STATE OF MICHIGAN
IN THE SUPREME COURT

FIRST INDUSTRIAL L.P.,
Appellee
Plaintiff-Cross-Appellant,

v

MICHIGAN DEPARTMENT OF TREASURY,
Appellant
Defendant-Cross-Appellee.

Supreme Court Docket No. 139748
Court of Appeals Docket No. 282742
Lower Court: Court of Claims Case No. 06-04-MT

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PLAINTIFF-CROSS-APPELLANT'S APPLICATION FOR LEAVE TO CROSS APPEAL

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STATEMENT OF JURISDICTION AND GROUNDS FOR APPEAL TO THE SUPREME COURT

A. Jurisdiction.

This *Application for Leave to Cross Appeal* ("*Application*") is filed under MCR 7.302(D) from the unpublished *per curiam* decision of the Michigan Court of Appeals (the "*Opinion*") dated August 18, 2009, issued by the Honorables Karen Fort Hood, Mark J. Cavanagh, and Kirsten Frank Kelly. A copy of the Court of Appeals' *Opinion* is attached to this *Application for Leave to Cross Appeal* as Exhibit "1." This *Application for Leave to Cross Appeal* is timely brought before this Court under MCR 7.302(D) because it is filed within 28 days after Defendant-Cross-Appellee Michigan Department of Treasury ("Treasury") filed its *Application for Leave to Appeal* relating to an issue decided adversely to it, that involving Plaintiff-Cross-Appellant First Industrial L.P.'s ("FILP's") eligibility for a business loss deduction under Michigan's Single Business Tax Act, 1975 PA 228, *as amended*, MCL 208.1 *et seq.* (now repealed, *see,* 2006 PA 325; MCL 208.151). However, the business loss deduction issue was not the sole issue decided by the Court of Appeals; in its August 18, 2009 *Opinion*, it also affirmed the Court of Claims' determination that, in the event FILP is not eligible to claim a business loss deduction for the tax years in issue, it may not claim a capital acquisition deduction ("CAD") for those same years for the assets it acquired from First Industrial Financing Partnership ("FIFP"). It is from that adverse Court of Appeals ruling with respect to the CAD that FILP offers this *Application for Leave to Cross Appeal.*

FILP respectfully requests that, in the event this Honorable Court grants Treasury's *Application for Leave to Appeal,* it also grant FILP's *Application for Leave to Cross Appeal,* enabling all of the issues decided by the Court of Appeals to be heard by the Court, and

ultimately reversing the Court of Appeals' determination of the CAD issue in the event this Court determines that FILP is not entitled to its claimed single business tax business loss deduction.

B. Grounds for Application Under MCR 7.302(B)(2), (3) and (5)

Three of the six grounds for appeal identified in MCR 7.302(B) are unequivocally presented by the matter now before this Court, as Plaintiff-Cross-Appellant FILP will more fully show through its *Argument, infra:*

➢ First, grounds for review by this Court under ***MCR 7.302(B)(2) and (3)*** clearly exist because this case involves an issue relating to the administration of a tax, Michigan's single business tax, that, although now-repealed, remains in play through ongoing audit, collection, and litigation of various issues, including the CAD issue posited by this case. Moreover, this case presents a serious issue of significant jurisprudential import to Michigan taxpayers as a whole, for it not only addresses a specialized issue focused upon a unique tax enactment, but also has potential widespread impact as to SBT taxpayers who continue to seek proper interpretation of the boundaries of claims to a CAD, thus presenting grounds for review under MCR 7.302(B)(3). Treasury, an agency of Michigan's executive branch, is responsible for administration of the SBT and its scheme, MCL 205.1 *et seq.* Significant public interest exists with respect to the question presented – public interest in the correct determination of a tax issue – and the case is brought against the State or one of its agencies or subdivisions (Treasury) – grounds under MCR 7.302(B)(2).

➢ Ample additional grounds for review by this Court exist under ***MCR 7.302(B)(5)*** because, as this Court shall see, the Court of Appeals, in deciding that under the circumstances presented by this case FILP is not entitled to claim a CAD in the event it does not qualify for a

business loss deduction, has issued a determination that is clearly erroneous as a matter of fact and law and that will cause material injustice in the event the error is not corrected.

STATEMENT OF QUESTIONS

1. **IS THE COURT OF APPEALS' DECISION THAT FILP IS NOT ENTITLED TO A CAPITAL ACQUISITION DEDUCTION IN THE EVENT IT DOES NOT QUALIFY FOR A BUSINESS LOSS DEDUCTION AN ERRONEOUS DETERMINATION THAT WILL CAUSE MATERIAL INJUSTICE, SO THAT THIS MATTER IS APPROPRIATE FOR A GRANT OF LEAVE TO CROSS APPEAL AND CONSIDERATION BY THIS COURT UNDER MCR 7.302(B)(5)?**

   Plaintiff-Cross-Appellant says "Yes."
   Defendant-Cross-Appellee says "No."
   The Court of Claims would say "No."
   The Court of Appeals says "No."

2. **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)?**

   Plaintiff-Cross-Appellant says "Yes."
   Defendant-Cross-Appellee says "No."
   The Court of Claims would say "No."
   The Court of Appeals says "No."

CONCISE STATEMENT OF MATERIAL PROCEEDINGS AND FACTS

A. The Record.

The Court of Claims did not conduct an evidentiary hearing in connection with this matter, inasmuch as the case was presented for the trial court's consideration on the parties' cross-motions for summary disposition under MCR 2.116(C)(10). Accordingly, no evidentiary record exists that can be referenced by the parties to this *Application*. However, the parties did provide the lower court with a *Stipulation of Facts* (appended to this *Application for Leave to Cross Appeal* as Exhibit "2"), and references are available to the transcript of oral argument offered by the parties on their cross-motions.

B. Introduction and Summary of Issues

As permitted by MCR 7.302(D), FILP applies for leave to cross appeal from the unpublished *per curiam Opinion* issued by the Court of Appeals on August 18, 2009. This *Application for Leave to Cross Appeal* concerns only one of the issues considered and decided by the court, that relating to FILP's eligibility to claim a single business tax CAD in the event it does not prevail on its claim that it is entitled to a business loss deduction for the contested tax years. Inasmuch as the Court of Appeals correctly decided the primary business loss deduction issue in FILP's favor, and Treasury has filed an *Application for Leave to Appeal* addressed to that issue, FILP brings this request to cross appeal so as to bring the CAD issue into play should this Court grant Treasury's *Application.*

In this case, both the Court of Claims and the Court of Appeals failed to understand that FILP in fact ***is*** eligible for a single business tax CAD in the event it is not entitled to claim a business loss deduction for the tax years under consideration, and that FILP accordingly is entitled to (at a minimum) a partial refund of SBT paid to Treasury. Their decisions to the contrary are

clearly erroneous and will constitute a material injustice to FILP and similarly-situated Michigan taxpayers if not reversed. Moreover, both lower courts failed to understand that Treasury has ignored its own guidance concerning the validity of FILP's refund request on these facts. Furthermore, neither the Court of Claims nor the Court of Appeals properly attended to the well-known governing precept that laws involving the imposition of a tax are to be construed in favor of the taxpayer, and against the government, for the reason that they entail the appropriation of the taxpayer's funds or property.

