

STATE OF MICHIGAN
DEPARTMENT OF ENERGY, LABOR & ECONOMIC GROWTH
MICHIGAN TAX TRIBUNAL

Heartland Employment Services, LLC,
Petitioner,

v

Department of Treasury,
Respondent.

MTT Docket Nos. 341804
and 359201

Tribunal Judge Presiding
Kimbal R. Smith, III

FINAL OPINION AND JUDGMENT

ORDER GRANTING PETITIONER'S MOTION FOR SUMMARY DISPOSITION

ORDER GRANTING STIPULATION AND PROPOSED ORDER TO CONSOLIDATE

I. INTRODUCTION

Petitioner, Heartland Employment Services, LLC, is appealing a Decision and Order of Determination, issued by Respondent, Michigan Department of Treasury on July 24, 2007. The Decision and Order of Determination established that a proposed deficiency, for single business tax in the amount of \$2,652,421.00, shall be assessed on Petitioner. On October 6, 2008, Petitioner filed a motion requesting the Tribunal grant summary disposition in its favor, pursuant to MCR 2.116(C)(10) and request for oral argument. On October 24, 2008, Respondent filed a response in opposition to Petitioner's Motion for Summary Disposition. In its response, Respondent requested the Tribunal grant summary disposition to it pursuant to MCR 2.116(I)(2). Petitioner subsequently filed a reply brief on November 18, 2008.

On November 20, 2008, the Tribunal entered an Order granting Petitioner's Request for Oral Argument.

On February 4, 2009, Judge Kimbal R. Smith, III heard oral arguments on Petitioner's and Respondent's Motions to determine whether any genuine issues of material fact exist.

On March 6, 2009, the parties filed a stipulation and proposed order to consolidate docket numbers 341804 and 359201. In support of their stipulation, the parties contend that they:

. . . request consolidation of *Heartland Employment Services, LLC, f/k/a/ Heartland Employment Services, Inc v Michigan Department of Treasury*, Michigan Tax Tribunal, MTT Docket No. 0359201 into *Heartland Employment Services, LLC, f/k/a Heartland Employment Services, Inc v Michigan Department of Treasury*, Michigan Tax Tribunal, MTT Docket No. 0341804. Both cases arise out of the same general type of transaction and involve a substantial and controlling common question of law and fact. Any decision on Petitioner's Motion for Summary Disposition and Respondent's Motion for Summary Disposition . . . shall apply to Docket No. 0359201.

II. FINDINGS OF FACT

Petitioner is an employment management company that provides human resource and employment services to various entities. Petitioner, under service agreements, employs and leases to its clients employees who possess the requisite skills to operate in the areas of the client's businesses. Pursuant to the service agreements, Petitioner was responsible for all of the costs of the management and administration of the employees, including salary and benefits.

Most of Petitioner's employees provided services in a single location for a specific client. However, some employees with regional responsibilities worked at multiple locations and all employees were subject to reassignment from one location to another.

For tax years 2002, 2003 and 2004 Petitioner determined its single business tax liabilities by calculating an apportioned single business tax base to the State of Michigan, pursuant to MCL 208.41. Petitioner was subsequently audited by Respondent and on January 3, 2006, Respondent issued an Audit Determination Letter assessing net single business tax due of \$4,080 and interest in the amount of \$430, resulting in a total assessment of \$4,510. Petitioner paid the deficiency in full. On March 17, 2006, Respondent issued a revised Audit Determination Letter assessing single business tax of \$2,652,698 and interest in the amount of \$280,035, for a total amount due

of \$2,932,733. Respondent modified Petitioner's original assessment after it recalculated Petitioner's sales factor so that Petitioner's receipts under its contracts were apportioned to Michigan based on payroll paid to service providers in Michigan to payroll paid to service providers everywhere.

Respondent issued a Notice of Intent to Assess, which indicated tax and interest due of \$2,932,733, on May 30, 2006. Petitioner subsequently requested an informal conference to protest the assessment. The informal conference was held on November 16, 2006. The hearing referee issued a recommendation that Petitioner's receipts from the provision of human resources and employment services should be sourced on a contract-by-contract basis because each contract constituted a separate sale. The Department of Treasury issued a Decision and Order of Determination on July 24, 2007 that overruled the Hearing Referee's recommendation and upheld Respondent's assessment. In response, Petitioner filed the above-captioned appeal with this Tribunal.

On January 16, 2009, Petitioner filed another petition appealing Respondent's Decision and Order of Determination which found that Petitioner was not entitled to a refund of SBT paid for tax year 2001. The subsequently filed case, docket number 359201, has parallel facts and circumstances of Petitioner's initial appeal in docket number 341804.

III. PETITIONER'S CONTENTIONS

Petitioner contends that it properly sourced its service contract receipts to Michigan applying the "cost of performance test," MCL 208.53(b), on a contract-by-contract basis.

