

STATE OF MICHIGAN  
DEPARTMENT OF LICENSING & REGULATORY AFFAIRS  
MICHIGAN ADMINISTRATIVE HEARING SYSTEM  
MICHIGAN TAX TRIBUNAL

Associates Resources, Inc,  
Petitioner,

v

MTT Docket No. 383270

Michigan Department of Treasury,  
Respondent.

Tribunal Judge Presiding  
Cynthia J Knoll

FINAL OPINION AND JUDGMENT

**SUMMARY**

Associates Resources, Inc. (“Petitioner”) appeals an assessment issued by the Michigan Department of Treasury (“Respondent”) of Single Business Tax (“SBT”) for the 2003 tax year, which disallowed the Small Business/Alternate Credit (“SBC”) in full. Assessment No. P782462 includes tax of \$39,083.00, plus statutory interest. Petitioner argues that Respondent improperly assessed the tax based on its erroneous determination that an officer/employee of an operating company, Mr. Mark Thompson, was an officer/employee of Petitioner, and that wages paid to him exceeded the \$115,000 threshold for the SBC set forth under MCL 208.36. Petitioner asserts that the operating company was required to add back Mr. Thompson’s compensation because that was the entity for which he devoted the majority amount of his work time and the entity receiving the benefit of his services. Respondent contends that under the express terms of the employee leasing agreement, Petitioner was the employer of the workers and it reserved the exclusive right over their direction and control. The Tribunal disagrees. Following the precedential decision of *McCartney v Michigan Department of Treasury*, 16 MTT 443, July 20, 2006, Petitioner is not required to add back the compensation paid to Mr. Thompson. The assessment is cancelled.

**BACKGROUND**

Petitioner was organized for the business purpose of providing personnel on a leased basis to client companies, commonly referred to as a Professional Employer Organization (“PEO”). During the year at issue, Petitioner leased employees to three operating companies: 1) Thermico, Inc. (“Operating Company”), 2) 3i Supply Company, and 3) Garcia Insulation Fabrication Company, pursuant to separate Employee Leasing Agreements (“Leasing Agreement”). Mark A. Thompson was 100% owner of Operating Company, 100% owner of 3i Supply Company and 70% owner of Petitioner. Although his compensation was paid by Petitioner, Petitioner argues that it processed the payroll and prepared, filed and paid payroll taxes on behalf of Mr. Thompson strictly as an administrative convenience. Petitioner further asserts that the Operating Company was Mr. Thompson’s employer because it was the entity for which he devoted a substantial amount of work time thereby receiving the benefit of his employee services; and as

such, the Operating Company is required to include Mr. Thompson's compensation in its SBT tax base.<sup>1</sup>

Respondent conducted an SBT audit for the 2003 tax year and determined that Petitioner had a tax liability in the amount of \$39,083, plus statutory interest, as a result of disallowing the SBC based on excessive officer compensation. In contention are wages Respondent asserts Petitioner paid to Mr. Thompson. Respondent reasoned that Petitioner's Leasing Agreement states that Petitioner had the right to hire and fire employees leased. Additionally, the Agreement states the parties agree that all Contract Personnel are employees of Petitioner. Respondent determined that Mr. Thompson was an employee of Petitioner and as an employee his wages must be considered in determining Petitioner's eligibility for the SBC. Respondent found that the wages received by Mr. Thompson during the tax year at issue exceeded the \$115,000 threshold set forth in MCL 208.36(2)(b)(i), and therefore, Petitioner was not entitled to the Credit.

In February 2008, Respondent issued a Bill for Taxes Due (Intent to Assess) No. P782462. Petitioner requested, and Respondent granted, an informal conference with the Hearings Division, which was held on October 14, 2009, to appeal the assessment. On October 27, 2009, Respondent issued its Decision and Order of Determination, accepting the recommendation of the Hearing Referee and determined that the Intent to Assess should be assessed as originally determined, with interest to be computed in accordance with 1941 PA 122. Petitioner filed this appeal with the Tribunal on December 18, 2009. A hearing was held on June 20, 2011.

