

STATE OF MICHIGAN  
IN THE SUPREME COURT

FIRST INDUSTRIAL,

Supreme Court No. 139748

Plaintiff-Appellee/Cross-Appellant,

Court of Appeals No. 282742

v

Court of Claims No. 06-04-MT

REVENUE DIVISION, DEPARTMENT  
OF TREASURY, STATE OF MICHIGAN,  
Defendant-Appellant/Cross-Appellee.

139748  
DFAT-XAE's Supd

**SUPPLEMENTAL BRIEF OF DEFENDANT-APPELLANT/CROSS-APPELLEE  
REVENUE DIVISION. DEPARTMENT OF TREASURY, STATE OF MICHIGAN**

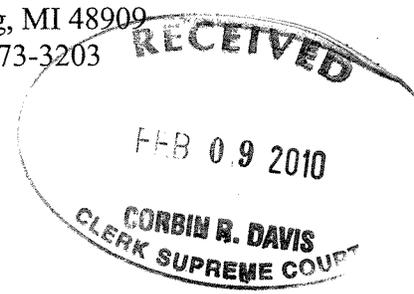
**ORAL ARGUMENT REQUESTED**

Michael A. Cox  
Attorney General

B. Eric Restuccia  
Solicitor General  
Counsel of Record

Bruce C. Johnson (P62645)  
Assistant Attorney General  
Attorneys for Defendant-Appellant/  
Cross-Appellee  
P.O. Box 30754  
Lansing, MI 48909  
(517) 373-3203

Dated: February 9, 2010



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## STATEMENT OF QUESTIONS

- I. The question presented in Defendant-Appellant Cross-Appellee's Application for Leave to Appeal was: Section 23 of the Single Business Tax Act, as interpreted by the Michigan Department of Treasury in its Revenue Administrative Bulletin 1992-3, authorizes a transferee of assets to claim a business loss deduction carryover for any unused business loss of the transferor when the transferor completely discontinues operations and is no longer a taxpayer under the Single Business Tax Act. First Industrial Financing Partnership transferred assets to Appellee First Industrial Limited Partnership but did not completely discontinue business operations and was still a taxpayer under the Single Business Tax Act. Is Appellee Industrial entitled to a transfer of Financing Partnership's business loss carryover?
  
- II. The question presented in Defendant-Appellant Cross-Appellee's Application for Leave to Appeal was: Does the issue presented by this cross-application – whether FILP is entitled to a capital acquisition deduction in the event it ultimately is determined that it is not entitled to a business loss deduction – have significant public interest and involve an agency of the State of Michigan, and does it present legal principles of major significance to this State's jurisprudence, so that ample grounds for review by this Court exist under MCR 7.302(B)(2) and (3)?

## INTRODUCTION

This Supplemental Brief is being filed in accordance with the Court's December 29, 2009 Order, which provided that the parties may file supplemental briefs, but not to repeat arguments already set out in the leave applications. Defendant-Appellant/Cross-Appellee Michigan Department of Treasury ("Treasury") addressed the first issue at length in its application for leave. As to that issue, this Supplemental Brief seeks to clarify the relation between the statute at issue and the implementing revenue administrative bulletin ("RAB"). The second issue – which was raised by Plaintiff-Appellee First Industrial, L.P. ("First Industrial") in its cross-appeal – has not yet been addressed by Treasury, so Treasury will address that issue in this brief.

The law on both issues is clear. On the first, First Industrial relies on RAB 1992-3 to claim a transferee's interest in a business loss deduction. But this interest, while recognized by the RAB, is not mentioned in the governing statute – the Single Business Tax Act ("SBTA")<sup>1</sup>. It was illogical for the Court of Appeals, in reversing the Court of Claims, to interpret RAB 1992-3 contrary to its plain meaning and logical purpose. The Court of Appeals further compounded its error when it based this ruling on a provision of the SBTA having nothing to do with conditions for transfer of a business loss deduction.

On the second issue, the Court of Appeals correctly ruled that First Industrial could not claim a capital acquisition deduction for capital assets it paid nothing to acquire. The Court of Appeals also correctly ruled that claims for tax deductions – which violate the principle of tax equality – must be strictly construed against parties claiming deductions. Had the Court of Appeals applied this principle in its ruling on the first issue, it would not have allowed the business loss deduction.

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<sup>1</sup> MCL 208.1 *et seq.*

Because the leave application contains a full Statement of Facts, and because the Court directed the parties not to repeat the content of their original briefs in this brief, no separate Statement of Facts will be included with this brief; rather, the one from Treasury's application is fully incorporated by reference.

