STATE OF MICHIGAN

IN THE SUPREME COURT

INTERNATIONAL BUSINESS MACHINES CORPORATION, Plaintiff/Appellant, v DEPARTMENT OF TREASURY OF THE STATE OF MICHIGAN, Defendant/Appellee.	Supreme Court No. 146440 Court of Appeals No. 306618 Court of Claims No. 11-033-MT

CLIFFORD W. TAYLOR (P21293)
GREGORY A. NOWAK (P39240)
Miller, Canfield, Paddock and Stone, P.L.C.
150 W. Jefferson Avenue, Suite 2500
Detroit, Michigan 48226
313/ 963-6420

AMY L. SILVERSTEIN*
EDWIN P. ANTOLIN*
JOHANNA W. ROBERTS*
**admitted pro hac vice*
Silverstein & Pomerantz LLP
55 Hawthorne Street, Suite 440
San Francisco, California 94105-3910
415/ 593-3502

Attorneys for Plaintiff/Appellant
International Business Machines Corporation

BILL SCHUETTE
Attorney General
JOHN J. BURSCH (P57679)
Solicitor General
RICHARD A. BANDSTRA (P31928)
Chief Legal Counsel
MICHAEL R. BELL (P47890)
Assistant Attorney General
Revenue & Collections Division
G. Mennen Williams Building, 2nd Floor
525 W. Ottawa Street
P.O. Box 30754
Lansing, Michigan 48909
517/ 373-3203

Attorneys for Defendant/Appellee
Michigan Department of Treasury

REPLY BRIEF OF PLAINTIFF/APPELLANT INTERNATIONAL BUSINESS MACHINES CORPORATION

ORAL ARGUMENT REQUESTED

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I. INTRODUCTION

The plain language of the Michigan Business Tax Act ("MBTA") does not conflict with the Multistate Tax Compact ("Compact"), and there is no evidence the MBTA overrode the Compact's election provision which expressly allows taxpayers to choose between a state apportionment formula (here, the "MBTA Formula") and the Compact's apportionment formula ("Compact Formula"). Thus, there can be no implied repeal. The Department's harmonization argument is just a disguise for its argument that the MBTA repealed the Compact election.

Moreover, the Compact language establishes its contractual nature. A model law would not "enter into force when enacted into law by any seven States," would not require enactment in "substantially" the same form, and would not contain a withdrawal provision. As an interstate compact, the Compact is, at once, a state statute and a contract *between* sovereign states, and compact law and the Contract Clause prohibit Michigan from overriding any of the Compact's provisions through subsequent statutes. Michigan is a party to dozens of interstate compacts which are crucial to resolve problems states face collectively. Appellant's Br, Att R (listing Michigan compacts). A decision that the MBTA overrode the Compact's election would invite party states to these compacts to eschew their obligations to Michigan and other states. Applying United States Supreme Court precedent, this Court should enforce the Compact's express terms.

II. ARGUMENT

A. The MBTA and the Compact Allow the Apportionment Election

The Department argues that the word "shall" makes the MBTA Formula the "mandated exclusive formula," eliminating the Compact election and Compact Formula. Dept's Br, p 22-23. However, reading the Compact Formula in isolation, one would reach the same conclusion, i.e., by use of "shall," the Compact Formula trumps any alternative formula:

All business income *shall* be apportioned to this state by multiplying the income

> by a fraction the numerator of which is the property factor plus the payroll factor plus the sales factor and the denominator of which is three. (Emphasis added.)

MCL 205.581, Art IV(9). The MBTA Formula and the Compact Formula must be read *in pari material* with statutes on the same subject (Dept's Br, p 19), including the Compact's election:

> Any taxpayer subject to an income tax. . . may elect to apportion and allocate his income in the manner provided by the laws of such state . . . without reference to this compact, or may elect to apportion and allocate in accordance with article IV.

MCL 205.581, Art III(1). Thus, a taxpayer "may elect to apportion . . . in the manner provided by the [state] laws," in which case the state formula "shall" apply, "or [the taxpayer] may elect to apportion . . . in accordance with [the Compact]," in which case the Compact Formula "shall" apply. Reading all relevant provisions together, there is no conflict. See Appellant's Br, p 17-19.