### **PETITIONER'S CONTENTIONS**

Petitioner asserts that the originally filed 2003 Single Business Tax return was accurately filed. It argues that Respondent ". . . arbitrarily moved [Mr.] Thompson's compensation from the [Operating Company's] 2003 Single Business Tax return to . . ." Petitioner's return. "The Small Business Credit, claimed on the originally filed return, was disallowed because. . . [Mr. Thompson's] compensation exceeded \$115,000, the disqualifying amount."<sup>3</sup> Petitioner contends that Respondent's assessment is erroneous because ". . . [Mr. Thompson's] compensation was reported on the Federal Income Tax return and Single Business Tax return of [Operating Company] consistent with guidance provided in Respondent Letter Ruling 2002-4 (LR 2002-4) and proper interpretation made by the Court of Claims in *Bandit Industries, Inc. v. Michigan Department of Treasury*."<sup>4</sup>

Petitioner submits that "Petitioner was formed for business purposes to streamline and make more efficient the employment of employees working at different entities and at different locations as well as the administration of payroll, employee benefits and payroll taxes."<sup>5</sup> Petitioner asserts that MCL 208.5(1) and (2), "specifies that 'to withhold for federal income tax

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<sup>1</sup> For tax years beginning after December 31, 2003, the statute has been amended to address employee leasing directly. This amendment was not in effect for the year at issue.

<sup>2</sup> Petitioner's Petition, p. 5

<sup>3</sup> Petitioner's Petition, p. 5

<sup>4</sup> Petitioner's Petition, p. 4

<sup>5</sup> Petitioner's Prehearing Statement, p. 3

purposes’ is only ‘prima facie’ evidence of an employer/employee relationship,”<sup>6</sup> thus creating a rebuttable presumption. Petitioner rebuts this presumption, claiming that under *Mid America Management Corporation v Department of Treasury*, Petitioner did not meet the common law control test and did not possess the right to direct and control Mr. Thompson’s work performance.<sup>7</sup> Petitioner claims that in regard to Mr. Thompson, it acts as a payroll agent, not as an employer.<sup>8</sup>

Petitioner contends that it was not the employer of Mr. Thompson. It asserts that Respondent has a long standing policy of relying on Internal Revenue Service Regulation 31.3401(c)-1, relating to the definition of employee, and 31.3401(d)-1(a)-(d), relating to the definition of employer. With respect to any worker, employer status generally is determined by the presence or absence of an employer/employee relationship.<sup>9</sup> Petitioner contends that it did not have an employer/employee relationship with Mr. Thompson because it did not possess “the right to direct and control [Mr. Thompson’s] performance both with respect to details (when, where, and how the work should be done) and the final results.”<sup>10</sup>

Petitioner asserts that through Mr. Thompson’s ownership and position with Operating Company, it demonstrates his complete control of the terms of his employment. Mr. Thompson had the ability to cancel the contract with Petitioner, determine his own work hours, set his own income, and decide which customers to work for. Petitioner had no power to discharge Mr. Thompson from Operating Company, which was his own business. Petitioner asserts that Mr. Thompson, as “an officer and 100% owner of [Operating Company] creates a non-rebuttable presumption that he is the common law employee of [Operating Company] because in no practical way does [Petitioner] direct any aspect of [Mr. Thompson’s] actions as owner and President.”<sup>11</sup> “As applied to [Mr.] Thompson, no risks of any employment have been transferred to Petitioner. Under *Mid America*, Thompson received compensation from himself.”<sup>12</sup>

Petitioner contends that Mr. Thompson’s compensation was derived for services performed primarily for the Operating Company, “the entity for whom he devoted the majority amount of his work time and the entity receiving the benefit of his services.”<sup>13</sup> At hearing, Mr. Thompson testified that he “. . . probably spend[s] about 60 percent of . . . [his] time on . . . [Operating Company] business and 40 percent or 38 percent on 3i Supply business and maybe two percent on . . .” Petitioner business.<sup>14</sup> He further testified to having the following responsibilities with regard to Operating Company:

- Handle all corporate matters.
- Meet with attorneys as necessary over contracts and purchase orders.