## ARGUMENT

- I. **RAB 1992-3 allows a transfer of a business loss deduction for assets only when the previous owner of the assets "completely discontinues operations" and is "no longer a taxpayer under the Single Business Tax Act." Reversing the Court of Claims, the Court of Appeals allowed the business loss deduction to be transferred by a taxpayer that had merely stopped doing business in Michigan, but had not completely discontinued operations. The Court of Appeals erred by allowing a transfer of a business loss deduction as authorized only by the RAB, when the conditions set out by the RAB were not satisfied.**

A. **Standard of Review**

In general terms, the issue being appealed is a legal question as to the interpretation of a statute, and as such, is subject to *de novo* review.<sup>2</sup> Statutes are interpreted according to their plain meaning, where possible.<sup>3</sup> Besides these general principles of review of the issue, there is a specialized question involving the review of the tax issue here, which the Court of Appeals resolved correctly, and which First Industrial has misconstrued.

The Court of Appeals was correct in noting that, whereas tax laws generally are strictly construed in favor of taxpayers, the opposite is true with exceptions to taxation, which are "strictly construed against the taxpayer and in favor of the taxing authority,"<sup>4</sup> so that taxpayers have the burden of proving entitlement to them.<sup>5</sup> First Industrial is wrong in arguing (in its application for leave to cross-appeal) that this principle is limited to actual *exemptions* from taxation, and does not apply to credits and deductions. On the contrary, the principle is applied not only to exemptions, but to credits, regarded as the structural equivalents of exemptions,<sup>6</sup> and

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<sup>2</sup> *Dep't of Transportation v Tomkins*, 481 Mich 184, 190; 749 NW2d 716 (2008).

<sup>3</sup> *Tomkins*, 481 Mich at 191.

<sup>4</sup> *Nomads, Inc v Romulus*, 154 Mich App 46, 55; 397 NW2d 210 (1986) (emphasis supplied).

<sup>5</sup> *Elias Bros Restaurants, Inc v Treasury Dep't*, 452 Mich 144, 150; 549 NW2d 837 (1996).

<sup>6</sup> *Auto-Owners Ins Co v Dep't of Treasury*, 226 Mich App 618, 621; 575 NW2d 770 (1995); *DeKoning v Dep't of Treasury*, 211 Mich App 359, 361-362; 536 NW2d 231 (1995).

to deductions, such as the one at issue here.<sup>7</sup> The reason for this rule is that exceptions to taxation "represent the antithesis of tax equality,"<sup>8</sup> so that they must be narrowly construed in order to preserve the general principle of equality of tax treatment.<sup>9</sup>

**B. The Court of Appeals erred when it allowed a business loss deduction carryover provided for in an RAB contrary to the terms under which the RAB allows it.**

Treasury addressed this issue at length in its leave application. However, there is a rather unique aspect to the posture of the Court of Appeals' ruling the application did not address. Mindful of this Court's injunction to limit this brief to new points, this brief will focus on that unique posture. Treasury continues to argue the points made in the leave application, and

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<sup>7</sup> *ADR Pipeline Co v Dep't of Treasury*, 266 Mich App 190, 201; 699 NW2d 707 (2005), lv den, 474 Mich 936 (2005) (stating that it is "generally acknowledged that a deduction ""depends upon legislative grace; and only as there is clear provision therefor can any particular deduction be allowed."" (citing *Town & Country Dodge, Inc v Dep't of Treasury*, 420 Mich 226, 242; 362 NW2d 618 (1984); see also, e.g., *Stinson Estate v United States*, 214 F3d 846, 848 (CA7, 2000); *Wisely v United States*, 893 F2d 660, 666 (CA4, 1990); *Weingarden v Commissioner*, 825 F2d 1027, 1029 (CA6, 1987); *Templeton v Commissioner*, 719 F2d 1408, 1410-1411 (CA7, 1983).

<sup>8</sup> *Elias Bros Restaurants*, 452 Mich at 150.

<sup>9</sup> In addition to cases cited *supra*, see, e.g., *American Concrete Inst v Mich State Tax Com*, 12 Mich App 595, 606-607; 163 NW2d 508 (1968), lv den, 381 Mich 782 (1968); *In re Smith Estate*, 343 Mich 291, 297; 72 NW2d 287 (1955).

believes that these points, focusing on the proper interpretation of Revenue Administrative Bulletin (RAB) 1992-3 provide a compelling reason for granting the leave application and reversing the Court of Appeals' decision.<sup>10</sup>

1. **It is illogical for the Court of Appeals to allow a carryover that is only authorized by an RAB and not by the statute itself, when doing so is contrary to the language of the RAB.**

This case presents a rather unusual situation. On the one hand, it is a case presenting an issue of statutory interpretation. On the other hand, strictly speaking, there is no statutory language to interpret.

