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MICHIGAN'S SHORT STATUTE OF LIMITATIONS APPLYING TO TAX LAWS: A CONSTITUTIONAL CONTROVERSY

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Michigan's current 90-day statute of limitations (Public Act 58 of 1986, as amended)[1] may be in jeopardy due to a case currently before Michigan's Supreme Court[2] challenging the constitutionality of the law. This law limits the amount of time a taxpayer has to seek a tax refund that is based on the constitutional validity (or federal statutory) of a tax law. If the 90-day statute is declared unconstitutional, the state could be exposed to a significant loss of revenue.

The Michigan legislature passed this law primarily to preserve the state's fiscal stability in the event a court declared a tax law to be unconstitutional. In addition, there were concerns that the proliferation of tax cases based on claims of the unconstitutionality of Michigan tax statutes was clogging the Court of Claims and the Michigan Tax Tribunal.

Public Act 58 of 1986 has limited the state's exposure to fiscal chaos resulting from tax refunds. Consider these examples involving potentially devastating financial exposure to the state:

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[1] MCL 205.27a(6); MSA 7.657(27a)(6) states as follows: "Notwithstanding the provisions of subsection (2), a claim for refund based upon the validity of a tax law based on the laws or constitution of the United States or the State constitution of 1963 shall not be paid unless the claim is filed within 90 days after the date set for filing a return."

[2] American States Insurance Company v Department of Treasury (No. 181244) and Traveler's Indemnity Company v Department of Treasury (No. 182539), decided *sub nom.* American States Insurance Company v Department of Treasury, 220 Mich. App. 586, 560 N.W. 2d 644 (Mich. App. 1996), *application for leave to appeal pending*.

- ✦ At the time the constitutionality of Michigan's Single Business Tax was resolved in *Trinova Corp v Department of Treasury*,[3] there were approximately 480 refund actions pending against the state, ***with refunds totaling in excess of $200 million***.[4]

- ✦ Before the constitutionality of Michigan's Capital Acquisition Deduction was decided in *Caterpillar Inc v. Department of Treasury*,[5] 550 related refund claims had been filed, ***involving more than $560 million in potentially lost revenues***.[6]

- ✦ In connection with the issue of whether the Single Business Tax violates federal law (ERISA), 212 refund cases were filed in Michigan ***seeking $142 million in refunds***.[7] The issue was later resolved in the state's favor in *Thiokol Corp. v. Department of Treasury*.[8]

In the absence of the 90-day statute of limitations, if Michigan had lost ***any*** of these cases, the refund claims could have had a staggering financial impact on the state. Because of the 90-day statute, however, the vast majority of these refunds were not filed in a timely manner (i.e., within 90 days of the filing of the respective returns) and would have been barred had Michigan lost any of the above cases. This short statute of limitations has thus preserved Michigan's fiscal integrity in light of important court case decisions.

How Does Public Act 58 of 1986 Work?

Public Act 58 of 1986, as amended, provides a short statute of limitations provision for refunds based on tax laws that are claimed or found to be unconstitutional (or violative of a federal law). Specifically, when a tax refund in Michigan is based on the claim that a tax law is unconstitutional (or violates a federal law), a special statute of limitations applies which requires that claims for refunds based upon such a decision be filed within 90 days after the date set for filing the return.[9]

Under this statute, a Michigan taxpayer alleging that a tax law is unconstitutional would thus have 90 days from the time the tax is due to claim a refund. This is a special exception to the general statute of limitations which allows a taxpayer to

3 498 US 358; 111 S Ct 818; 112 L Ed 2d 884 (1991).

4 Defendant-Appellee's Brief on Appeal at 17-18, The Traveler's Indemnity Co. v Department of Treasury (Docket No. 182539). *See supra* note 2.

5 440 Mich. 400, 488 N.W. 2d 182 (Mich. 1992), *cert. denied*, 506 U.S. 1014 (1992).

6 *See supra* note 4.

7 *Id.*

8 76 F3d 751 (6th Cir. 1996), *cert. den.*, 117 S Ct 2448 (1997). The Court ruled that ERISA does not preempt the Michigan Single Business Tax which has only a peripheral effect on a covered employee benefit plan.

9 MCL 205.27a(6); MSA 7.657(27a)(6).

claim a refund within four years after the date set for filing an original return.

Is the 90-day Provision Constitutional?

Although the United States Supreme Court has approved the use of short statutes of limitations where certain due process requirements are met,[10] it has recently been alleged that the Michigan 90-day provision does not meet these requirements, and that Michigan's short statute of limitations is unconstitutional.