The Department's rebuttal is circular because, other than the word "shall," there is no evidence the Legislature intended the MBTA Formula to be exclusive. Dept's Br, p 22-23 (relying exclusively on "shall" as "express and unambiguous language" to argue the "sales-factor apportionment formula [is] the mandated exclusive formula that precludes any other formula").[1]

Finally, the Department's harmonization argument is a disguise for its repeal argument:

> [T]he Legislature . . . mandated the [MBTA Formula]. As a result, Treasury was legislatively commanded . . . that only the [MTBA Formula] fairly represented a taxpayer's business activity in this State. Thus, all other formulas (such as the Compact's) failed to fairly represent any taxpayer's business activity in this State unless the taxpayer petitions [for] a different formula. Dept's Br, p 21.

MCL 208.1309 allows a petition for *any* formula; therefore, the Department's construction renders the Compact election superfluous. Further, a relief petition and the election serve different purposes (constitutional circuit breaker versus uniformity) and operate differently (permissive versus elective). Appellant's Br, p 19-20; Apx 39a. The Department's argument does not harmonize the Compact provisions but writes them out of the law.

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[1] In 2011 legislation, the Legislature *did* expressly reference the Compact and its intent to eliminate the Compact election beginning January 2011. Appellant's Br, p 22-24.

B. The Compact Election was Not Repealed by Implication

The Department has not established either of its two bases for implied repeal. First, as discussed above, the MBTA and the Compact do *not* conflict. Dept's Br, p 21-23. Second, the Department failed to establish that the MBTA was intended to occupy the field to the exclusion of the Compact. *Id.*, p 24-25. The Compact serves a different purpose than the comprehensive state tax acts. Because it omits nearly all of the necessary elements of a tax act other than an apportionment formula, plainly it was always intended to co-exist with the party states' tax acts. *US Steel Corp v Multistate Tax Comm,* 434 US 452, 457; 98 S Ct 799 (1978) (explaining Compact leaves tax base, tax rate, collection and enforcement to state legislatures).

Further, concluding the MBTA repealed the Compact election would violate the reenactment rule, Const 1963, art IV, § 25. Appellant's Br, p 24-25. The premise of the "complete within itself" exception to republishing (see Dept's Br, p 27) is that the mischief addressed by the rule (deliberate misleading by the Legislature, lack of notice and certainty) is absent. See *Drake v Mahaney,* 13 Mich 481, 497 (1865); *Nalbandian v Progressive Michigan Ins Co,* 267 Mich App 7, 13-15; 703 NW2d 474 (2005). Because neither the word "shall" nor any other evidence indicates intent to repeal the election, if the MTBA repealed the election, it was deliberately misleading and lacked notice and certainty, and the exception would not apply.

C. The Compact is a Binding Interstate Compact

At bottom, the Department argues that the Compact is not an interstate compact, either because it does not have the key indicia of a compact, or because it is not a contract under Michigan law. Neither argument has merit. See also, Appellant's Br, p 31-34.

The Supreme Court plainly analyzed the Compact as a compact or agreement between states, just not one "that would impermissibly enhance state power at the expense of federal

supremacy." *US Steel, supra* at 472.[2] If it were not a compact, the Court would not have engaged in its lengthy evaluation of whether Congressional consent was necessary.[3] See, e.g., *Northeast Bancorp, Inc v Bd of Governors*, 472 US 159, 175; 105 S Ct 2545 (1985) ("We have some doubt as to whether there is an agreement amounting to a compact.").

The Compact has the *Northeast Bancorp* indicia of a compact, i.e., a joint body, statutes conditioned on actions by other states (e.g., enters into force when enacted by seven states), withdrawal terms, and limitations on state powers that are reciprocal (e.g., mandatory apportionment formula election). *Id.;* Appellant's Br, p 32-34. A compact need not expressly prohibit unilateral modification; that is an inherent characteristic. See Appellant's Br, p 27-30.

The Department's authority does not state that a compact must cede sovereignty to other states or to a compact agency (Dept's Br, p 9)[4], but rather that a compact *may* cede authority, and it is silent as to whether the sovereignty has to be ceded to anyone/anything in particular:

> [C]ompacts are . . . fundamentally instruments for contractually allocating collective state governing authority. This in turn *may* require the member states to cede a portion of their individual sovereignty for the collective good of the member states.

Broun on Compacts, p 17 (emphasis added). In any event, the parties did cede sovereignty over specified matters. Through the election, they ceded the right to mandate an exclusive apportionment formula, thus promising other states not to double tax their residents. Also, party

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[2] The Department's claim that the Supreme Court "referred to the Compact as a model law" is misleading. Dept's Br, p 14. The Court's reference to "[t]he model Act proposed as the Multistate Tax Compact" (*US Steel, supra* at 456 n 5) was to the final version of the Compact that party states had to "enact[]. . . in the form substantially as set forth." See MCL 205.581, § 1; Appellant's Br, Att G at 4-22 (suggested enabling act and Compact text). It did not mean the term of art "model law," which states can borrow from or adapt. See Dept's Br, p 8-9.