The entitlement to a transfer, or carryover, of a business loss deduction arises from RAB 1992-3. The statute itself, the SBTA,<sup>11</sup> says nothing about such a transfer or carryover. This fact

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<sup>10</sup> The full text of RAB 1992-3 was attached to Treasury's leave application. For ease of reference here, its relevant language can be set out as follows:

Transfers of property through certain tax-free events described in sub-paragraphs (1) through (8) of this section receive the following treatment for SBT purposes: transferor is not required to recapture CAD on such property; transferee is not entitled to a CAD on such property; transferee holds the property as if such property was in the hands of the transferor, therefore, the transferee must recapture CAD depending on the acquisition date of the property by the transferor; and **transferee is entitled to an SBT business loss carryover for any unused business loss of the transferor when transferor completely discontinues operations and is no longer a taxpayer under the Single Business Tax Act (SBTA).**

\* \* \*

(2) Contribution to a partnership. The transfer of property where no gain or loss is recognized under IRC 721.

\* \* \*

(4) Property distributed by a partnership to a partner(s) in a partial or complete liquidation of the partner(s) interest and the property is used in a business activity of an organization in which the partner(s) own a controlling interest (i.e., partners having at least 80% ownership in original partnership must have at least 80% ownership in new entity).

\* \* \*

(8) Liquidation of partnership interest with no sale or exchange of property is a tax-free event providing such partnership is considered as continuing under Section 708 of the IRC. (Emphasis added).

makes First Industrial's position seem rather inconsistent. First Industrial wants a carryover, as the RAB permits, but does not want it to be limited to the circumstances under which the RAB allows a carryover. First Industrial, in a sense, is sawing off the branch it wants to sit on. If – as First Industrial argues and the Court of Appeals ruled – the RAB is not binding, where does First Industrial's right to a carryover come from?

This is one of the reasons the Court of Appeals' expansive reading of the carryover's scope is wrong. It is generally true that RABs are not legally binding, as the Court of Appeals ruled.<sup>12</sup> But it was illogical to rule that the RAB could not be enforced after having ruled that the RAB entitled the taxpayer to the claimed deduction in the first instance. This is rather like a court ruling that a statute is unconstitutional, and then awarding a judgment pursuant to the unconstitutional statute.

**2. The Court of Appeals treated an aspect of the statute that is not at issue in this case as controlling with respect to a completely unrelated aspect of the statute, in a way that leads to an illogical result.**

The second reason the Court of Appeals' reasoning is flawed as to why the carryover should be allowed is that it interprets one part of the statute to reach a conclusion on a completely separate question. The Court of Appeals notes, correctly (Slip Opinion at 2-3), that the SBTA allows (and requires) a taxpayer to apportion its business activity according to whether or not the activity took place in Michigan.<sup>13</sup> The reason it does this is simple – it would violate fairness and equity, and the United States Constitution as well, if Michigan were to impose taxes on activities that had nothing whatever to do with Michigan. And a business loss deduction is

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<sup>11</sup> MCL 208.1 *et seq.*

<sup>12</sup> E.g., *Catalina Marketing Sales Corp v Dep't of Treasury*, 470 Mich 13, 21; 678 NW2d 619 (2004). An RAB is issued pursuant to MCL 205.3(f) in order to “explain current [Treasury] interpretations of current state tax laws.” See Court of Appeals Slip Opinion in this case, 3.

<sup>13</sup> MCL 208.41.

computed with reference to the tax on the business activity apportioned to Michigan<sup>14</sup> – after all, only the business activity that is actually apportioned to Michigan is taxed, and any tax loss must be referenced to something that is actually taxed.