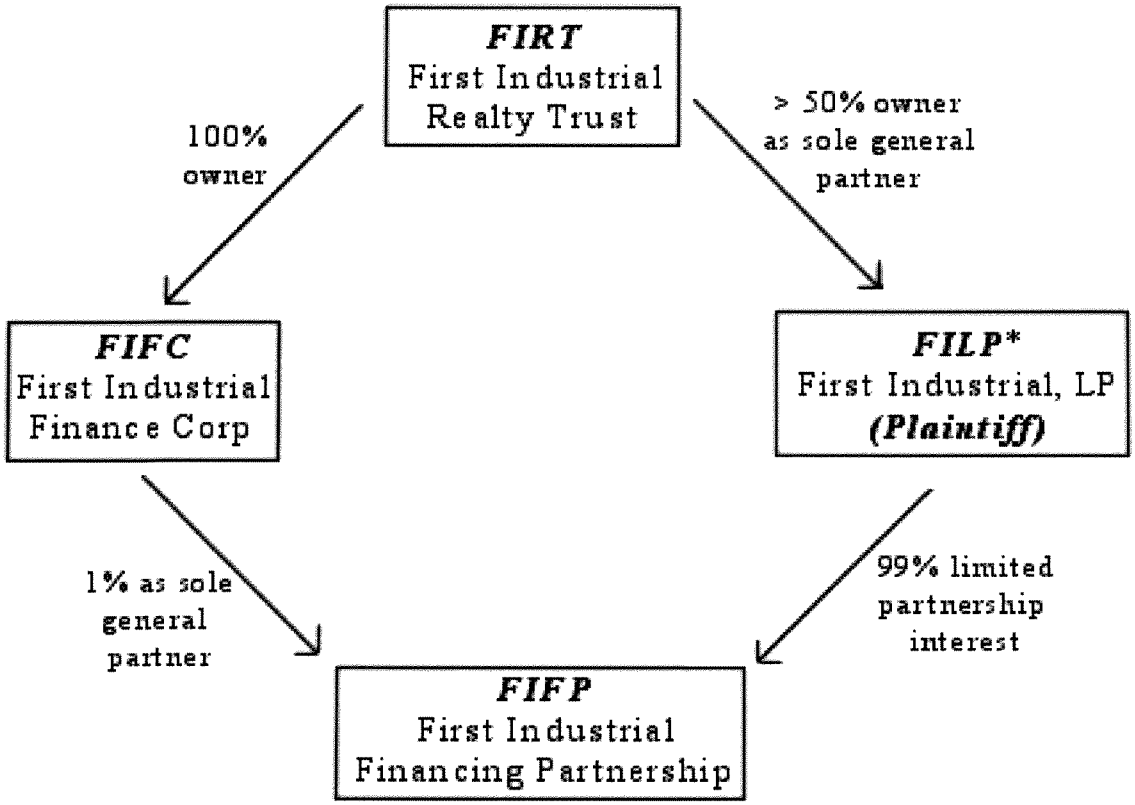
STATEMENT OF FACTS AND PROCEEDINGS

A. Factual background.

The facts of this case are somewhat complex. First Industrial Realty Trust, Inc. ("FIRT") is a 100% owner of First Industrial Finance Corporation ("FIFC"). FIRT is also the sole general partner of, and owns more than a 50% interest in, Plaintiff First Industrial, L.P. ("FILP"). FILP is (a) the "operating partnership" through which FIRT and its affiliates generally operate their real estate-related business, and (b) the entity that generally holds title to most of the real estate assets owned and operated on behalf of FIRT and its affiliates (the foregoing arrangement, the "First Industrial Structure").

Before 1998, FIFC was the sole general partner of, and owned a 1% general partner interest in, First Industrial Financing Partnership, L.P. ("FIFP"), while FILP owned a 99% limited partner interest in FIFP. *Affidavit of Scott Musil* ¶4 ("*Musil Affidavit,*" Exhibit "3"). A diagram of the First Industrial structure in 1997 is pictured below.

FIRST INDUSTRIAL STRUCTURE IN 1997

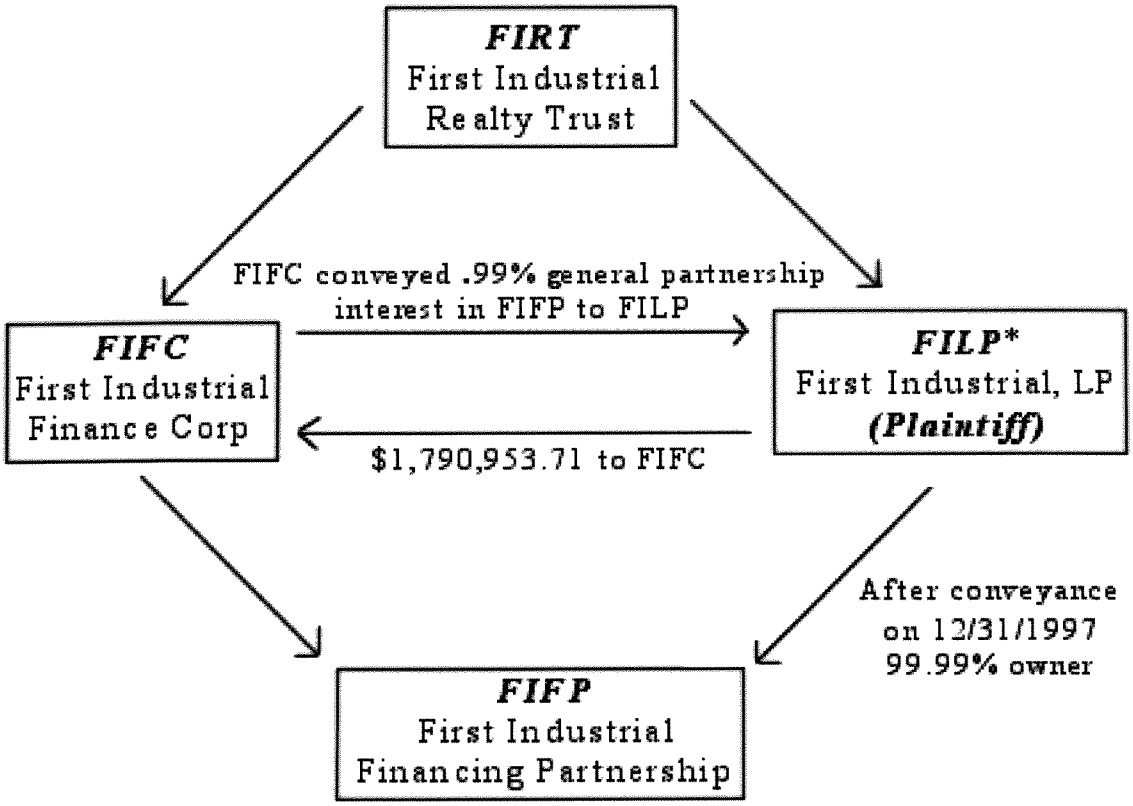


* First Industrial, LP (FILP) is the operating partnership of the First Industrial structure.