[3] The Commission's brief does not inform the interpretation of the Compact. Dept's Br, p 12-14. *US Steel* speaks for itself.

[4] Many compacts have commissions that are advisory (see, e.g., Insurance Product Regulation Compact (MCL 3.1031, Art IV)), and others have no commission at all (see, e.g., Michigan Boundary Compact (MCL 2.201); Interstate Compact on Mental Health (MCL 330.1920, Art X)). See Broun on Compacts, ch 5 (discussing various structures for administering compacts).

states must allow "full credit" for sales or use tax on the same property paid to another state. MCL 205.581, Art V(1). And, upon enactment, states "entered into [the Compact] with all jurisdictions legally joining therein" (*Id.* at § 1) and agreed to the terms for withdrawal (*Id.* at Art X) — these provisions all constitute "express . . . language that satisfies the vital consideration for whether a uniform or model law is a contractual compact." Dept's Br, p 15.

D. The Compact Must Be Interpreted Uniformly Across States

To be sure, a compact not approved by Congress does not become federal law and trigger the Supremacy Clause. Still, it is a compact *between states*, and the context in which courts state that compacts are interpreted as state law is critical:

> Because Congressional consent was neither given nor required, the [ICPC] does not express federal law. Consequently, this Compact must be construed as state law. Nevertheless, *uniformity of interpretation* is important in the construction of a Compact because in some contexts it is a contract between the participating states. Having entered into a contract, *a participant state may not unilaterally change its terms.* A Compact also *takes precedence* over statutory law in member states. (Emphasis added).

McComb v Wambaugh, 934 F2d 474, 479 (CA3, 1991)(overruled on other grounds, *Dept of Econ Sec v Leonardo,* 200 Ariz 74, 22 P3d 513 (Ariz, 2001). That is, a compact is not just a contract and statute *in* a particular state, but a contract *between* states and must be interpreted uniformly across states. See 1 A Singer, Sutherland Statutory Construction (7th ed), § 32:5, p 723 (interpret compacts as both contracts between states and statutes within those states); Appellant's Br, p 26-30. Uniformity cannot be achieved by interpreting a compact in each state according to that state's laws. Also, a state cannot invoke its own laws to avoid its compact obligations.[5] See, e.g., *West Virginia ex rel Dyer v Sims,* 341 US 22, 71 S Ct 557 (1951) (refusing to allow party state to avoid its obligations by arguing compact was unconstitutional).

Because compacts must be interpreted uniformly across states, the Department cannot

[5] This is a corollary of the principle that a compact (whether or not approved) takes precedence over statutory law in member states and cannot be unilaterally altered. Appellant's Br, p 27-30.

now avoid its Compact obligations by invoking Michigan law, e.g., unmistakability doctrine. See Dept's Br, p 11-12. Further, the Compact's terms confirm it is a contract. See Appellant's Br, p 35-36.

The Department cites no authority for the meaning of "power of taxation" in Const 1963, art 9, § 2. This provision, common to many state constitutions, was a response to perpetual and irrepealable tax immunities that states had granted in corporate charters and was intended to bar such sweeping grants. *Harsha v Detroit,* 261 Mich 586, 596; 246 NW 849 (1939); see also, *Switzer v Phoenix,* 86 Ariz 121, 126-28; 341 P2d 427 (Ariz, 1959) (interpreting parallel provision with same history as a "prohibition against the surrender or relinquishment of the right to impose a tax" and "against the irrepealable grant of immunity from tax[]"). Courts have not been persuaded that the provision is implicated outside of that original context. See *WA Foote Hosp v Jackson Hosp Auth,* 390 Mich 193, 215; 211 NW2d 649 (1973) (statutory exemption did not violate provision); *Gaylord v City Clerk,* 378 Mich 273, 301; 144 NW2d 460 (1966) (giving up lien power did not violate provision because not power of taxation); *Keefe v Oakland County,* 306 Mich 503, 513; 11 NW2d 220 (1944) (not violated because land still subject to tax).

By agreeing to the Compact election, Michigan did not surrender the "power of taxation." The election is not permanent, as a party state can withdraw. MCL 205.581, Art X. In any event, by allowing an election of apportionment formulas, Michigan has not surrendered the power of taxation. Michigan exercises its power to tax with respect to every taxpayer, whatever apportionment formula the taxpayer elects. And, the Legislature retained full control of the tax base, the tax rate, and the means and methods of tax collection. *US Steel, supra* at 457.

