

STATE OF MICHIGAN
COURT OF APPEALS

SOVEREIGN SALES, LLC.,

Petitioner-Appellee,

v

DEPARTMENT OF TREASURY,

Respondent-Appellant.

UNPUBLISHED
March 18, 2014

No. 313982
Tax Tribunal
LC No. 00-431694

Before: RONAYNE KRAUSE, P.J., and FITZGERALD and WHITBECK, JJ.

PER CURIAM.

On November 28, 2012, the Michigan Tax Tribunal issued a final judgment ordering respondent to refund to petitioner \$9,888.00 plus statutory interest. Respondent appeals as of right. We affirm.

This case involves petitioner's tax liability under Michigan's Single Business Tax Act (SBTA) for the year ending December 31, 2007.¹ Respondent argues that the tribunal erred when it held that petitioner's sale of substantially all its business assets to a competitor, including inventory, constituted a "casual transaction" excluding it from taxation under the SBTA. We disagree.

Petitioner is a limited liability company formed on October 2, 1997, as a successor to a business originally founded in 1987. Throughout its existence, petitioner has been in the business of selling so-called "department store fragrances" to large retailers such as Walmart, Sam's Club and Costco. On August 11, 2006, petitioner entered into an asset purchase agreement (APA) with its competitor, Elizabeth Arden, Inc. (Arden). Under the APA, petitioner agreed to sell to Arden all of its business assets including its accounts, purchase orders, licenses, permits, copyrights, trademarks, good will, equipment, and inventory. Petitioner also entered into a three-year covenant not to compete with Arden.

¹ Michigan's Single Business Tax Act (SBTA), 1975 PA 228; MCL 208.1 *et seq.*, was repealed effective December 31, 2007, by 2006 PA 325. The year in issue is 2005 so the SBTA applies.

The agreed purchase price was \$23 million plus the value of inventory at closing and a promissory note for \$11 million. \$2.5 million of the \$23 million was to be paid in installments from September 15, 2006, to January 15 2007. At closing the value of inventory was \$68,540,485. The agreement required petitioner to continue shipping products from its warehouse on Arden's behalf through the 2006 holiday season. The purchase price included \$800,000 as the value of services petitioner was to provide to Arden during this transition period. At closing, the total consideration was roughly \$101 million.

The promissory note was to be paid in two installments, \$6 million on September 1, 2007, and \$5 million on September 1, 2008. Payment was conditioned on Arden meeting certain business goals. This type of conditional payment is commonly used when a business is sold to assure the buyer that the business will continue to perform as it had before the sale. The conditions in the note were ultimately fulfilled and Arden paid petitioner the two payments as required.²

After the 2006 Christmas season, Arden moved its newly acquired inventory and equipment out of petitioner's warehouse to Arden's facility in West Virginia. Arden left behind equipment it did not need. Petitioner sold, gave away, or threw away this remaining equipment. Petitioner laid off the bulk of its workforce, retaining only a small number of staff to clean the warehouse and conduct a final accounting. Petitioner's lease on its warehouse continued through 2010 and Arden agreed to pay half of the rent after the asset purchase. Petitioner continues to exist today. As late as 2011, petitioner filed business tax returns in Michigan.

Petitioner included gain from the sale of its assets to Arden in its 2007 SBT tax return. Petitioner later filed an amended return claiming that it was entitled to a refund of \$9,888. In a statement filed with the amended return, petitioner stated it was entitled to a refund because it had improperly included \$5,434,911³ from the sale of its business to Arden as business income in its SBT tax base. This income, petitioner contends, should have been excluded from its SBT base because it was income from a "casual transaction."

A Treasury hearing referee recommended the refund be granted. Respondent disagreed with the referee and denied petitioner's refund. Petitioner appealed respondent's decision and order of determination to the Michigan Tax Tribunal. The tribunal held in petitioner's favor, stating:

Having reviewed the applicable statutes and case law, as well as the evidence and testimony presented by the parties, the Tribunal concludes that Petitioner's sale of its business (i.e., the sale of substantially all of its assets) constitutes a casual

² Only the payment made in 2007 is at issue in this case. The payment made in 2008 is governed by Michigan Business Tax (MBT) that replaced the SBT. Petitioner reported the 2008 payment on its MBT return because there is no casual transaction exclusion under the MBT.