In 1997, FIFP owned certain Michigan real property that constituted a portion of the collateral for a certain securitized loan made to FIFP (the "REMIC Loan"). FIFP defeased the REMIC Loan in a two-step process on April 4 and December 31, 1997. Thereafter, FIFP was free to distribute its assets (including those properties in Michigan) that had been collateral for the REMIC Loan. Subsequent to the defeasement of the REMIC Loan, management within the First Industrial structure determined that, for business operational purposes, it would be in the best interests of the First Industrial structure to cause assets owned by FIFP (including the Michigan properties) to be transferred to FILP, given FILP's role as the operating partnership of the First Industrial structure. Exhibit "3", ¶5.

To accomplish the first step in the distribution and transfer of FIFP's Michigan assets to FILP and accommodate the requirements of certain Real Estate Investment Trust ("REIT") rules, FIFC, as the sole general partner of FIFP, conveyed 99% of its 1% general partner's partnership interest in FIFP to FILP. FILP paid FIFC $1,790,953.71 in consideration of this transfer. As a result of this transaction, FILP's ownership percentage in FIFP increased by .99%, to 99.99%. Aside from this particular change in ownership percentage, no other change in FILP's ownership percentage in FIFP occurred. Exhibit "3", ¶6. Please see the following diagram, which illustrates the transfer of partnership interests in exchange for cash.

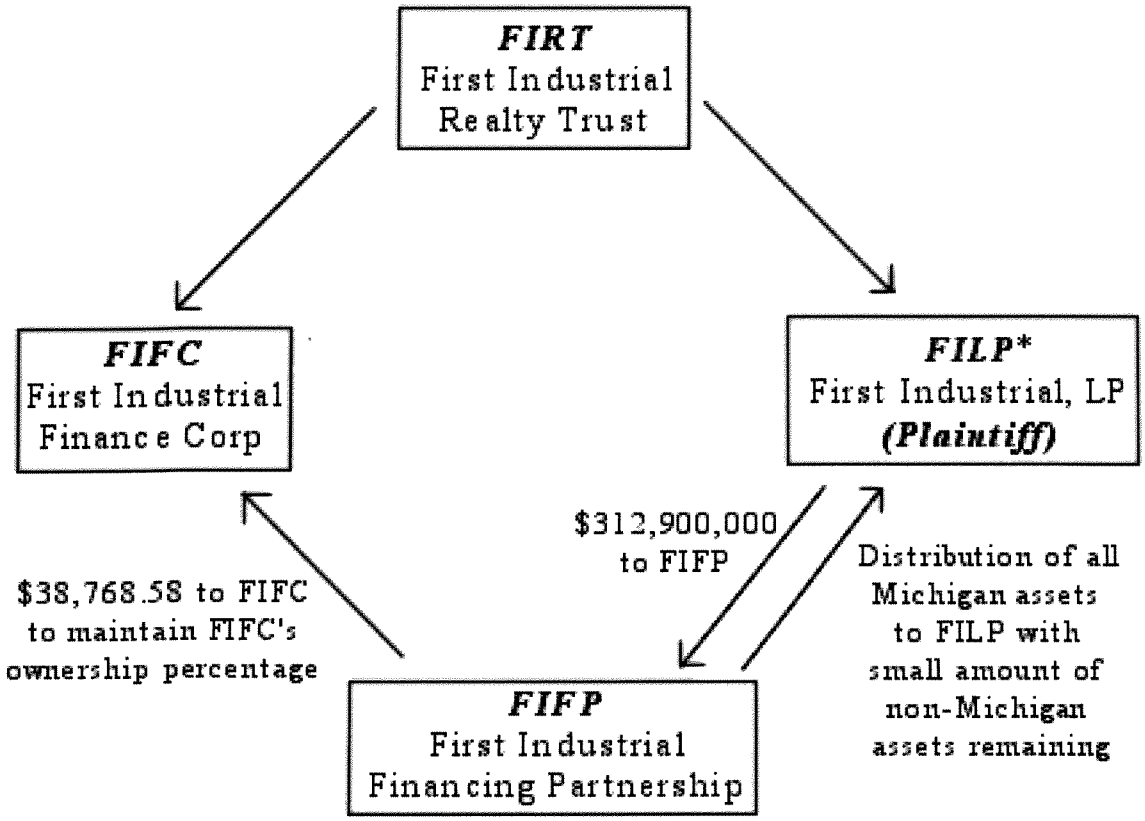
FIRST INDUSTRIAL RESTRUCTURING TRANSACTION 12/31/1997



* First Industrial, LP (FILP) is the operating partnership of the First Industrial structure.

On January 1, 1998, FIFP distributed a majority of its assets to FILP, leaving a small amount of non-Michigan assets in FIFP. FILP acquired the assets for $312.9 million. At the same time, FIFP distributed $38,768.58 to FIFC to ensure that FIFC's ownership interest in it remained the same after the distribution. Exhibit "3", ¶7. The distribution of assets in exchange for $312.9 million is diagrammed below:

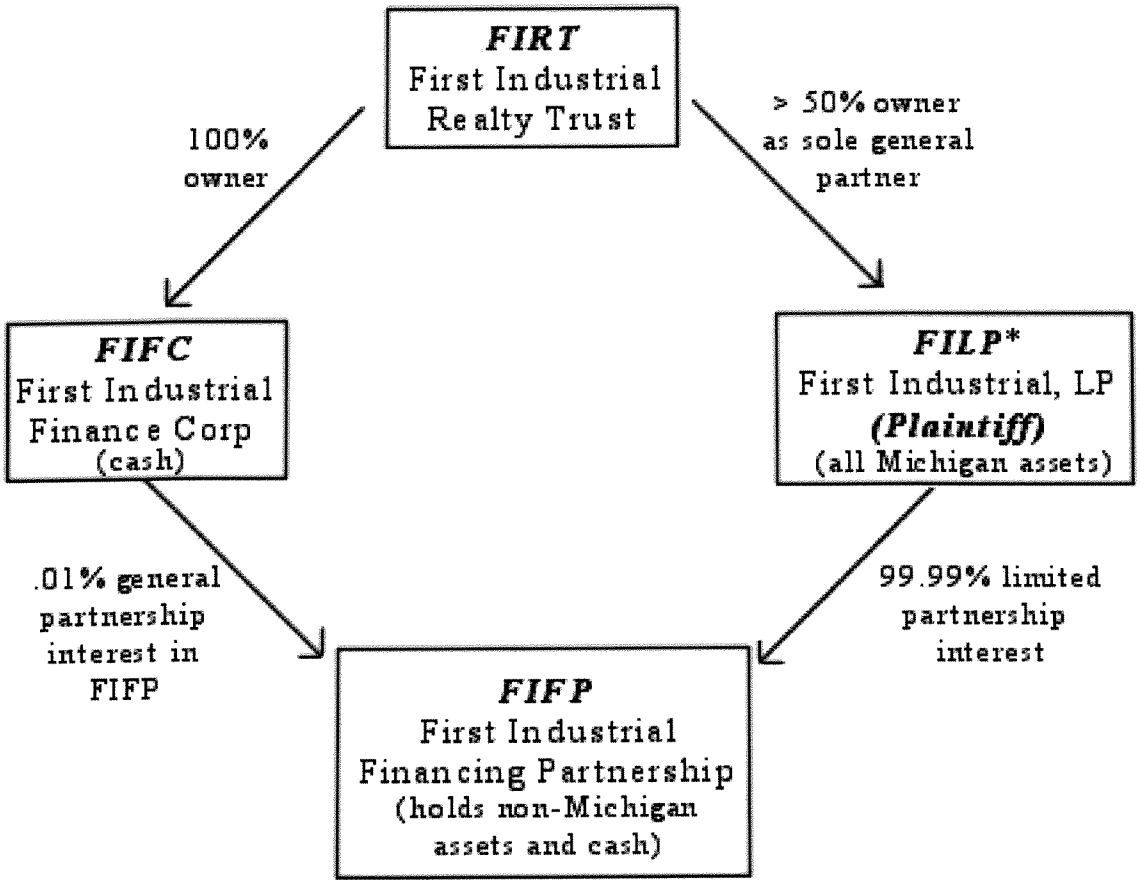
FIRST INDUSTRIAL RESTRUCTURING TRANSACTION 1/1/1998



* First Industrial, LP (FILP) is the operating partnership of the First Industrial structure.

The resulting First Industrial Structure is diagrammed next:

FIRST INDUSTRIAL STRUCTURE AFTER 1/1/1998 RESTRUCTURING TRANSACTION



* First Industrial, LP (FILP) is the operating partnership of the First Industrial structure.

B. Procedural facts.

FILP is a limited partnership with its principal place of business at 311 S. Wacker Drive, Suite 4000, Chicago, IL 60606. [*Stipulation of Facts* ("*SOF*") No. 1, Exhibit "2"] Treasury is the statutorily-designated collection agent for the tax imposed by the SBTA. Treasury's principal place of business is located at the Treasury Building, Lansing, Michigan. (Exhibit "2," No. 2) The taxes involved are Michigan single business taxes ("SBT") (together with interest) assessed by Treasury to FILP for the taxable period extending from January 1, 1999 through December 31, 2000, *i.e.,* for tax years 1999 and 2000. (Exhibit "2," No. 3)

On January 1, 1998, FIFP executed quit claim deeds transferring all of its Michigan assets to FILP. (Exhibit "2," No. 8) During each of the years in issue, FILP engaged in business activity in Michigan and was subject to payment of Michigan SBT. For the 1998 tax year, FILP originally filed a Michigan SBT return on which it claimed an available business loss deduction carryover in the amount of $149,207,916, the greater part of which was attributable to the unused business loss deduction carryover of FIFP, and the remainder of which was attributable to the business loss deduction carryover of FILP. (Exhibit "2," No. 11) On its original 1998 SBT return, FILP did not claim a CAD relating to the Michigan assets it acquired in the 1998 partnership distribution from FIFP. (Exhibit "2," No. 12)

Treasury audited FILP for tax years 1998 through 2000, and as a result disallowed the unused business loss deduction carryover of FIFP that FILP had reported on its 1998 SBT return. *Complaint* ¶ 16. Subsequent to the audit, Treasury issued Bill for Taxes Due (Intent to Assess) L924193, reflecting its assertions that FILP is liable for SBT in the amount of $1,056,255 for tax years 1999 and 2000, as well as for interest computed with respect to the alleged tax deficiency. (Exhibit "2," No. 14) FILP timely requested an informal conference before Treasury as

permitted by MCL 205.21.

The informal conference convened on June 20, 2005. (Exhibit "2," No. 15) At the informal conference, FILP contended that, for the years in question, it is entitled to claim as a business loss deduction carryover a portion of FIFP's business loss deduction carryover, for the reason that the business loss deduction was created by the assets that were transferred to FILP. FILP offered as an alternate position that, if it cannot use a portion of FIFP's business loss deduction carryover, it is entitled to a CAD on the Michigan assets it received in the non-liquidating distribution from FIFP. (Exhibit "2," No. 16) After informal conference, Treasury's hearing referee issued her recommendation sustaining the Bill for Taxes Due (Intent to Assess) L924193 as issued, and on October 25, 2005, the Administrator of the Office of Hearings, acting on behalf of former State Treasurer Jay B. Rising, issued his *Decision and Order of Determination*, in which he accepted the hearing referee's recommendation as Treasury's final determination. (Exhibit "2," No. 17)

Thereafter, Treasury, on November 2, 2005, issued Final Bill for Taxes Due (Final Assessment) L924193, reflecting Treasury's determination that FILP is liable for SBT for tax years 1999 and 2000 in the amounts of $567,354 and $488,901, respectively, and interest computed to the date of the Final Assessment totaling $356,589.18, a total alleged amount due of $1,412,844.18. (Exhibit "2," No. 18) On December 20, 2005, FILP remitted to the Michigan Department of Treasury its check number 173332 in the amount of $1,429,413.31, in full payment of Final Bill for Taxes Due (Final Assessment) L924193, together with additional interest computed through December 31, 2005. In correspondence that accompanied this payment, FILP protested payment of the tax and interest, and expressly requested a refund of the tendered amount. (Exhibit "2," No. 19)

FILP filed its *Complaint* against Treasury on January 13, 2006, requesting a full refund of the total amount of SBT and interest paid as a consequence of Treasury's issuance of its *Decision and Order of Determination* and Final Bill for Taxes Due (Final Assessment) L924193. (Exhibit "2," No. 19) Treasury responded to FILP's *Complaint* in its *Answer* filed on March 3, 2006. Discovery ensued, including several filings of interrogatories, requests for production, and requests to admit by both Treasury and FILP. Pursuant to the *Joint Stipulation and Motion for Adjournment of Trial, and For Entry of Order Scheduling the Filing of a Stipulation of Facts, Motion for Summary Disposition and Responses to the Summary Disposition and Hearing Date* filed on May 11, 2007, discovery closed on June 29, 2007, and Defendant and FILP subsequently agreed to file respective *Motions for Summary Disposition* on September 7, 2007 and *Responses* to these *Motions* by October 1, 2007.