E. The Election is Unambiguous, Providing No Role for Extrinsic Evidence

The Compact's obligation to allow an election of apportionment formulas is express and unambiguous, not "silent" or "ambiguous" as the Department contends:

> Any taxpayer subject to an income tax whose income is subject to apportionment and allocation for tax purposes pursuant to the laws of a party state . . .*may elect* to apportion and allocate his income in the manner provided by the laws of such state . . . without reference to this compact, or may elect to apportion and allocate in accordance with article IV.

MCL 205.581, Art III(1) (emphasis added). Because it is unambiguous, the Compact election must be enforced as written. See *Kansas v. Colorado,* 514 US 673, 690-91; 115 S Ct 1733 (1995) (rejecting "subsequent practice of parties" as inconsistent with "clear language" of the compact); *Alabama v North Carolina,* 560 US 330; 130 S Ct 2295, 2309-13 (2010); *Tarrant Reg Water Dist v Herrmann*, 596 US __; 133 S Ct 2120, 2131-32, 2135; 186 L Ed 2d 153 (2013) (considering party states' conduct to interpret ambiguous compact provision).

Consideration of other states' conduct to construe the election provision contrary to its terms is inappropriate for additional reasons. First, other states have not acted consistently. Many states have not altered the election. See, e.g., Missouri (RS Mo § 32.200); North Dakota (ND Cent Code, § 57-59-01); Montana (Mont Code Ann § 15-1-601); New Mexico (N M Stat Ann § 7-5-1). Others have chosen to withdraw from the Compact. *US Steel, supra* at 454 n1 (citing repealing statutes in four states as of 1978); Nevada ((1981 Nev Stat ch 181, at 350); Maine (PL 332 (2005)); Nebraska (LB 344 (1985)); West Virginia (Act 1985 (160)).

Second, because nearly all state variances occurred ten to twenty-plus years *after* Michigan enacted the Compact, they do not inform the relevant Legislature's intent. See *Iron Street Corp v Unemp Comp Comm,* 305 Mich 643, 655, 9 NW2d 874 (1943) (subsequent legislative action is not relevant to original intent of enacting legislature). And many of the state variances occurred after litigation over the Compact was filed. See, e.g., Alabama (2011 Ala HB No 434); Utah (2010 Ut SB 165); *Klapp v United Ins Grp,* 468 Mich 459, 479; 663 NW2d 447 (2003) (in construing ambiguous term, may consider parties' conduct *before* controversy arose).

Third, much more probative of the parties' intent upon entering the Compact is the

drafting and negotiation evidence and the Compact's stated purposes which confirm that the election provision is binding. *Oklahoma v New Mexico,* 501 US 221, 231-37; 111 S Ct 2281 (1991) (relying on "purpose and negotiating history" to interpret ambiguous compact terms); *Texas v New Mexico,* 462 US 554, 568; 103 S Ct 2558 (1983) (using context at enactment to interpret ambiguous term); *Arizona v California,* 292 US 341, 359-60; 54 S Ct 735 (1934); *McComb, supra* at 481. The Compact election is central to each of the Compact's purposes, was essential to the Compact impetus of avoiding federal preemption, and was intended by the drafters to be mandatory. Appellant's Br, p 7-12; Att I (1969 Commission 1st Ann Rep) (origin of Compact was avoiding federal action); Att G (1966 Council of State Governments memo with Compact text) at 1-2 (party states required to provide taxpayers the option to use the Compact Formula); Att H (1967 CSG Compact Analysis) at 9 (securing uniformity through election to avoid federal preemption); Att J at 8 (1970 Commission 3rd Ann Rep).

F. An Alternative Ground for Taxpayer Recovery is the Contract Clause

The Department argues Appellant can pursue its Contract Clause arguments *only* if it has contractual rights under the Compact. Dept Br, p 29-30. As explained above, the contractual and statutory nature of compacts are not two separate characterizations. The Compact is *at once* a statute and a contract, and not just any contract, but a contract *between* sovereign states.[6] See *supra,* p 5. Appellant sues not for breach of contract but instead for tax refund. To establish its proper tax liability, Appellant is entitled to argue for interpretation and enforcement of the Compact as an interstate compact and as subject to Contract Clause limitations. See also, Appellant's Br, p 41-43. In addition, the Court must construe the MBTA and the Compact constitutionally if possible. See *People v Lown,* 488 Mich 242, 275; 794 NW2d 9 (2011);

[6] Taxpayers are intended beneficiaries of the Compact because it confers rights on taxpayers and the stated purposes confirm the intent to protect taxpayer interests. MCL 205.581, Art I, III(1).