Apportionment of business activity, though, as a prelude to determining the tax base that can be taxed, is not an issue in this case. Apportionment could be at issue in a carryover case – for example, if the activity being carried over occurred partly in Michigan and partly outside it, in which case only the portion of the activity apportioned to Michigan would affect the carryover, and the size of the resulting deduction – but it is not in this one. The issue rises from the fact that Treasury decided that it was appropriate to allow a successor of a company that goes out of business to use the defunct company’s carryover, since the defunct company is no longer around to take it. This decision was set out in RAB 1992-3. If the other company is still in business, regardless of whether it has business activity to apportion to Michigan or not the company still exists, so transferring its assets (like a credit) to someone else is hardly logical. It is similar to allowing the heirs to a will to claim the estate’s assets before the testator dies. Just as a sick person can recover, a business that is still in operation, but has ceased doing business in Michigan, may decide to start doing business in Michigan again, only to find that someone else has already used its loss carryover. This would be unfair, and it would be an illogical way to read the statute. Treasury’s interpretation is correct – certainty can be served, and someone else’s carryover properly claimed, only if the entity that originally had a right to it no longer exists.

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<sup>14</sup> MCL 208.23b(h).

3. **The Court of Appeals ignored the principle that it set out, that because claims for tax credits and deductions violate the principle of tax equality, they must be strictly construed against the party making the claims.**

The final reason the Court of Appeals is wrong in its expansive reading of the statute is just that – it *is* expansive. As the Court of Appeals correctly ruled in this case (with respect to the issue on cross-appeal), tax deductions and credits, like exemptions from taxation, violate the principle of tax equality, and therefore must be strictly construed against the party claiming them.<sup>15</sup> Here, there is an interpretation of a statute – or actually, of language read into a statute, by expanding an RAB beyond its terms – that is not even close to the plain meaning of the statute. By definition, since the statute is construed by the Court of Appeals in a way that goes beyond the statute’s terms, the construction is not strict, and therefore the taxpayer is receiving a credit contrary to the canon regulating availability of credits, thereby undermining the principle of tax equality.

**II. Under MCL 208.23, a taxpayer may claim a capital acquisition deduction in the year of acquisition for qualifying assets if it paid or accrued a cost for those assets. Financing Partnership transferred assets to First Industrial as a return of capital contribution and First Industrial did not pay or accrue a cost for those assets. First Industrial is, therefore, not entitled to a capital acquisition deduction.**

**A. Standard of Review**

The standard of review is the same as that set forth with respect to the first issue.

**B. Analysis**

The Court of Appeals was correct in affirming the Court of Claims’ ruling that First Industrial was not entitled to a capital acquisition deduction since it failed to satisfy the requirements as set forth in §23 of the SBTA and as explained in RAB 1992-3. Section 23 of the

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<sup>15</sup> See cases cited *supra* in fns. 6-9, and the discussion in the accompanying text.

SBTA authorizes a taxpayer to reduce its tax base using the capital acquisition deduction.<sup>16</sup> The capital acquisition deduction allows a taxpayer to deduct the cost of depreciable property "paid or accrued" in the year of acquisition.<sup>17</sup> Treasury, again through its RAB 1992-3, has interpreted §23 and indicated that there are certain acquisitions of property and an associated cost that may be claimed as a capital acquisition deduction.

RAB 92-3 (3A), (3B), (3D), and (3E), state in relevant part:

A. Cost is the amount paid or accrued for the acquisition of a qualifying tangible asset, hereafter, referred to as property. This cost usually equals the basis of property that will be recovered through depreciation, amortization, or other means of write-off.

B. Fair market value or other value is substituted as cost for the following acquisitions:

\* \* \*

(4) Property transferred or distributed by a corporation or a partnership in a complete or partial liquidation of the corporation or partner's interest, except through a tax-free event as defined in Paragraph 3E. Cost is the amount used as the adjusted basis for federal income tax purposes of the property in the hands of the distributee.

\* \* \*

D. No cost is eligible for a CAD for the following acquisitions:

- (1) Property acquired by gift.
- (2) Property acquired from a decedent.
- (3) Property acquired through a tax-free event as defined in paragraph 3E.

E. Transfers of property through certain tax-free events described in subparagraphs (1) through (8) of this section receive the following treatment for SBT purposes: transferor is not entitled to CAD on such property; transferee is not entitled to a CAD on such property; transferee holds the property as if such property was in the hands of the transferor, therefore, the transferee must recapture CAD depending on the acquisition date of the property by the transferor; and transferee is entitled to an SBT business loss carryover for any

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<sup>16</sup> MCL 208.23.

<sup>17</sup> *Dow Chemical Co v Dep't of Treasury*, 185 Mich App 458, 463-464; 462 NW2d 765 (1990).

unused business loss of the transferor when transferor completely discontinues operations and is no longer a taxpayer under the Single Business Tax Act (SBTA).