As specifically concerns the "cost paid or accrued" issue, the following colloquy took place before the Court of Claims at oral argument on the parties' cross-motions for summary disposition. In this discussion with the Court, FILP attempted to explain to the Court of Claims the meaning of the word "accrue" in the context of a deductible cost pursuant to Revenue Administrative Bulletin ("RAB") 1992-3 (Exhibit "5"):

> ***Ms. Tonda***: Well, I do want to clarify what the definition of cost is.
> ***The Court***: And what page would that be?
> ***Ms. Tonda***: Actually, I have the RAB right here, your Honor if you would like me to bring it to you, and I've got the page marked. Mike, I can give you copy too.
> ***Mr. Bell***: Okay.
> ***Ms. Tonda***: Your Honor, I want to direct your attention to paragraph 3a.
> ***The Court***: This something that's put out by the Government.
> ***Ms. Tonda***: Yes, your Honor. This is the Revenue Administrative Bulletin that discussed the capital acquisition deduction.
> ***The Court***: Okay.
> ***Ms. Tonda***: And what this definitional paragraph provides is, the first sentence, "Cost is that amount paid or accrued for the acquisition of a qualifying tangible assets, hereafter referred to as property," and I think both Treasury and

limited partnership has discussed this particular sentence at length; but what nobody else has gone into is the second sentence which states, "This cost usually equals the bases of property that will be recovered through depreciation, amortization or other means of right-off [sic]; and it's…

The Court: You mean by recovered that's a fancy word you folks use for repayment, right?

Ms. Tonda: Well, the—the way depreciation would work would be it would be a cost recovery system so that the cost you initially laid out for whatever particular asset you would be able to recover that.

The Court: I have a tangible asset, and I dispose of it. What is recovered?

Ms. Tonda: If you have a tangible asset, and you dispose of it, what is recovered?

The Court: Right.

Ms. Tonda: I'm not sure I understand.

The Court: Under CAD.

Ms. Tonda: Oh, oh, oh, okay. So you're talking about the capital recovery position?

The Court: Yes.

Ms. Tonda: Okay, all right. That's something different than what I'm referring to.

The Court: Okay.

Ms. Tonda: Okay. What I'm referring to is actually what happens when that—when limited partnership acquired the assets from the financing partnership what cost was incurred.

The Court: Oh.

Ms. Tonda: And it's our position that the cost was the $312.9M that I referred to in my brief.

The Court: What tangible assets are you talking about?

Ms. Tonda: The tangible assets there were in the property transfer your Honor, the financing partnership—excuse me, the limited partnership acquired assets from the financing partnership, and those were tangible personal property. It was real estate and buildings that were transferred to the limited partnership.

The Court: Okay.

Ms. Tonda: And those assets were valued—had depreciation deduction left on, on that—those particular assets in the amount of $312.9M.

The Court: But you're both in agreement as to what the government describes as the CAD and so forth?

Ms. Tonda: I'm sorry, I' not sure…

The Court: Well, you're all in accord with this bulletin, whatever you want to call it?

Ms. Tonda: Oh, do we mean—I'm sorry. That we agree that this is a government document, is that—

The Court: Right.

Ms. Tonda: All right. I believe so that we believe that this is the relevant document that explains and describes the capital acquisition deduction and the circumstances that involve the limited partnership.

> ***The Court***: Okay. Now when does the Single Business Tax expire so I can get some sleep?
>
> ***Ms. Tonda***: 12-31-2007
>
> ***Mr. Bell***: December 31, 2007
>
> ***Ms. Tonda***: December 31, 2007.
>
> ***The Court***: So January 1st we can celebrate not only a new year but the demise of the Single Business Tax.
>
> ***Ms. Tonda***: Yeah, I don't know if the new tax is as much to celebrate, but we could certainly celebrate the demise of the Single Business Tax.
>
> Your Honor, just to finish up, the limited partnership's acquisition of this property equals the bases that it will recover through depreciation deductions in the amount of $312.9 million. That's the cost that was paid and accrued and pursuant to the RAB; and therefore we fall squarely within the requirements of the RAB; and if you have any further questions, I'll be happy to answer them at this time.
>
> ***The Court***: Nope. *Transcript*, 5:9 – 8:23.

The Court of Claims issued its *Order Granting Defendant's Motion for Summary Disposition* on December 11, 2007, Exhibit "4." With respect to the CAD issue that is the solitary subject of this *Application for Leave to Cross Appeal*, the Court of Claims determined that FILP did not demonstrate that it had paid or accrued anything for the assets it acquired, and therefore was not entitled to a CAD.

FILP timely appealed the Court of Claims' decision to the Court of Appeals and presented oral argument. On August 18, 2009, the Court issued its unpublished *Opinion* per curiam, in which it looked to RAB 1992-3(3)(E)(4), and stated the following with respect to the CAD issue that is the subject of this *Application for Leave to Cross Appeal*:

> Plaintiff contends that it entitled to a CAD because it does not meet the above definition [that set forth in RAB 1992-3(3)(E)(4)], or any others listed in RAB 1992-3, as the transfer of assets from FIFP was a non-liquidating distribution for federal tax purposes pursuant to IRC § 732(a)(1). The enumerated list in RAB 1992-3 does not contain a non-liquidating distribution as one of the tax-free events that receive special tax treatment under the SBTA.
>
> Defendant acknowledges that there was a non-liquidating distribution, but argues that the non-liquidating distribution was merely a return of plaintiff's capital investment in FIFP. Defendant presented the

> affidavit of defendant's auditor, John Clancy, which outlined the transactions between plaintiff and FIFP. Clancy stated that FIFP purchased property in 1994 and 1995, for which it claimed CAD and a resulting business loss deduction. In 1998, the subject property was transferred to plaintiff in a tax-free distribution. Plaintiff claimed a business loss deduction of $135,099,663 for the same property in 1998. Clancy stated, "During the audit, my review of [plaintiff's] single business tax returns and other documents did not disclose that [plaintiff] ever paid or accrued a cost for the assets that [FIFP] transferred to [plaintiff]."
>
> Plaintiff also presented the affidavit of Scott Musil, who was employed with First Industrial Realty Trust, Inc., a 50% owner of plaintiff's partnership. Musil stated that FIFP distributed a majority of its assets to plaintiff for $312.9 million as a return of capital to plaintiff.
>
> 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 tax benefits from the tax-depleted assets, the purposes of the SBT in general and the CAD specifically would be subverted.
>
> Moreover, exemptions from tax are not favored, must be construed strictly in favor of the government, and the party asserting the exemption bears the burden of proof. 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." Here, plaintiff did not prove that it expended any amount of money during the tax year to acquire the assets, but instead merely provided 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 provide 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. (citations omitted) *Slip Opinion*, pp ***.

Treasury filed its *Application for Leave to Appeal*, and FILP now files its *Application for Leave to Cross Appeal*. FILP presents this *Brief* in support of its *Application for Leave to Cross Appeal* demonstrating to this Court that the Court of Appeals' decision of the CAD issue is patently erroneous, that the issue is significant to Michigan tax jurisprudence, and that there is

ample public interest associated with this issue that warrants a grant of leave to cross appeal in the event this Court grants Treasury's *Application* with respect to the business loss deduction issue.