General Expressways, Inc v Iowa Reciprocity Bd, 163 NW2d 413, 419 (Iowa, 1968) (Att T) (interpreting later legislation to not conflict with a compact to avoid Contract Clause violation).

G. Appellant's Refund Claim was Timely Filed

Appellant complied with MCL 205.27a(6) (requiring only the filing of a "claim" within 90 days of return deadline) because its 2008 return was a timely claim for refund. It reported an overpayment of taxes and claimed the refund at issue based on the Compact election. Dept's Br, p 3; Apx 48a-49a; 56a-59a; MCL 205.30(2) ("If a tax return reflects an overpayment . . ., the declaration of that fact on the return constitutes a claim for refund.").

Further, MCL 205.27a(6) applies only to challenges of "the validity of a tax law based on the laws or constitution. . ." See *Am States Ins Co v Dep't of Treas*, 220 Mich App 586, 589; 560 NW2d 644 (1996) (applies to claims based on preemption "by a constitutional provision or federal law"). Appellant is not claiming invalidity or unconstitutionality but rather that both the Compact and the MBTA are valid and should be harmonized. See *supra* p 1-3.[7]

H. The Compact Applies to the MGRT

To determine whether the Compact applies here, the question is whether the MGRT satisfies the Compact's income tax definition. *Texas v New Mexico*, 482 US 124, 128, 106 S Ct 2279 (1987) (a compact is "a legal document that must be construed and applied in accordance with its terms").[8] Appellant methodically analyzed that definition, establishing that the MGRT is an income tax under the Compact. Appellant's Br, p 43-50; MCL 205.581, Art XII

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[7] The Department did not raise this at the Court of Appeals, cross-appeal, or seek to add the issue to the order granting leave to appeal, thus it is not properly before this Court. MCR 7.302(H)(4). By contrast, Appellant preserved the issue of the Contract Clause and the status of MCL 205.581 as a compact/contract at the Court of Claims (Apx 26a-30a); it was addressed by the Court of Appeals (Apx 40a); and this Court granted leave to appeal this issue.

[8] This Court is empowered to construe the Compact, and doing so would not involve improper policy determinations. Dept's Br, p 34. There is no risk of double taxation because the MBIT and MGRT apply to different tax bases. *C F Smith Co v Fitzgerald*, 270 Mich 659, 685; 259 NW 352 (1935)("Double taxation occurs when a second tax is imposed on the same property").

("[C]ompact shall be liberally construed so as to effectuate the purposes thereof."). The Court should reject the Department's arguments which are all divorced from the Compact definition.

First, the Legislature's label does not control. Dept's Br, p 33-34. The Compact definition includes taxes "on or measured by an amount arrived at by deducting [certain expenses]." MCL 205.581, Art II(4). By including "measured by," the drafters intended an analysis that goes beyond labels to the components used to compute the tax. See *Trinova Corp v Dept of Treas,* 498 US 358, 374; 111 S Ct 818 (1991) ("labeling the SBT a tax on 'business activity' does not permit [the court] to forego examination of the actual tax base").

The Department takes issue with the starting point of the MGRT—gross receipts—as not the same as for "income taxes" generally. Dept's Br, p 38. However, what is relevant is the starting point under the Compact definition—gross income, which at the time the Compact was enacted, was considered synonymous with gross (all) receipts. See Appellant's Br, p 45-46.

Likewise, the Department claims an income tax should allow deductions for *all* expenses, or at least a general business deduction. Dept's Br, p 36-37. However, the Compact's definition does not require a deduction for *all* expenses but rather requires only that it allow one or more deductions for expenses "not specifically and directly related to particular transactions." The MGRT allows deductions that are not specifically and directly related to particular transactions, namely *all* purchases of inventory, depreciable assets, and materials and supplies acquired during the tax year without regard to any particular transactions. MCL 208.1113(6)(a)-(c); see Appellant's Br, p 47-49. The MGRT is an income tax under the Compact definition.

Date: November 13, 2013

Respectfully submitted,
MILLER, CANFIELD, PADDOCK and STONE, P.L.C.
Attorneys for Plaintiff/Appellant

By: _____
Clifford W. Taylor (P21293)
150 W. Jefferson Avenue, Suite 2500 Detroit, MI 48226