\* \* \*

(4) Property distributed by a partnership to a partner(s) in a partial or complete liquidation of an organization in which the partner(s) own a controlling interest (i.e., partners having at least 80% ownership in original partnership must have at least 80% ownership in new entity).

First Industrial already owned the assets at issue through its 99.99% ownership of the partnership, and never supplied documentation showing that it paid or accrued a cost for acquiring those assets from Financing Partnership since January 1, 1998. Even during the audit, Treasury's auditor did not find that First Industrial treated the distribution as having a related cost that was either paid or accrued for the assets.<sup>18</sup> Further, during the course of discovery First Industrial supplied a document called a "bill of sale" for the assets between Financing Partnership and First Industrial.<sup>19</sup> However, the document does not state that a cost was paid or accrued by First Industrial, but instead states that First Industrial has given "good and valuable consideration." There is nothing to show that a cost was paid or accrued for the assets, as required by §23 of the SBTA.

Absent any proof of costs paid or accrued, First Industrial wants the courts to take its word that it paid or accrued a cost for those assets. However, it is well-established that the burden is on the taxpayer to maintain accurate records and to provide proof that it qualifies for

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<sup>18</sup> Attachment 3, ¶16, Affidavit of John Clancy. (All referenced attachments are to those in Treasury's brief filed in the Court of Appeals.)

<sup>19</sup> Defendant's Brief in Support of Summary Disposition, Attachment 2, Plaintiff's Response to Defendant's First Request for Production of Documents, Exhibit D.

various exemption, exclusion, and refunds, if such proof is requested.<sup>20</sup> Section 28(5) of the general statute on taxation states:

A person liable for any tax imposed under this act shall keep and maintain accurate and complete records necessary for the proper determination of liability as required by law or rule of the department [of Treasury].<sup>21</sup>

This burden on the taxpayer is consistent with the overall scheme of the tax statutes and the Legislature's intent to give Treasury a means of basing an assessment on the best information available to it under the circumstances. Had First Industrial provided evidence of such costs which were paid or accrued, it would have been entitled to the capital acquisition deduction against its Michigan SBT liability. However, it did not.

Moreover, First Industrial's argument that the Court of Claims demonstrated indifference to its claim lacks merit. The Court of Claims fully analyzed MCL 208.23 and the effect of the language of RAB 1992-3 and properly applied it to the facts of this case. First Industrial failed to establish that it paid or accrued any costs for the assets at issue therefore it did not satisfy the requirements of RAB 1992-3. The Court of Claim's decision was based on the inescapable conclusion that no cost was paid or accrued. That Court employed valid reasoning and examined all of the submitted evidence as required by law. While First Industrial presented an affidavit by Chief Accounting Officer, Scott Munsil, in which he stated that a cost was paid and accrued, he also admits that First Industrial was unable to provide financial documentation to Treasury of the transfer of assets whose value well exceeded \$100,000,000.<sup>22</sup> This evidence was plainly insufficient. Deductions are a matter of legislative grace, and the taxpayer has the burden to

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<sup>20</sup> *Vomvolakis v Dep't of Treasury*, 145 Mich App 238, 246; 377 NW2d 309 (1985).

<sup>21</sup> MCL 205.28(3).

<sup>22</sup> Attachment 17, ¶6, Affidavit of Scott Munsil, First Industrial Realty Trust, Inc. Chief Accounting Officer, Treasurer and Assistant Secretary.

prove he or she is entitled to any deduction claimed.<sup>23</sup> As previously mentioned, a taxpayer is required by MCL 205.28(3) to substantiate amounts claimed as deductions by maintaining the records necessary to establish entitlement to the deductions. A court need not accept a taxpayer's self-serving testimony when the taxpayer fails to present corroborative evidence.

Because First Industrial was unable to provide credible evidence that it paid or accrued costs for the assets Treasury found that it did not pay or accrue a cost for the assets at issue. The Court of Claims was correct in holding that First Industrial is not entitled to the capital acquisition deduction, and the Court of Appeals was right to affirm this holding. The Court of Appeals aptly summed up the facts in these words:

If a limited partner could purchase a substantial interest in a partnership (99% or more in this case), have the partnership obtain any and all tax benefits from the assets purchased with the limited partner's contribution, and then have those assets transferred back to the limited partner for a second opportunity to obtain the same tax benefits from the tax-depleted assets, the purposes of the SBT in general and the CAD specifically would be subverted. (Slip Opinion, 4.)