Although the issue was recently decided in favor of the state by the Michigan Court of Appeals, the Michigan Supreme Court may decide otherwise in the near future.[11] The arguments being made against the state are twofold.

> ***Due Process:*** One of the claims made is that the 90-day provision violates the due process clause of the United States and Michigan Constitutions.[12] As applied to tax statutes, due process requires that a state provide a meaningful tax remedy either before the tax is paid (allowing the taxpayer to avoid paying the contested tax) or after the tax is paid (allowing an opportunity to contest the tax after it is paid).[13]
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> When a taxpayer alleges that a tax law is unconstitutional, several options are available. He/she can seek a declaratory judgment in Circuit Court as to the invalidity of the tax law. The taxpayer can also wait for the state to issue a notice of deficiency advising the taxpayer that taxes are due, after which two other options are available for contesting a tax law: an appeal can be made to the Michigan Tax Tribunal without paying the tax, or alternatively, the taxpayer can pay the tax and appeal to the Court of Claims.
>
> Arguably, contesting the tax before it is paid does not provide relief to the taxpayer claiming a tax statute is unconstitutional, because the Michigan Tax Tribunal is not a court of law and does not have the power to declare a law unconstitutional.[14] Therefore, it is argued that the only remedy for a constitutional claimant is paying the tax first, and requesting a refund in the Court of Claims which can decide on the constitutionality of a state law.
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> Despite these arguments, the

[10] McKesson Corp v Division of Alcoholic Beverages & Tobacco, 496 US 18; 110 S Ct 2238; 11-L Ed 2d 17 (1990).

[11] American States Insurance Company v Department of Treasury (No. 181244) and Traveler's Indemnity Company v Department of Treasury (No. 182539), decided *sub nom*. American States Insurance Company v Department of Treasury, 220 Mich. App. 586, 560 N.W. 2d 644 (Mich. App. 1996), *application for leave to appeal pending*.

[12] U.S. Const., art XIV; MI Const., art I, §17[1] 1963 .

[13] *See McKesson Corp*, 496 U.S. at 36-39.

[14] *See* Fonger v Department of Treasury, 193 Mich App 71; 483 NW 2d 920 (1992); *lv den*, 440 Mich 888; 487 NW 2d 472 (1992). Note however, that the issue can be raised in the Michigan Tax Tribunal and preserved for later appeal to the Court of Appeals.

Court of Appeals has held that a 90-day statute of limitations in which to file such a claim does not violate the due process clause. In *American States Insurance Co. v Dept of Treasury* (see footnote 2), the court noted that the imposition of a shortened statute of limitations could be justified on the grounds that it promotes the state's interest in providing stable fiscal planning when weighed against the constitutional obligations to provide relief from an unlawful tax law.[15]

Equal Protection: A second argument made against the 90-day provision is that it violates the Equal Protection Clauses of the of the United States and Michigan Constitutions.[16] In general, when a law is challenged as violating the guarantees of equal protection, the court upholds the law unless it finds that the law is completely arbitrary and is not rationally related to a legitimate governmental purpose.[17]

The court will subject the law to a higher scrutiny, however, where a "suspect class" (based on such things as race, national origin, or ethnicity) is involved, or where a fundamental right is being impinged upon. In these so-called "strict-scrutiny" cases, the statute will be upheld only where it is found to be precisely tailored to serve a compelling governmental interest.[18]

It has been argued that the 90-day provision involves a "suspect class" and that it involves a fundamental right of access to the courts and should, therefore, be subjected to "strict scrutiny" by the court. Alternatively, it is argued that the law is not rationally related to a legitimate governmental purpose.

These arguments have so far failed, and the 90-day provision has been determined not to involve a suspect class or a fundamental right, and to be rationally related to a legitimate governmental purpose — that of preserving Michigan's fiscal integrity.

Conclusion

It is important for Michigan to continue its strong interest in maintaining fiscal health. The state's 90-day statute of limitations provision promotes this goal and helps prevent the financial chaos that could arise from a court's order that a particular tax statute is unconstitutional.

[15] *American States Ins.*, citing *McKesson* at 45.

[16] U.S. Const., art XIV; MI Const., art 1, §2 (1963). In general, Equal Protection requires that all persons be treated equally under the law.

[17] *Doe v Dept of Social Services*, 438 Mich 650, 661-662; 487 NW 2d 166 (1992).

[18] *Id.*

If the Michigan Supreme Court decides in the near future that this 90-day statutory provision is unconstitutional, the state may have to revisit its current procedural safeguards and find new ways to ensure that state revenues are preserved when court decisions are rendered which threaten the state's fiscal structure.