Petitioner further contends that:

. . . the cost of performance test is an all or nothing test because, if the greater cost of performing the services for a sale is in Michigan, all receipts are deemed to be Michigan receipts. If the greater cost of performing these

services is outside of Michigan, then no receipts are Michigan receipts.¹
(Emphasis in original)

Petitioner cites *Detroit Lions, Inc v Dep't of Treasury*, 157 Mich App 207; 403 NW2d 812 (1986), for the notion that a taxpayer must look to its own business activity that gives rise to the entitlement of the revenues as the business activity whose location must be determined under MCL 208.53. *Id.* at 226. The *Detroit Lions* Court found that it was the Detroit Lions' contract with and membership in the NFL that gave rise to entitlement of the income. Therefore, the income had to be sourced on a contractual basis. Petitioner contends that *Detroit Lions* is controlling in the above-captioned case and the proportion of Michigan wages for Petitioner should be determined on a contractual basis for the relevant tax years. Petitioner states that it is entitled to fees by entering into contracts to provide its human resources and employment services on a contractual basis. Further, Petitioner contends it does not enter into written employment contracts for each employee.

IV. RESPONDENT'S CONTENTIONS

Respondent contends that the sole issue to be decided in this case is: what is the relevant sale to be apportioned? Respondent quotes MCL 208.7(1)(a), which states that "sale" means the performance of services, which constitutes business activities. Respondent contends that "[t]he 'services' and 'business activities' which Heartland is offering its customers are the work of the employees placed at the customers' hospitals."² Respondent further argues that because of the changing nature of the services that Petitioner provided, there are a number of discrete sales based upon needs that changed; Petitioner did not offer a sale of hospital staff to its clients.

¹ Petitioner's Brief in Support of Motion for Summary Disposition, at 13.

² Respondent's Brief in Response to Petitioner's Motion for Summary Disposition, at 6.

Respondent cites *Fluor v Dep't of Treasury*, 477 Mich 170; 730 NW2d 722 (2007). Although *Fluor* was decided under MCL 208.53(c), rather than MCL 208.53(b), Respondent contends the case parallels the current appeal. Specifically, Respondent argues that the *Fluor* case held that one must focus on the center of gravity as to where the results of the work are realized. Respondent argues that if the *Fluor* case is followed here, it supports Respondent's approach.

Respondent also cites *Honigman Miller Schwartz and Cohn LLP v Dep't of the Treasury, State of Mich*, Ct. of Claims Case No. 05-200MT opinion and order entered December 10, 2007. Here, the Court of Claims determined that "one must focus on the location of each separate business activity (i.e., each individual service)," rather than on the totality of services performed for a client. *Id.*

Ultimately, Respondent contends that ". . . sales of employee services should be sourced according to where the employee works, whether in Michigan or elsewhere, and not to where a headcount shows the majority of the employees with a particular buyer are employed."³

V. APPLICABLE LAW

Petitioner moves for summary disposition pursuant to MCR 2.116(C)(10). In *Occidental Dev LLC v Van Buren Twp*, MTT Docket No. 292745 (March 4, 2004), the Tribunal stated "[a] motion for summary disposition under MCR 2.116(C)(10) tests the factual support for a claim and must identify those issues regarding which the moving party asserts there is no genuine issue of material fact." Under subsection (C)(10), a motion for summary disposition will be granted if the documentary evidence demonstrates that there is no genuine issue of material fact, and the moving party is entitled to judgment as a matter of law. *Smith v Globe Life Insurance*, 460 Mich

³ Respondent's Brief in Response to Petitioner's Motion for Summary Disposition at 12.

446, 454-455; 597 NW2d 28 (1999). In the event, however, it is determined that an asserted claim can be supported by evidence at trial, a motion under subsection (C)(10) will be denied. *Arbelius v Poletti*, 188 Mich App 14; 469 NW2d 436 (1991).

The Michigan Supreme Court has established that a court must consider affidavits, pleadings, depositions, admissions, and documentary evidence filed by the parties in the light most favorable to the non-moving party. *Quinto v Cross & Peters Co*, 451 Mich 358, 362-63; 547 NW2d 314 (1996) (citing MCR 2.116(G)(5)). The moving party bears the initial burden of supporting his position by presenting his documentary evidence for the court to consider. *Neubacher v Globe Furniture Rentals*, 205 Mich App 418, 420; 522 NW2d 335 (1994). The burden then shifts to the opposing party to establish that a genuine issue of disputed fact exists. *Id.* Where the burden of proof at trial on a dispositive issue rests on a nonmoving party, the nonmoving party may not rely on mere allegations or denials in pleadings, but must go beyond the pleadings to set forth specific facts showing that a genuine issue of material fact exists. *McCart v J Walter Thompson*, 437 Mich 109, 115; 469 NW2d 284 (1991). If the opposing party fails to present documentary evidence establishing the existence of a material factual dispute, the motion is properly granted. *McCormic v Auto Club Ins Ass'n*, 202 Mich App 233, 237; 507 NW2d 741 (1992).