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<sup>6</sup> Petitioner’s Trial Brief, p. 9

<sup>7</sup> Petitioner’s Trial Brief, p.12

<sup>8</sup> Transcript, p. 36

<sup>9</sup> Petitioner’s Trial Brief, p. 12

<sup>10</sup> Petitioner’s Trial Brief, pp. 12 and 16

<sup>11</sup> Petitioner’s Response to Respondent’s Trial Brief, p. 4

<sup>12</sup> Petitioner’s Trial Brief, p. 17, relying on *Mid America Management Corporation v Department of Treasury*, 153 Mich App 446; 395 NW2d 702 (1986)

<sup>13</sup> Petitioner’s Trial Brief, p. 17

<sup>14</sup> Transcript, p. 17

- Revise company's proposals, including terms and conditions to protect the corporate interests.
- Develop processes to meet the requirements of the lien laws to protect the company's receivables.
- Meet with accountants over various accounting matters, including record keeping, tax planning, reporting, and equipment acquisitions, lease versus buy.
- Meet with various banking and lending institutions and supply them with their required information.
- Purchasing all insurance.
- Handle relationships with banking and other lending institutions.
- Negotiate loans as needed.
- Perform some estimating functions.
- Develop forms and spreadsheets for estimating.
- Maintain or revise various templates for all aspects of the Operating Company's business.
- Handle commercial and industrial estimating for insulation, painting, et cetera..
- Meet with bonding companies to maintain and establish a bonding line to bid various types of contracts.
- Meet with customers to insure their requirements are met.
- Institute procedural changes to meet or exceed customers' expectations.
- Attend various meetings with related organizations to promote business.
- Attend and hold meetings with the vice presidents in charge of various areas of the company.
- Review job progress, including current percent complete versus accounting percent complete.
- Physically visit jobs to inspect workmanship, contact with workers, and so on.
- Meet with accounting personnel to review billing matters and receivable matters.
- Make contact with customers' accounts payable or job superintendents to expedite payments.
- Read and sign contracts for some jobs.
- Provide advice and suggestions that may lead to a better, more complete accurate estimate.
- Perform random checks on take off specifications unit prices.<sup>15</sup>

He also performs similar duties on behalf of 3i Supply Company. Mr. Thompson testified that in his role as president of the Operating Company, he manages and controls all of the other personnel and makes all decisions in regard to the operation of the business.<sup>16</sup> . Mr. Thompson testified that Petitioner does not, in any manner or form, directly or indirectly, manage and control his activities at the Operating Company.<sup>17</sup> He stated that “. . . [Petitioner] really wouldn't have any control over me and I can make the decision for . . . [Petitioner].”<sup>18</sup>

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<sup>15</sup> Transcript, pp. 18 – 23

<sup>16</sup> Transcript, p. 25

<sup>17</sup> Transcript, pp. 31 – 32

<sup>18</sup> Transcript, p. 33

Finally, Petitioner asserts that the current case has an identical fact pattern to *McCartney Enterprises, Inc v Department of Treasury*, MTT Docket No 321164, in which the Tribunal issued an Order Designating Decision as Precedent in “defining whether certain compensation to a leased employee should be included in calculating the [SBT] of the leasee entity, pursuant to MCL 208.9.”<sup>19</sup>

### RESPONDENT’S CONTENTIONS

Respondent contends that “Petitioner is not entitled to the small business credit . . . because . . . [Mr. Thompson’s] compensation exceeds the \$115,000 ceiling.”<sup>20</sup> Respondent asserts that MCL 208.36(2)(b)(i) clearly states that “[i]f an officer or shareholder of a corporation is compensated more than \$115,000.00 in a tax year, it is disqualified from receiving the small business credit.”

Respondent contends that Petitioner “incorrectly omitted the wages of owner/officer/employee Mark Thompson from its Single Business Tax Return and Form C8000-KC to avoid exceeding the leasing company’s \$115,000 threshold for the small business credit set forth in MCL 208.36.”<sup>21</sup> Further, Respondent contends that “[Petitioner] reported the compensation of two other officers, Mr. Garcia and Ms. Varner, on the credit schedule. This reporting position allowed Associates Resources to appear as though it remained under the \$115,000 threshold.”<sup>22</sup>

Respondent argues that Mr. Thompson’s compensation is attributable to Petitioner because he was subject to Petitioner’s direction and control, therefore meeting the common-law employee standard set out in *Mid America, supra*. Respondent points to the express terms of the Employee Leasing contract, in particular provisions 8 and 10, to show that “the workers were [Petitioner]’s employees, and [Petitioner] reserved the exclusive right over their direction and control.”<sup>23</sup>