ARGUMENT

I. THE COURT OF APPEALS RENDERED A CLEARLY ERRONEOUS DECISION ON A NUMBER OF COUNTS THAT WILL CREATE A MATERIAL INJUSTICE, SO THAT THIS MATTER IS APPROPRIATE FOR A GRANT OF LEAVE TO CROSS APPEAL AND CONSIDERATION BY THIS COURT UNDER MCR 7.302(B)(5).

A. Overview of the pertinent statutory and administrative scheme.

One of the post-allocation and apportionment deductions permitted under MCL 208.23 is the CAD, which allows taxpayers to deduct of the entire cost, paid or accrued, of certain tangible assets in the year of acquisition. MCL 208.23 exists to give a measure of relief to SBT taxpayers who own and use property that adds value to Michigan's economy. As this Court noted in *Caterpillar, Inc v Dep't of Treasury,* 440 Mich 400, 409; 488 NW2d 182 (1992), "[t]he CAD does just what its name suggests. It provides a deduction for the acquisition of capital assets."

In its RAB 1992-3, Treasury discusses at length the circumstances in which a taxpayer may claim a CAD, and outlines the instances in which CAD must be recaptured.

Generally speaking, an asset is eligible for the CAD permitted under MCL 208.23 if it is of the type that is or will become eligible for depreciation or amortization under the Internal Revenue Code. *RAB 1992-3 ¶2(A).* As the assets acquired by FILP consist entirely of items of Michigan real property that are eligible for depreciation or amortization under the Internal Revenue Code, they unmistakably are assets eligible for a CAD.

The question affecting FILP is whether it is entitled to a CAD under the circumstances involving the asset transfer outlined in the factual portion of this *Application for Leave to Cross Appeal.* While both the Court of Claims and the Court of Appeals determined that FILP did not demonstrate a cost paid or accrued for these assets, these determinations are factually and legally erroneous, requiring reversal.

RAB 1992-3 addresses situations involving transfers of property through certain tax-free events, and identifies CAD, CAD recapture, and SBT business loss carryover treatment in such situations. Specifically with respect to the CAD, RAB 1992-3, in ¶ 3(D), states that no CAD is permitted for property acquired through a tax-free event as defined in ¶ 3(E). Eight tax-free events are specified, and this list is all-inclusive:[1]

(1) Transfer to a controlled corporation. The transfer of property where no gain or loss is recognized under IRC 351.

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

(3) Property acquired by a corporation from another corporation in the following liquidations and reorganizations as provided under the IRC. (§ references are to the IRC.)

(A) The complete liquidation of a subsidiary corporation where no gain or loss is recognized in accordance with the provisions of § 332, but only if the basis of the assets distributed to the acquiring corporation is not adjusted by § 334(b)(2);

(B) A statutory merger or consolidation qualifying under § 368(a)(1)(A) to which § 361 applies;

(C) A reorganization qualifying under § 368(a)(1)(C);

(D) A reorganization qualifying under § 368(a)(1)(D) if the requirements of § 354(b)(1)(A) and (B) are satisfied; and

(E) A mere change in identity, form, or place of organization qualifying under § 368(a)(1)(F).

(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).

(5) Corporate reorganization under certain receivership and bankruptcy proceedings to the extent § 371 of the IRC applies.

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[1] *See* the Department's *Answers to Plaintiff's First Request for Admissions*, No. 13.

(6) Initiation of proceedings under the Bankruptcy Code.

(7) Proceedings under the Bankruptcy Code when at least a 51% interest of the entity emerging from the bankruptcy proceedings is retained by the original 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 § 708 of the IRC.

By its own terms, the language of RAB 1992-3 – to the extent that it ***does not allow*** a CAD for those events that are expressly identified in ¶ 3(E) – ***does allow*** the CAD for tax-free events that do not satisfy the definition of "tax-free event" found in ¶ 3(E). A determination of whether assets transferred in a particular tax-free event are eligible for a CAD under Treasury's RAB 1992-3 is guided by the time-honored legal maxim, *expressio unius est exclusio alterius* (the expression of one thing excludes all others).[2] Treasury did not say in RAB 1992-3 that the list of events enumerated in ¶ 3(E) was not comprehensive; accordingly, we must assume that it is an exhaustive list.[3] Thus, to the extent the Department has expressed in RAB 1992-3 those tax-free events for which no CAD is available, *all other tax-free events not mentioned are, to the contrary, eligible for a CAD with respect to transferred assets.* The Court of Appeals' *Opinion* in this case indicates the court's apparent acquiescence in this assertion.

RAB 1992-3 ¶ 3(E) sets forth the eight (8) different tax-free events listed above, for which no CAD may be taken, and no CAD recapture need be recognized. Of the eight (8) different tax-free events specified above for which no CAD is allowed, only <u>one</u> – that which is set forth in RAB 1992-3 ¶ 3(E)(4) – even potentially addresses the transfer of assets in 1998 from FIFP to FILP. The tax-free event for which no CAD is permitted as disclosed in RAB 1992-3 ¶

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[2] *See Durant v State Bd of Education*, 424 Mich 364; 381 NW2d 662 (1985); *Newhall v Ace Steel & Fabricating Co*, 352 Mich 528; 90 NW2d 459 (1958).

[3] *See also,* the *Department's Answer to Plaintiff's First Request for Admissions No. 13* where the Department admits that ¶3(E)(1)-(8) encompasses all the tax free events for which no CAD is

3(E)(4) involves:

> 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).

The asset distribution from FIFP to FILP that occurred in 1998 does not meet the definition of "tax-free event" for which no CAD is allowed under RAB 1992-3 because the property ***was not distributed by FIFP in a partial or complete liquidation of FIFP's partnership interest.***[4] The distribution of assets was treated as a non-liquidating distribution for federal tax purposes pursuant to IRC §732(a)(1). IRC §732(a)(1) discusses distributions other than in liquidation of a partner's interest. IRC §761(d) defines liquidation of a partnership interest as "the termination of a partner's entire interest in a partnership by means of distribution, or a series of distributions, to the partner from the partnership." The 1998 distribution of assets from FIFP to FILP did not involve any liquidation of a partnership interest, as there was no termination of any partner's interest. However, as the Department's Hearing Referee determined in her *Informal Conference Recommendation*, "the relevant inquiry is not the tax treatment of FIFP, but whether MCL 208.23 authorizes CAD on assets that were distributed by FIFP to Petitioner in 1998."

B. The Court of Appeals' decision is clearly erroneous in a number of critical respects and, if not reversed will create a material injustice.

The decision rendered by the Court of Appeals in this case is clearly erroneous and thereby qualifies this case as an appropriate one for review by this Court on leave to cross appeal in several key respects.

(continued)
permitted.

[4] *See Musil Affidavit* ¶¶6, 7 and 8(f). *See also*, *SOF* Nos. 6 and 7.

1. The Court of Appeals clearly erred in holding that FILP did not pay or accrue any amount with respect to the transferred assets.