³ This amount represents the principal on the \$6 million payment obligation under the promissory note.

transaction, and as such, the income recognized from the sale during the 2007 tax year shall not be subject to SBT.

The tribunal ordered respondent to pay petitioner's refund plus statutory interest.

“In the absence of fraud, review of a decision by the Tax Tribunal is limited to determining whether the tribunal erred in applying the law or adopted a wrong principle; its factual findings are conclusive if supported by competent, material, and substantial evidence on the whole record.” *Michigan Bell Tel Co v Dep't of Treasury*, 445 Mich 470, 476; 518 NW2d 808 (1994). This case involves questions of statutory interpretation reviewed de novo. *Twp of Bingham v RLTD R Corp*, 463 Mich 634, 641; 624 NW2d 725 (2001). The primary goal of statutory interpretation is to give effect to the intent of the Legislature. *In re MCI Telecom Complaint*, 460 Mich 396, 411, 596 NW2d 164 (1999). The intent of the Legislature is discerned from the plain language of the statute. *Id.* If the statute is unambiguous, this Court presumes that the Legislature intended the meaning plainly expressed, and further judicial construction is neither permitted nor required. *DiBenedetto v West Shore Hosp*, 461 Mich 394, 402, 605 NW2d 300 (2000). In general, tax laws are construed against the government. *DeKoning v Dep't of Treasury*, 211 MichApp 359, 361, 536 NW2d 231 (1995).

The Michigan Tax Tribunal did not err in applying the law when it concluded that petitioner's sale of substantially all of its business assets was a casual transaction excluded from taxation under the SBTA. The tribunal also did not err in concluding that the 2007 installment payment was part of the purchase price for the business and not payment for services.

Michigan's Single Business Tax Act (SBTA), 1975 PA 228; MCL 208.1, *et seq.*, was repealed effective December 31, 2007.⁴ The SBTA imposed a tax on “business activity” within the state of Michigan. MCL 208.31. “The SBTA employ[ed] a value-added measure of business activity, but its intended effect [was] to impose a tax on the privilege of conducting business activity within Michigan.” *ANR Pipeline Co v Dep't of Treasury*, 266 Mich App 190, 198; 699 NW2d 707 (2005).

Business activity is defined under MCL 208.3(2) as follows:

“Business activity” means a transfer of legal or equitable title to or rental of property, whether real, personal, or mixed, tangible or intangible, or the performance of services, or a combination thereof, made or engaged in, or caused to be made or engaged in, within this state, whether in intrastate, interstate, or foreign commerce, with the object of gain, benefit, or advantage, whether direct or indirect, to the taxpayer or to others, *but shall not include* the services rendered by an employee to his employer, services as a director of a corporation, or a *casual transaction*. [Emphasis added.]

MCL 208.4(1) defines the term “casual transaction” as

⁴ 2006 PA 325.

a transaction made or engaged in other than in the ordinary course of repeated and successive transactions of a like character, except that a transaction made or engaged in by a person that is incidental to that person's regular business activity is a business activity within the meaning of this act.

Petitioner's asset disposition was a sale substantially all of its business assets with the object of gain, so it meets the definition of a business activity under MCL 208.3(2). The issue is whether petitioner's asset disposition was a "casual transaction" excluding it from the definition of business activity for SBTA purposes.

This is an issue of statutory interpretation that was directly addressed by this Court in *Manske v Dep't of Treasury*, 265 Mich App 455; 695 NW2d 92 (2005). In *Manske*, this Court was asked to determine whether a hotel company engaged in a casual transaction when it disposed of its sole asset by deed in lieu of foreclosure to its lender in exchange for debt forgiveness. *Manske*, 265 Mich App at 456-457. This Court held that MCL 208.4(1) provides a two-step analysis. First, the statute requires the court to ask whether the transaction at issue is "in the ordinary course of repeated and successive transactions of a like character." If the transaction is *not* in the ordinary course of repeated and successive transactions of a like character, then it is a casual transaction. If the transaction meets the definition of casual transaction, the court next considers whether the transaction is "incidental to that person's regular business activity." If the transaction is incidental to the taxpayer's regular business activity, then it is not a casual transaction and is considered business activity for SBTA purposes.