Respondent contends that “[w]hile the analytical framework of *Mid America Management Corp* applies equally here, the parties’ use of the word ‘exclusive’ in their agreement distinguishes this dispute from the fact of *Mid America Management Corp*.”<sup>24</sup> Respondent argues that the contract in this case did not contain a similar contractual ambiguity over the right to control as was found in *Mid America*; rather, Petitioner’s contract provides “the exclusive right to exercise all power and control over its employees belonging to an employer at common law and by statute.” [Emphasis in original] <sup>25</sup> Respondent asserts that an “[a]nalysis of the agreement under the common law test set forth in *Mid America* yields the conclusions the . . . [Petitioner] is the employer, that Mr. Thompson’s compensation belongs on . . . [Petitioner’s] Single Business Tax return and credit schedule and that . . . [Petitioner] is not entitled to the credit set forth in MCL 208.36.”<sup>26</sup>

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<sup>19</sup> Petitioner’s Trial Brief, p. 17, quoting *McCartney Enterprises, Inc v Department of Treasury*, MTT Docket No 321164, ORDER DESIGNATING DECISION AS PRECEDENT

<sup>20</sup> Respondent’s Prehearing Statement, p. 2

<sup>21</sup> Respondent’s Trial Brief, p. 1

<sup>22</sup> Respondent’s Trial Brief, p. 4

<sup>23</sup> Respondent’s Trial Brief, p. 2

<sup>24</sup> Respondent’s Trial Brief, p. 7

<sup>25</sup> Respondent’s Pretrial Brief, p. 7

<sup>26</sup> *Id.*

Respondent opposes Petitioner's introduction of "evidence at variance with the express terms of the contract between" Petitioner and the Operating Company. "Respondent objects to the introduction of any such [parol] evidence on two grounds:

1) The Agreement itself states:

D. This agreement constitutes the entire agreement between the parties hereto with respect to the subject matter hereof. No other agreement, statement, promise or practice between the parties relating to the subject matter hereof shall be binding on the parties.

E. This Agreement may be changed only by a written amendment signed by [Operating] Company and [Petitioner]; and 2) the parol evidence rule prohibits a contracting party from using extrinsic evidence to vary terms of an unambiguous contract."<sup>27</sup>

Respondent contends that the ". . . use of the term 'exclusive' to modify the term 'right' in paragraph 7.A. of the agreement . . . renders the issue of control unambiguous."<sup>28</sup>

### **STIPULATED FINDINGS OF FACT**

The parties stipulated to the following findings of fact and the Tribunal finds:

1. Petitioner is the successor of Associates Resources, LLC organized on November 8, 2000 and Associates Resources of Midland, Inc., incorporated on February 7, 2001.
2. Petitioner was incorporated in Michigan on February 12, 2001.
3. Mark Thompson is the Resident Agent.
4. The Registered Office Address is 3405 Centennial Drive, Midland, Michigan 48642.
5. On February 23, 2001 Associates applied for and was issued Employer Identification Number (EIN) 38-3584092 by the Internal Revenue Service ("IRS").
6. Petitioner's shareholders are: Mark A. Thompson (70%), Carol J. Varner (15%) and David Garcia (15%).
7. Petitioner's officers are: Mr. Thompson (President), Carol J. Varner (Secretary-Treasurer) and David Garcia (Vice-President)
8. Petitioner leases employees to Operating Company pursuant to an Employee Leasing Agreement executed on December 1, 2000 and effective January 1, 2001.
9. Petitioner leases employees to 3i Supply Company pursuant to an Employee Leasing Agreement executed on December 1, 2000 and effective January 1, 2001.
10. Petitioner leases employees to Garcia Insulation Fabrication Company pursuant to an Employee Leasing Agreement executed on December 1, 2000 and effective January 1, 2001.
11. On December 1, 2000 Petitioner executed a separate Leasing Agreement with Operating Company. The agreement was in effect during the audit period.