In accordance with Treasury's own delineation in RAB 1992-3 of circumstances in which a CAD is available to a taxpayer upon the transfer of assets, and given that the transferred assets are of a type that are or will become eligible for depreciation or amortization under the Internal Revenue Code, FILP is entitled to claim a CAD in 1998 for the assets transferred to it by FIFP. The Court of Appeals' determination to the contrary constitutes clear error.

As a preliminary matter, Treasury admitted in its *Answers to Plaintiff's First Request for Admissions*, No. 13, that RAB 1992-3(3)(E)(1)-(8) encompasses all of the tax free events in which property is acquired and the transferee is not eligible for a CAD.[5] Therefore, Treasury confirmed (and the Court of Appeals accepted) FILP's reading of the RAB that events not listed in ¶ 3(E) are, in fact, eligible for a CAD. The partners' (FIFC's and FILP's) ownership interests in FIFP did not change after the distribution of the assets. In fact, the ownership percentages were exactly the same immediately before and after the distribution. *See SOF No.* 7, Exhibit "2." Accordingly, as there was no liquidating distribution with regard to the transfer of assets from FIFP to FILP, and because, by the Department's own admission, RAB 1992-3(3)(E)(1)-(8) embraces each and every one of the tax-free events in which a transferee would not qualify for a CAD, FILP qualifies for a CAD.

Contrary to the Court of Appeals' determination, FILP is clearly entitled to a CAD under MCL 208.23 as it acquired Michigan assets that are eligible for depreciation through payment or accrual. The Court of Appeals, in ruling that FILP did not qualify for the CAD despite meeting every requirement for the deduction, achieved a conclusion that is clearly contrary to established law and must be reversed.

The Court of Appeals committed a critical error in concluding that because FILP did not document that a cost was paid or accrued for the Michigan assets, it was not entitled to the claimed CAD. The lower court's interpretation is in complete derogation of the concept of "accrued." "Accrue" means "to happen or result as a natural growth, addition, etc" or "to be added as a matter of periodic gain or advantage, as interest on money." *Merriam-Webster Online Dictionary* (2008). Similarly, the *Compact Oxford English Dictionary* defines "accrue" to mean "of a benefit or sum of money received in regular or increasing amounts; or accumulate or receive (payments or benefits)." It is readily apparent that the Court of Appeals failed to understand that FILP indeed did have a cost "accrued" because it accumulated or received substantial benefits with its asset acquisition.

Contrary to the lower courts' understandings, FILP accrued the assets from FIFP as it added value to its portfolio by the acquisition. And, contrary to the Court of Appeals' determination, FILP ***did*** provide documentation of the cost accrued – primarily in the form of the affidavit of Scott Musil, FILP's Chief Accounting Officer (Exhibit "3"), stating that a transfer of assets from FIFP to FILP occurred in the amount of $312.9 million. Not only is evidence of the accrual of a cost shown through the Musil affidavit, it also is demonstrated by FILP's and Treasury's stipulation that FILP is a transferee and FIFP a transferor with respect to the 1998 transfer of assets, and that as a result of the transfer, FILP received additional Michigan assets. *See, SOF¶¶ 25 and 26*, Exhibit "2." Although the Musil affidavit indicates that a conversion in FILP's general ledger system prevented the recovery of accounting documentation for the transaction, *Musil Affidavit, ¶9*, the affiant, a key participant in the transaction, was intimately involved in the transfer, and had personal knowledge of the transaction, how it was structured,

(continued)
[5] *See* No. 13 Exhibit "F" attached to *Plaintiff's Brief in Support of Motion for Summary Disposition.*

and the amount and type of assets that were distributed in exchange for the $312.9 million. *See,* Exhibit "3." This affidavit, which demonstrates an accrual of cost, is entitled to substantial weight, weight that the Court of Appeals, in error, declined to give.

It is clear that FILP accrued a cost with respect to Michigan assets as a result of the asset transfer to it from FIFP; the Court of Appeals' determination to the contrary constitutes an error causing material injustice to this and other similarly-situated taxpayers.

2. The decision of the Court of Appeals is "clearly erroneous" and warrants review under MCR 7.302(B)(5) because the court, in rendering its decision, improperly gave more credence to the affidavit of Treasury's auditor and largely overlooked the affidavit supplied by a corporate officer with personal knowledge of the transaction.

Inexplicably, the Court of Appeals' decision in this case attaches great weight to an affidavit of John Clancy, a Treasury auditor, without affording appropriate consideration to the affidavit of FILP's Chief Accounting Officer, Scott Musil, a person who, unlike Mr. Clancy, had comprehensive personal knowledge of the asset transfer in question here. Specifically, this is what the court observed about the parties' affidavits:

> Defendant presented the affidavit of defendant's auditor, John Clancy, which outlined the transactions between plaintiff and FIFP. Clancy stated that FIFP purchased property in 1994 and 1995, for which it claimed CAD and a resulting business loss deduction. In 1998, the subject property was transferred to plaintiff in a tax-free distribution. Plaintiff claimed a business loss deduction of $135,099,663 for the same property in 1998. Clancy stated, "During the audit, my review of [plaintiff's] single business tax returns and other documents did not disclose that [plaintiff] ever paid or accrued a cost for the assets that [FIFP] transferred to [plaintiff]."
>
> Plaintiff also presented the affidavit of Scott Musil, who was employed with First Industrial Realty Trust, Inc., a 50% owner of plaintiff's partnership. Musil stated that FIFP distributed a majority of its assets to plaintiff for $312.9 million as a return of capital to plaintiff. *Slip Opinion,* p 4.

In the "battle of affidavits," the Court of Appeals erred in attributing greater weight to Treasury's auditor's affidavit than it did to that of Mr. Musil, someone with first-hand experience and information about the transaction in issue. Moreover, the Court of Appeals' rendition in this case is most telling for what is missing, allusion to that component of the Musil affidavit that amply demonstrates that FILP did accrue a cost for the assets it obtained from FIFP, *i.e.,* Musil's statement that FILP acquired the assets for $312.9 million, Exhibit "3," ¶ 7. In addition, the lower court assumed too much from Clancy's generalized statement that he reviewed tax returns and documents and did not glean "cost paid or accrued" from his examination; however, his affidavit fails to show the extent of his examination, nor does it detail exactly what documents he reviewed. For all the Court of Appeals knew, Clancy reviewed "documents" such as articles of incorporation and bylaws which by no means would detail anything about 'cost paid or accrued" by FILP for the asset transfer.

The Court of Appeals' primary reliance on the Clancy affidavit in the face of the more meaningful and reliable Musil affidavit is clearly erroneous, thus warranting further review by this Court should it determine to grant Treasury's *Application for Leave to Appeal.*

3. The decision of the Court of Appeals is clearly erroneous and warrants review under MCR 7.302(B)(5) because the court premised its decision to deny FILP a CAD as an alternate measure on inappropriate grounds, grounds that demonstrate the court's failure to understand the workings of the CAD.