VI. CONCLUSIONS OF LAW

The Tribunal has carefully considered Petitioner's Motion for Summary Disposition under the criteria for MCR 2.116(C)(10), and based on the pleadings, affidavits and other documentary evidence filed with the Tribunal, determines that granting Petitioner's Motion is appropriate. The Tribunal concludes that the pleadings, affidavits and documentary evidence prove there is no genuine issue with respect to any material fact. Specifically, the parties have

stipulated to facts and the admissibility of documents that show there are no questions of fact that remain. The only remaining issues are questions of law, specifically, the “. . . correct sourcing of sales of services and the application of the cost of performance test under MCL 205.53(b) to the sales of human resources and employment services by Petitioner. . . .”⁴

Petitioner performs its business activities both within and outside of the State of Michigan. As a multi-state entity, Petitioner is required to apportion its income under MCL 208.53(b) of the Single Business Tax Act. MCL 208.53(b) provides:

Sales, other than sales of tangible personal property, are in this state if:

* * *

- (b) The business activity is performed both in and outside this state and, based on costs of performance, a greater proportion of the business activity is performed in this state than is performed outside this state.

Petitioner argues that “costs of performance” includes all costs involved with a particular contract between Petitioner and its clients involving activities in Michigan. Specifically, when more than 50% of the costs of performance were incurred within Michigan, Petitioner sourced all receipts to Michigan. Alternatively, when 50% or less of the costs of performance was incurred outside Michigan, Petitioner sourced no receipts to Michigan. Respondent contends that “costs of performance” includes only Petitioner’s employees’ wages because the employees’ services are what are being sold. The Tribunal finds that it must look to the contract to determine what is being sold. Article III of Petitioner’s Employee Leasing Agreement states that

. . . Lessee shall pay [Petitioner a base fee.] [A base fee is] [a]n amount equal to the direct wage and compensation expenses incurred by [Petitioner] to provide the services of the Personnel to Lessee (the ‘Base Fee’). Such [Petitioner] expenses shall include all wages, salaries, bonuses, employer payroll taxes, employee benefit costs, administration expenses, and overhead

⁴ Petitioner and Respondent’s Stipulation of Facts and Admissibility of Documents.

expenses (excluding any interest income or expense) relating to the Personnel.

...

The Tribunal finds that Petitioner is reimbursed for all expenses related to the lessor-lessee contract between Petitioner and its clients. In fact, even when none of Petitioner's employees are actively working for their clients and are thus not earning any wages, Petitioner's clients are still charged for the administration of other costs that are a part of the base fee, i.e. employee benefit costs, administration expenses, and overhead expenses. As such, the Tribunal concludes that after looking to Petitioner's Employee Leasing Agreement, the contract shows that Petitioner's receipts must be sourced to the particular contract, rather than to a particular employee's wages, because services are provided to Petitioner's clients on a per-contract basis. Further, Petitioner is reimbursed for all services provided, not just the wages earned by Petitioner's employees.

Although Respondent argues that an "all-or-nothing" approach is unfair, the Tribunal would be remiss to remind the parties that the cost-of-performance method of apportionment is no longer utilized in the State of Michigan. The Tribunal recognizes that the cost-of-performance method may be distortive because ". . . some states will receive no tax as a result of services performed in substantial part within their borders, whereas other states will receive tax windfalls from services performed, to a considerable extent, in other states."⁵ However, the Department of Treasury issued an Internal Policy Directive (IPD) providing guidance on the proper interpretation and application of MCL 208.53. The IPD specifically states:

there is no statutory provision for splitting service revenue from a single transaction between several states based on a time or cost allocation. Revenue from a transaction is sourced to the state where the majority of the business activity is performed, i.e., the greater proportion of the business activity is

⁵Hellerstein & Hellerstein, *State Taxation*, §9.18, 3d ed. (1998);

performed in the state than is performed outside the state based on costs of performance.

IPD 2006-8. The Department of Treasury's IPD and the *Detroit Lions* decision supports Petitioner's method of sourcing. The Tribunal rejects Respondent's sourcing of component parts of a single sale. Therefore, the Tribunal finds that Petitioner has shown that there is no genuine issue of material fact and that it is entitled to judgment as a matter of law, under MCR 2.116(C)(10). The Tribunal further finds that the proper sourcing methodology is to source receipts from Petitioner's sales of employment services to Michigan on a contract-by-contract basis treating each contract as a separate sale.

The Tribunal concludes that the proposed stipulation to consolidate is proper and that consolidation is appropriate in view of the common issues of fact and law involved.

VII. JUDGMENT

IT IS ORDERED that Petitioner's Motion for Summary Disposition is GRANTED.

IT IS FURTHER ORDERED that Respondent's Decision and Order of Determination, dated July 24, 2007, for tax years 2002, 2003, and 2004 is CANCELLED.

IT IS FURTHER ORDERED that Respondent's Decision and Order of Determination, dated December 17, 2008, for tax year 2001 is CANCELLED.

IT IS FURTHER ORDERED that the parties' Stipulation and Proposed Order of Consolidation is GRANTED.

MICHIGAN TAX TRIBUNAL

Entered: March 18, 2009
sms

By: Kimbal R. Smith III