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<sup>27</sup> Respondent's Trial Brief, citing *Mid America Management Corp v Department of Treasury*, 153 Mich App 446, 395 NW2d 702,707 (1986)

<sup>28</sup> *Id.*

12. The only year at issue in this appeal is 2003. Petitioner agrees with and has paid the tax assessed for 2004 and 2006. There was no adjustment of the 2005 return.
13. Treasury moved Mr. Thompson's compensation from the Operating Company's 2003 SBT return to Petitioner's 2003 SBT return.
14. The Small Business Credit, claimed on Petitioner's originally filed return, was disallowed because Thompson's compensation exceeded \$115,000, the disqualifying amount.

### **FINDINGS OF FACT**

In addition to the stipulated facts above, the Tribunal finds the following facts:

1. Mr. Thompson is the President of Petitioner.
2. Mr. Thompson is the sole shareholder and President of the Operating Company and 3i Supply Company (3i).
3. Mr. Thompson's working time is divided among the three entities as follows: Operating Company (59%), 3i (38%) and Petitioner (2%).
4. Garcia Insulation Fabrication Company is a Michigan Partnership organized by David Garcia and Frank Garcia.
5. Petitioner was organized as a PEO as that term was later defined in Section 4(4) of the Single Business Tax Act (1975 PA 241).<sup>29</sup>
6. Petitioner was formed for business purposes to streamline and make more efficient the employment of employees working at different entities and at different locations as well as the administration of payroll, employee benefits and payroll taxes.
7. Petitioner processes the payroll, for administrative convenience, for Mr. Thompson.
8. All the employees' compensation, except that of Mr. Thompson, was reported on Petitioner's Single Business Tax return for the year at issue.
9. Mr. Thompson's compensation was reported on the Single Business Tax return of the Operating Company.
10. The employee leasing agreement reserves to Petitioner the exclusive right to exercise all power and control over its employees leased to the Operating Company.
11. The employee leasing agreement specifies that the Operating Company will define positions to be leased.
12. The Employee Leasing Agreement provides in relevant part:

#### **1. Contract Staffing**

[Petitioner] agrees to furnish to the Company, and the Company agrees to engage from [Petitioner], contract staffing for all of the personnel positions described on Exhibit A hereto as amended from time to time (the "Job Positions"), upon the following terms and conditions. The personnel provided by [Petitioner] to the Company are hereafter referred to as "Contract Personnel."

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1. <sup>29</sup> It should be noted that the provisions of Section 4(4) of the Single Business Tax Act are not applicable in this case because the tax year in question is 2003 and Public Act 603 of 2002, which added Section 4(4) to the Single Business Tax Act, was made effective for tax years starting after 2003.

Under [Job Positions] of Exhibit A it states that “All positions to be defined by Company.”<sup>30</sup>

**7. Administration**

The parties agree that all Contract Personnel are employees of [Petitioner] and that [Petitioner] is an independent contractor here. Company agrees that [Petitioner] reserves the exclusive right to exercise all power and control over its employees belonging to an employer at common law and by statute, including, without limitation, the following rights: the right to determine whether an employee is to be hired or retained; the right to supervise, through [Petitioner] personnel, the performance criteria established by [Petitioner]; the right to reprimand, suspend, terminate or otherwise discipline employees; the right to determine and control such other terms and conditions as are incidental to employment. However, [Petitioner] agrees to provide, as Contract Personnel, its best and most qualified employees to Company should [Petitioner], enter into employee leasing agreements with other third parties.

**9. Contract Personnel**

[Petitioner] agrees that all Contract Personnel shall be duly qualified and skilled in the areas in which their services are to be utilized. [Petitioner] shall not be obligated to hire or retain former employees of Company. [Petitioner] shall consult with Company in filling Job Positions, but [Petitioner] has the sole right to determine which of its employees shall be designated to fill the Job Positions. Company shall have no right to approve such determination, but shall have the right to reject any employee so furnished if dissatisfied with such employee’s performance [. . .].

15. Thompson signed the Agreement as the President of Petitioner and as the President of Operating Company.
16. On audit, Respondent assigned Mr. Thompson’s compensation to Petitioner’s Form C8000KC and denied the SBC based on excessive officer compensation.
17. Respondent issued Assessment P782462 assessing the 2003 tax year for the following amounts:

Taxable Year	SBT	Interest*
2003	\$39,083.00	\$15,256.59

\*Accrued as of November 13, 2009 and continuing to accrue and to be computed in accordance with sections 23 and 24 of 1941 PA 122.