In deciding this case, the Court of Appeals weighed in relative to its view that allowing multiple taxpayers an opportunity to claim a CAD with respect to the same assets somehow violates the letter and spirit of the SBTA insofar as the CAD is concerned:

> 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 tax benefits from the tax-depleted assets, the purposes of the SBT in general and the CAD specifically would be subverted. *Slip Opinion,* p 4.

What this discussion shows, however, is that the Court of Appeals completely misunderstands just how the CAD operates. Without a doubt, the CAD may be available to different taxpayers with respect to the same assets – taxpayers, such as FIFP and FILP here routinely sell assets to other taxpayers qualifying the new owner to claim a CAD if it otherwise meets eligibility requirements. Under such circumstances, the ersatz "problem" identified by the Court of Appeals – that taxpayers may transfer assets "for a second opportunity to obtain the tax benefits from the tax-depleted assets" – is no problem at all, inasmuch as, upon transfer, the CAD must be recaptured from the previous owner. Thus, the Court of Appeals was patently wrong in its outlook: There is no "second opportunity to obtain the tax benefits," for the tax benefits conferred by the CAD must be paid back by the transferor upon asset transfer. Treasury's RAB 1992-3 verifies that this is the case, and further illustrates that, in the case at hand, the transferor would be required to recapture any CAD it took on the assets, particularly given that the transfer was not one of the tax-free events delineated in paragraph 3E, *see,* RAB 1992-3(7).

Given that the Court of Appeals rested its determination to deny FILP a CAD as an alternate measure upon an incongruous and mistaken view that no "second opportunity to obtain tax benefits" should be had – when, in fact, the interplay of CAD recapture details that there is no second opportunity – its decision is clearly erroneous and will cause material injustice, and therefore warrants review by this Court under MCR 7.302(B)(5).

4. The decision of the Court of Appeals is "clearly erroneous" and warrants review under MCR 7.302(B)(5) because the Court completely ignored special rules applicable to the proper interpretation of tax laws.

The Court of Appeals' determination that the CAD provisions must be construed in a manner

most favorable to Treasury, *see, Slip Opinion*, p 4, is erroneous, for several reasons.

First, the CAD provisions entail a tax deduction – not an exemption – thus calling into play the precept that "[w]hen there is doubt [about application of a tax provision], tax laws are to be construed in favor of the taxpayer." *Sharper Image Corp v Dep't of Treasury,* 216 Mich App 698, 702; 550 NW2d 596 (1996); *see also, Wyandotte v State Board of Tax Administration,* 278 Mich 47; 270 Mich 291 (1936); *Standard Oil Co v Michigan,* 283 Mich 85; 276 NW 908 (1937); *Michigan Bell Telephone Co v Dep't of Treasury,* 445 Mich 470, 477; 518 NW2d 808 (1994). Strict construction *against* the taxing authority is required because a tax effects a taking from the taxpayer.

Second, in ruling that the CAD provisions call into play the "strict construction in favor of Treasury" rule, the Court of Appeals inappropriately equated "tax exemptions" with "tax deductions," *see, Slip Opinion,* p 4. The "strict construction in favor of Treasury" precept has been applied to circumstances involving tax exemptions, *see, e.g., Liberty Hill Housing Corp v Livonia,* 480 Mich 44, 64; 746 NW2d 282 (2008); *In re D'Amico Estate,* 435 Mich 551; 460 NW2d 198 (1990), but tenet cannot be legitimately extended to tax deductions, which are used to measure a taxpayer's ultimate tax liability, but do not relieve a taxpayer from tax altogether. Finally, the "strict construction" rule, even if applicable, will not be applied in situations like this where application of the rule would result in a strained construction in derogation of legislative intent. *Michigan United Conservation Clubs v Lansing Charter Twp,* 423 Mich 661, 664-665; 378 NW2d 737 (1985); *Ann Arbor v The University Cellar, Inc,* 401 Mich 279, 289; 258 NW2d 1 (1977).

The Court of Appeals' application of the "strict construction" tenet to deny FILP its rightful CAD deduction is clearly erroneous and warrants review by this Court should it determine to grant this *Application for Leave to Cross Appeal.*

II. THE ISSUE PRESENTED BY THIS APPLICATION FOR LEAVE TO CROSS APPEAL – WHETHER FILP IS ENTITLED TO A CAD IN THE EVENT THE COURT OF APPEALS' DETERMINATION OF THE BUSINESS LOSS DEDUCTION ISSUE IS REVERSED – HAS SIGNIFICANT PUBLIC INTEREST AND INVOLVES AN AGENCY OF THE STATE OF MICHIGAN; MOREOVER, IT PRESENTS LEGAL PRINCIPLES OF MAJOR SIGNIFICANCE TO THIS STATE'S TAX JURISPRUDENCE, SO THAT AMPLE GROUNDS FOR REVIEW BY THIS COURT EXIST UNDER MCR 7.302(B)(2) AND (3).

Undoubtedly – and for the variety of reasons expressed earlier in this *Application* – the Court of Appeals overstepped its bounds in this case in determining that FILP may not avail itself of the CAD deduction allowed under the provisions of the SBTA. Taxpayers like FILP have a considerable interest in ensuring that the SBTA and the Department's administrative offerings are correctly interpreted in alignment with fairly and accurately applied rules of statutory interpretation. Both the Court of Claims and the Court of Appeals failed to recognize that statutes imposing a tax effect a taking from the taxpayer and are to be strictly construed in favor of the taxpayer, and against the government. Taxpayers – both this one and taxpayers in general – are entitled to have any doubts relative to imposition of a tax determined in their favor, inasmuch as their financial and property rights are implicated when the government asserts its taxing powers.

In addition, the taxpaying general public has an extreme interest in ensuring that the language of tax enactments will not be so narrowly construed – as the lower courts accomplished here – so as to foreclose legitimate claims.

In furtherance of sound public policy, and in the advancement of Michigan tax jurisprudence, this Court should undertake review of this matter in the event it grants leave to Treasury to appeal the business loss deduction issue, rectify the patent errors found in the Court of Appeals' *Opinion*, and resolve any doubts, ambiguities, or difficulties in favor of this taxpayer consistent with appropriate and accepted rules of statutory interpretation.

CONCLUSION AND RELIEF SOUGHT

This case meets three of the grounds set forth in MCR 7.302, and thereby warrants this Court's review should it determine to grant Treasury's *Application for Leave to Appeal*. Simply stated, it involves a ruling by the Court of Appeals that is clearly erroneous and will cause material injustice of not corrected, a Michigan state agency and its continued administration of the single business tax, and issues of significant public interest that also are key to Michigan tax jurisprudence.

For the reasons set forth in Plaintiff-Cross-Appellant's *Application for Leave to Cross Appeal*, this Court should grant the *Application,* and permit Plaintiff-Cross-Appellant, First Industrial, L.P., to appeal from the Court of Appeal's *Opinion* dated August 19, 2009 in the event this Court grants the Michigan Department of Treasury's *Application for Leave to Appeal.*

Respectfully submitted,

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