The word "incidental" is not defined in the statute. Applying the principles of statutory construction, the Court in *Manske* interpreted the word "incidental" by consulting a dictionary. *Manske*, 265 Mich App at 461, citing *Title Office, Inc v Van Buren Co Treasurer*, 469 Mich 516, 522; 676 NW2d 207 (2004). The court stated,

Black's Law Dictionary (7th ed) defines "incidental" to mean: "Subordinate to something of greater importance; having a minor role" *The American Heritage Dictionary, Second College Edition* (1982) defines "incidental" as follows: "Occurring or likely to occur as an unpredictable or minor concomitant . . . Of a minor, casual, or subordinate nature A minor concomitant circumstance, event, item, or expense." [*Manske*, 265 Mich App at 461.]

The *Manske* court concluded that, regardless of which dictionary's definition it applied, the word "incidental" referred to something minor and of little importance. *Id.* The court then stated "Transferring plaintiff's ownership interest was a major event, a significant act in a financial sense that extinguished plaintiff's business interest in the development in question." *Id.* It was stipulated in *Manske* that the plaintiff's sole business activity was the operation of the hotel. *Id.* *Manske*, accordingly, held that granting the deed in lieu of foreclosure was a casual transaction and the income received from it was, therefore, not taxable business activity under the SBTA. *Id.*

The tribunal correctly applied the analysis in *Manske* to the facts of this case. Before the asset purchase, petitioner was in the business of selling fragrances to retailers. The asset sale to Arden disposed of substantially all of petitioners assets—not only its inventory, but also its

equipment, copyrights, trademarks, trade dress, licenses and good will. Petitioner also entered into a covenant not to compete, effectively preventing it from continuing in the fragrance wholesale business. Petitioner had never in its history sold substantially all of its assets to a competitor in a one-time asset sale. The tribunal rejected respondent's argument that the sale of petitioner's entire inventory to Arden was of like character with its ongoing business of selling its inventory to retailers. Citing *Manske*, the tribunal stated that respondent failed to focus "on the characteristics of this specific transaction." *Manske*, 265 Mich App at 460.

The tribunal reasoned that "[p]urchasing a company's assets is a form of acquisition." The tribunal stated that selling its inventory and all its tangible and intangible property, as well as entering into a non-compete agreement, "essentially removed the heart of Petitioner's business as of the date of the closing and for at least three years thereafter."

Petitioner was in the business of selling fragrances to retailers. Under the APA, it essentially sold itself. The asset purchase was not of like character with petitioner's repeated and successive transactions. The gain from the asset purchase was, therefore, gain from a casual transaction and excluded from taxation under the SBTA.

Petitioner's sale of substantially all of its assets also cannot be considered incidental to its regular business activity under *Manske*. *Manske* held that incidental means something minor or of little importance. Here, as in *Manske*, the sale under the APA was a major event in petitioner's existence as a company. The sale effectively marked the end of petitioner's life in the wholesale fragrance business. The \$101 million sale was not a "minor concomitant circumstance." *Manske*, 265 Mich App at 461.

Respondent's characterization of the \$6 million installment payment in 2007 as a payment for services is also incorrect. The conditions in the promissory note did not require petitioner to take any action on Arden's behalf. The installment payments were conditioned only on whether Arden achieved certain business objectives. Although the conditional payment gave petitioner the incentive to support and not to interfere with Arden's relationships with petitioner's former customers and vendors, the terms of the note did not condition payment on petitioner performing any services for Arden. The \$6 million installment payment was just that—an installment payment for purchase price of the business. The fact that it was made conditional on Arden's success does not change its character.

Affirmed.

/s/ Amy Ronayne Krause
/s/ E. Thomas Fitzgerald
/s/ William C. Whitbeck