**APPLICABLE LAW**

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<sup>30</sup> Petitioner’s Exhibit 7, p. 8



The primary goal of statutory interpretation is to give effect to the intent of the Legislature. *People v Williams*, 475 Mich 245, 250; 716 NW2d 208 (2006). The first step in determining the intent of the Legislature is to look at the language of the statute. *People v Lively*, 470 Mich 248, 253; 680 NW2d 878 (2004). If the plain and ordinary meaning of the language is clear, judicial construction is neither necessary nor permitted. *Nastal v Henderson & Assoc Investigations, Inc*, 471 Mich 712, 720; 691 NW2d 1 (2005). The Legislature is presumed to have intended the meaning it plainly expressed, *People v Gardner*, 482 Mich 41, 50; 753 NW2d 78 (2008); *Rowland v Washtenaw Co Rd Comm*, 477 Mich 197, 219; 731 NW2d 41 (2007), and clear statutory language must be enforced as written, *Fluor Enterprises, Inc v Dep't of Treasury*, 477 Mich 170, 174; 730 NW2d 722 (2007). “Where a tax statute is the object of judicial construction, ‘ambiguities in the language . . . are to be resolved in favor of the taxpayer.’” *IBM v Dep't of Treasury*, 220 Mich App 83, 86; 558 NW2d 456 (1996), quoting *Michigan Bell Tel Co v Dep't of Treasury*, 445 Mich 470, 477; 518 NW2d 808 (1994). However, tax statutes that grant tax credits or exemptions are to be narrowly construed in favor of the taxing authority because such statutes reduce the amount of tax imposed. *Auto-Owners Ins Co v Dep't of Treasury*, 226 Mich App 618, 621; 575 NW2d 770 (1997).

### CONCLUSIONS OF LAW

At issue is whether Mr. Thompson is an employee of Petitioner and whether his compensation is attributable to Petitioner. In order to make this determination, the starting point for determining the legislature’s intent is the language of the statute itself.<sup>31</sup> Several authorities are useful in determining whether Petitioner was Mr. Thompson’s “employer” for purposes of the Single Business Tax Act (“SBTA”). The SBTA defines the terms “employee” and “employer” by referencing the definitions used in 26 USC 3401 (c) and (d) of the Internal Revenue Code. The SBTA defines the terms “employee” and “employer” as follows:

MCL 208.5(1) defines “Employee” as:

‘Employee’ means an employee as defined in section 3401(c) of the internal revenue code. A person from whom an employer is required to withhold for income tax purposes shall prima facie be deemed an employee.

MCL 208.5(2) defines “Employer” as:

‘Employer’ means an employer as defined in section 3401(d) of the internal revenue code. A person required to withhold for federal income tax purposes shall prima facie be deemed an employer. (MCL 208.5(2))<sup>32</sup>

Therefore, where one entity is required to withhold federal income taxes for another, it creates a rebuttable presumption that the former is the latter’s employer.<sup>33</sup> This “rebuttable presumption

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<sup>31</sup> *Stozicki v Allied Paper Co*, 464 Mich 257, 263; 672 NW 2d 293 (2001)

<sup>32</sup> An exception applies if the person for whom the individual performs the services does not have control of the payment of the wages. Then, the term employer means the person having legal control of the payment of the wages. See IRC §3401(d)(1) and Regulation 31.3401(d)-1(f). It should be noted that this exception is not applicable for SBTA purposes.

<sup>33</sup> *Mid America Management Corp v Department of Treasury*, 153 Mich App 458; 395 NW2d 702, 710 (1986)

establishes a prima facie case and places the burden of proof on the opposing party.”<sup>34</sup> The same presumption applies here, although Petitioner states that in regard to Mr. Thompson’s compensation Petitioner was acting as a payroll agent not an employer<sup>35</sup>, and its rebuttal depends on who had the right to direct and control Thompson.<sup>36</sup> Petitioner has the burden of rebutting this presumption.

