erred in allowing RAB 2002-14 to be applied retroactively. Plaintiff argues that RAB 2002-14 was unlawful because it created new rules that are contrary to MCL 208.65. However, as discussed above, RAB 2002-14 was a proper explanatory statement within the meaning of MCL 205.3(f). See *JW Hobbs Corp, supra* at 46. RAB 2002-14 may have been the first explanation of how defendant would apply 208.65, but it was not binding new law.

Plaintiff also argues that, even if RAB 2002-14 was a reasonable interpretation of MCL 208.65, it could not be applied retroactively. RAB 2002-14 was published in June 2002 and was applied to plaintiff for the period from October 1, 1998 to September 30, 2001. Plaintiff relies on *In re D'Amico Estate*, 435 Mich 551, 562; 460 NW2d 198 (1990), for the proposition that a new interpretation of a tax statute only applies prospectively. However, in that case, the new interpretation of the statute reversed defendant's previous interpretation, and the Court held that the defendant was bound by its first construction until the time of the "new development." *Id.* at 562, 564. This case involves a new taxing standard and defendant had the authority to retroactively apply a new taxing standard. *JW Hobbs Corp, supra* at 47. Additionally, in the case of a new rule created by case law, defendant may apply the new rule retroactively even when defendant had issued previous RAB's explaining the then current rules. *Rayovac Corp v Dep't of Treasury*, 264 Mich App 441, 448-449, 691 NW2d 57 (2004). Here, plaintiff concedes in its brief, "Prior to the issuance of RAB 2002-14, [defendant] had provided no guidance to financial organization taxpayers on how to source income from interest to Michigan." It appears that RAB 2002-14 was new only because it was defendant's first interpretation, and it is not argued that RAB 2002-14 contradicted any previous policy. Defendant was bound by its initial interpretation in RAB 2002-14, and was permitted to apply that interpretation retrospectively. *JW Hobbs Corp, supra* at 47.

Plaintiff next argues that, if MCL 208.65 does not control the sourcing of interest income, then its income would be sourced to a state other than Michigan under MCL 208.53(1)(b) as income from the sale of intangibles. As already determined, MCL 208.65 does govern the apportionment of the tax base of a financial organization. And plaintiff stated in the motion hearing that it agreed that it was a financial institution and that MCL 208.65 was the applicable statute. In their appeal briefs, the parties also agree that plaintiff was a financial organization during the tax years at issue.

Lastly, plaintiff argues that the Court of Claims erred in not providing plaintiff with relief from a penalty imposed on it by defendant for failure to file and pay taxes. Plaintiff was assessed a 25 per cent penalty of \$152,115 on a tax debt of \$608,446 for the years at issue. MCL 205.24 provides authority for the imposition of a penalty on taxpayers who fail or refuse to file a return or pay a tax administered under the SBTA within the time specified.

Plaintiff argues that its failure to file single business tax returns and pay the associated tax for the years at issue was reasonable and, for that reason, the penalty should be waived. MCL 205.24(4) provides for the waiver of a penalty:

If a return is filed or remittance is paid after the time specified and it is shown to the satisfaction of the department that the failure was due to reasonable cause and not to willful neglect, the state treasurer or an authorized representative of the state treasurer shall waive the penalty prescribed by subsection (2).

Plaintiff argues that it reasonably believed it had no income to report based on its interpretation of MCL 208.65 and defendant's lack of notice to taxpayers on its interpretation of the statute.

The administrative rule, 1999 AC, R 205.1013(5), requires taxpayers to act with ordinary business care and prudence in assessing their tax liability. MCL 205.24(4) also plainly states that the absence of willful neglect and the presence of good cause is the basis for waiving penalties assessed to taxpayers. However, in *TMW Enterprises Inc v Dep't of Treasury*, ___ Mich App ___, ___; ___ NW2d ___ (2009), this Court reversed a trial court's decision ordering a refund of a tax penalty where the taxpayer's interpretation was contradicted by the plain language of the statute.

Here, as discussed above, plaintiff's understanding of MCL 208.65 was contrary to the unambiguous meaning of the statute. Furthermore, plaintiff conceded that it was in the taxing jurisdiction of Michigan because of the physical presence of its employee in the state. Plaintiff's knowledge that its business in Michigan brought it under the taxing authority of the state should have raised the possibility that income from this business activity may have been subject to a value-added tax in the state. Plaintiff also failed to seek clarification through a letter ruling on the issue. Plaintiff acknowledged that it had sufficient business activity in Michigan to consider filing the return. But nevertheless chose not to because it felt its business activity would not be subject to tax. Plaintiff's willful neglect given the plain meaning of the statute was not the exercise of ordinary business care and prudence, and did not constitute reasonable cause.

The Court of Claims denied plaintiff's motion to abate the penalty because it found that plaintiff's delay was not due to reasonable cause. The court reasoned that, even though plaintiff did not have the benefit of RAB 2002-14 during the years in issue, plaintiff's interpretation of the SBTA was contrary to the Legislature's purpose and intent, and RAB 2002-14 merely explained defendant's current interpretations of the statute. The Court of Claims was not in error.

There were no errors warranting relief.

Affirmed.

/s/ Michael J. Talbot

/s/ Kurtis T. Wilder

/s/ Michael J. Kelly