Addressing the possibility of an alternative ground for First Industrial to claim the capital acquisition deduction, the Court of Appeals, after summarizing the rule that claims for tax exemptions are strictly construed against the taxpayer, then added:

The CAD statute was created to "allow[] the taxpayer's tax base to be reduced by the amount expended during the tax year to acquire capital assets." *Caterpillar, [Inc v Dep't of Treasury, 440 Mich 400,] 409[; 488 NW2d 182 (1992)]*. Here, plaintiff did not prove that it expended any amount of money during the tax year to acquire the assets, but instead merely produced evidence that it acquired the assets through a non-liquidating distribution. Therefore, either plaintiff owned the assets in full through its partnership interest prior to the non-liquidating distribution, or it did not prove that it paid any additional money for the assets, and therefore the incremental investment is zero. In either situation, plaintiff is not entitled to a substantive CAD. (Slip Opinion, 4.)

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<sup>23</sup> *Elias Bros Restaurants, Inc v Dep't of Treasury, 452 Mich 144, 150; 549 NW2d 837 (1996)*.

The Court of Appeals' ruling on this issue was sound. It does not require review by this Court or, if it is reviewed, it should be affirmed.

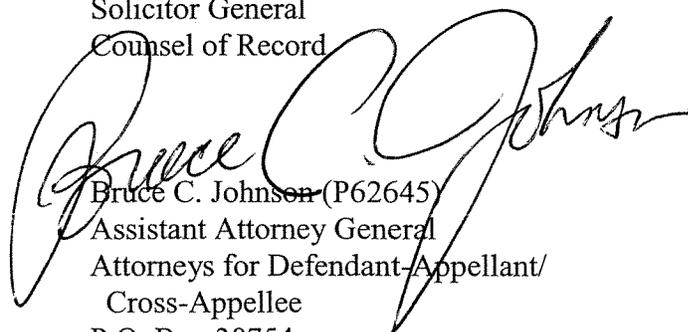
## RELIEF SOUGHT

The only basis for claiming a transfer or carryover of a business loss deduction is the one set out in RAB 1992-3, which provides conditions for such a carryover, conditions that First Industrial did not meet. A capital acquisition deduction may be claimed only where a party shows that it paid or accrued costs to acquire capital, a showing First Industrial failed to make. Defendant-Appellant/Cross-Appellee Michigan Department of Treasury therefore respectfully asks this Honorable Court to reverse the Court of Appeals' ruling that First Industrial was entitled to the business loss deduction and affirm the Court of Claims' ruling that First Industrial was not entitled to that deduction.

Respectfully submitted,

Michael A. Cox  
Attorney General

B. Eric Restuccia  
Solicitor General  
Counsel of Record



Bruce C. Johnson (P62645)  
Assistant Attorney General  
Attorneys for Defendant-Appellant/  
Cross-Appellee  
P.O. Box 30754  
Lansing, MI 48909  
(517) 373-3203

Dated: February 9, 2010

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STATE OF MICHIGAN  
IN THE SUPREME COURT

FIRST INDUSTRIAL,

Supreme Court No. 139748

Plaintiff-Appellee,

Court of Appeals No. 282742

V

Court of Claims No. 06-04-MT

REVENUE DIVISION, DEPARTMENT OF TREASURY,  
STATE OF MICHIGAN,

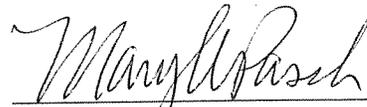
Respondent-Appellant.

**PROOF OF SERVICE**

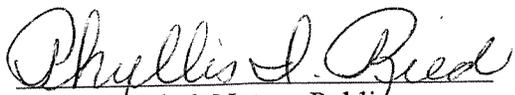
STATE OF MICHIGAN     )  
  ) ss.  
COUNTY OF INGHAM     )

Mary A. Pasch, being duly sworn, deposes and says that on February 9, 2010, she served a copy of Supplemental Brief with Respect to Leave Applications in Appeal and Cross-Appeal, Per the Court's Order of December 29, 2009 with Proof of Service upon the following by depositing the same in a receptacle of the United States Post Office in the City of Lansing, Michigan, enclosed in an envelope bearing postage fully prepaid, plainly addressed as follows:

Michele L. Halloran  
Joshua M. Wease  
WEASE HALLORAN PLC  
523 W. Ionia St.  
Lansing, MI 48933

  
\_\_\_\_\_  
Mary A. Pasch

Subscribed and sworn to before  
me this 9th day of February, 2010.

  
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Phyllis I. Ried, Notary Public  
Ingham County, Michigan  
My commission expires: 11/24/14