Respondent contends that the language of the Agreement is clear and unambiguous and as such the parol evidence rule prohibits the use of extrinsic evidence. The Agreement states that “Company agrees that [Petitioner] reserves the exclusive right to exercise all power and control over its employees belonging to an employer at common law and by statute. . . .”<sup>37</sup> Petitioner refutes this claim stating that the agreement contains an ambiguity because by the terms of the Agreement, the Company has the right to define all the positions and personnel positions that would be leased from Petitioner.<sup>38</sup> This section of the Agreement references “Exhibit A [Job Positions]” which states “[a]ll positions to be defined by Company.”<sup>39</sup>

The Agreement clearly gives Petitioner the exclusive right to hire, fire, supervise, discipline and control work assignments of the employees and contract personnel. The problem is, Exhibit A of the Agreement gives to Company the right to define and determine all the positions they require. The court in *NAG Enterprises Inc v All State Industries, Inc* states the parol evidence rule does not preclude admission of extrinsic evidence where the agreement was “partially integrated” because all the essential elements were not reduced to writing.<sup>40</sup> Therefore, in order to establish the scope of Thompson’s employment and his role with Company, parol evidence is admissible to make this determination.

The Tribunal permitted Mr. Thompson to testify as to the type and extent of his work responsibilities on behalf of the Operating Company. He testified that as sole officer of Operating Company approximately 60% of his time was dedicated to his duties, 38% at 3i and the remaining 2% at Petitioner.<sup>41</sup> Further, Mr. Thompson testified because of the nature of Petitioner’s business, it ran itself and did not require him to be heavily involved.<sup>42</sup> As such, Thompson’s role as an officer of Petitioner was minimal. The Tribunal relies on *Herald Wholesale* where the court states the “minor services” exception to the Internal Revenue Code (“IRC”) definition of employee, set out in 26 CFR 31.3401(c)-1(f) “does not consider an officer to be an employee if that officer, ‘as such’, performs no services or minor services and does not get paid for those services.”<sup>43</sup> Therefore, under the applicable regulations, Thompson, as such, here involved is not an employee of Petitioner for the purposes of the SBTA.

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<sup>34</sup> *Id.*

<sup>35</sup> Transcript of Testimony, p. 36

<sup>36</sup> *Id.*

<sup>37</sup> Respondent’s Trial Brief, p. 7

<sup>38</sup> Petitioner Response to Respondent’s Trial Brief, p. 3

<sup>39</sup> Petitioner’s Exhibit 7, p. 8

<sup>40</sup> 407 Mich 407, 285 NW2d 770 (1979)

<sup>41</sup> Transcript of Testimony, p. 17

<sup>42</sup> Transcript of Testimony, p. 59

<sup>43</sup> 262 Mich App 688; 687 NW2d 172, 178 (2004).

The Tribunal finds the testimony of Thompson to be credible in regards to the scope of his employment and duties with the Operating Company and Petitioner. This is notwithstanding Respondent's attempts to impeach Mr. Thompson by presenting an affidavit signed by him stating that he "was a common law employee of [Petitioner] during the 2000 year."<sup>44</sup> The Tribunal finds that the affidavit, which was signed in 2005, was in response to a letter from the discovery division at the Department of Treasury. The letter from the discovery division advised Petitioner that its small business credit would be denied if it did not report Mr. Thompson's compensation on Petitioner's tax return in accordance with Letter Ruling 2002-04.

Pursuant to MCL 205.765, the Michigan Tax Tribunal declared the July 20, 2006, decision rendered in *McCartney Enterprises, Inc v Michigan Department of Treasury*, MTT Docket No. 321164, (July 20, 2006), precedential for defining whether certain compensation to a leased employee should be included in calculating the Single Business Tax base of a lessee entity, pursuant to MCL 208.9. Unless the facts in this case can be distinguished from *McCartney*, the Tribunal must find that Mr. Thompson's wages must be included in the Company's SBT base.

The findings of facts in *McCartney Enterprises*, were as follows:

Mr. McCartney is the sole shareholder and director of McCartney Enterprises, Inc., Petitioner. Mr. McCartney no longer desired to perform the administrative duties of an employer and contracted with Orbis Management Group, L.L.C., a third party employee leasing company, to provide employment services. Mr. McCartney became an employee of Orbis and was leased back to Petitioner. Although Mr. McCartney was an employee of Orbis, he controlled the relationship because he had the ability to terminate the contract with Orbis.

Relying on the very practical, fact-intensive test applied in *Mid America, supra*, the Tribunal found:

In no practical way does Orbis direct any aspect of Mr. McCartney's actions as owner and president of his business. [He] has complete control of the terms of his employment under the contract with Orbis. He can cancel the contract with Orbis. He sets his own hours. He sets his own pay. He decides what customers to work for and provides the tools to do the work. . . . he operates his business like any other owner. Orbis cannot discharge Mr. McCartney from his business. As applied to Mr. McCartney, no risks of any employment have been transferred to Orbis.

The Tribunal further found that Orbis ". . . assumed no 'employer risk' and certainly assumed no 'substantial employer rights, responsibilities and risk' as required by the statutory definition with respect to Mr. McCartney." As such, even though the Tribunal concluded that Mr. McCartney was an employee of Orbis, it nevertheless concluded that his compensation must be included on the SBT return of his company.

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<sup>44</sup> Transcript of Testimony, p. 40

The issue now is whether there is sufficient control over Thompson by Petitioner to establish an employer-employee relationship. 26 CFR 31.3401(c)-1 provides:

(b) Generally the relationship of employer and employee exists when the person for whom services are performed has the right to control and direct the individual who performs the services, not only as to the result to be accomplished by the work but also as to the details and means by which that result is accomplished. That is, an employee is subject to the will and control of the employer not only as to what shall be done but how it shall be done. In this connection, it is not necessary that the employer actually direct or control the manner in which the services are performed; it is sufficient if he has the right to do so. The right to discharge is also an important factor indicating that the person possessing that right is an employer. Other factors characteristic of an employer, but not necessarily present in every case, are the furnishing of tools and the furnishing of a place to work to the individual who performs the services. In general, if an individual is subject to the control or direction of another merely as to the result to be accomplished by the work and not as to the means and methods for accomplishing the result, he is not an employee.

The Tribunal looks to the above-stated regulation, as well as the test set out in *Mid America* in determining whether an employer-employee relationship exists. The common-law test “primarily focuses on the right to direct and control the manner and method of providing a service, although other factors may be considered.”<sup>45</sup> The Tribunal also looks to several factors set out in IRS Revenue Ruling 87-41 for guidance in determining Thompson’s employee status. These factors include; (1) control/compliance: “control is present if the [company] for whom the services are performed has the right to require compliance with instructions,” (2) hours of work: “the setting of hours of work by the [company] for whom services are performed is a factor indicating control” and indicative of an employer-employee relationship, (3) right to discharge: “the right to discharge [the] worker is a factor indicating that the worker is an employee and the person possessing the right is an employer.”

In applying the *Mid America* test and the guidelines of IRS Revenue Ruling 87-41, the Tribunal finds that Petitioner does not possess the right to direct or control Mr. Thompson in his capacity as president and employee of Operating Company. Petitioner does not direct any aspect of Thompson’s performance or actions as sole owner and president of his business. The Tribunal finds that Mr. Thompson was not a Contract Personnel as defined by the terms of the Agreement and therefore he has complete control over the terms of his employment and performance. Thompson as president of Company determines his own hours, wage and the operations of his business. Petitioner does not possess the right to terminate Thompson from his business or direct Thompson. In accordance with *McCartney* and under the standard set out in *Mid America*, Thompson obtained his compensation from himself as president of Company.<sup>46</sup>

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<sup>45</sup> *Mid America Management Corp v Department of Treasury*, 153 Mich App 446, 458; 395 NW2d 702, 707 (1986), citing *Marvel v United States*, 719 F2d 1507 (CA 10, 1983)

<sup>46</sup> *McCartney Enterprises, Inc v Department of Treasury*, MTT Docket No 321164

For the aforementioned reasons, Petitioner has successfully rebutted the presumption that Mr. Thompson was an employee of Petitioner, rather than Company. Petitioner therefore was not required to include Mr. Thompson's compensation in its SBT tax base for the tax year at issue. Therefore,

**JUDGMENT**

IT IS ORDERED that Assessment P782462 that pertains to the 2003 tax year be CANCELLED.

This Final Opinion and Judgment resolves all pending claims in this matter and closes this case.

MICHIGAN TAX TRIBUNAL

Entered: July 27, 2011

By: Cynthia J Knoll