

MI Appellate Court – Legal services sourced to client location for Detroit City Income Tax sales factor purposes

Overview

In a published order issued on January 18, 2018, the Michigan Court of Appeals (“Appellate Court”) in *Honigman Miller Schwartz and Cohn LLP v. City of Detroit*, reversed a Michigan Tax Tribunal (“Tax Tribunal”) ruling which had previously held that legal services performed in the City of Detroit for a client located outside of the city were considered “in-city” revenues under the City Income Tax Act (“CITA”) sales factor provision.¹ Interpreting the term “services rendered” in a manner consistent with the destination sourcing of tangible goods, however, the Appellate Court concluded that the services performed by an attorney physically located in the City on behalf of a client who is physically located outside of the City are “out-of-city” revenues for sales factor purposes.²

This tax alert summarizes the relevant CITA provisions, the Tax Tribunal decision and the Appellate Court decision.

City Income Tax Act provisions

To the extent that a business’s entire business is not conducted within the City of Detroit, a business is required to apportion its income based on an equal-weighted three-factor (i.e., property, payroll, and sales) apportionment formula.³ Each respective factor is determined by an in-city percentage of activity in comparison to the business’s total activity for the factor in question. The sales factor is a percentage based on “gross revenue of the taxpayer derived from sales made and *services rendered in the city* [to] the total gross revenue from sales and services wherever made or rendered.”⁴

Tax Tribunal grant of Summary Disposition

Petitioner, a law firm with its primary office in the City of Detroit, represented clients both within Detroit and outside Detroit.⁵ During the subject years at issue, Petitioner had computed its sales factor, interpreting “services rendered” as the location where the client receives the services. The City of Detroit contested this interpretation, construing “services rendered” as the location where the work is physically performed. The Tax Tribunal hearing officer determined that the sales factor provision of the CITA was ambiguous and upheld the City’s interpretation of the statute.⁶ Petitioner then appealed the Tax Tribunal decision to the Michigan Court of Appeals.

Appellate Court Order

The Appellate Court first determined that the sales factor provision of the CITA, contrary to the Tax Tribunal’s determination, was unambiguous, and therefore looked to the plainly expressed meaning of the statute as contained in the words utilized by the Michigan legislature.⁷ The Appellate Court noted that the

¹ *Honigman Miller Schwartz and Cohn LLP v. City of Detroit*, No. 336175 (1st Dist., Jan. 18, 2018). A copy of the decision is available [here](#).

² *Id.* at 5.

³ MCL 141.620.

⁴ MCL 141.623 (emphasis added.)

⁵ *Honigman Miller Schwartz and Cohn LLP v. City of Detroit*, No. 336175 (1st Dist., Jan. 18, 2018.)

⁶ *Id.* at 2.

⁷ *Id.* at 2.

legislature used two different terms in drafting the payroll factor and the sales factor. The payroll provision sources wages based on where services are *performed*, while the sales provision sources revenue to the City based on where to services are *rendered*. The Court of Appeals determined that these two phrases must have separate meanings, for if it had been intended to be the same, "it would have used the same word."⁸

Although the sales factor provision of the CITA does not define the term "services rendered", the Appellate Court noted that the provision does "give explicit guidance to 'sales made in the city'" notably with regard to the sale of tangible goods.⁹ In reviewing the entirety of the sales provision, the Appellate Court stated:

There is a very obvious common thread . . . what is relevant is not the location of the taxpayer (or even the customer), but the destination of the goods.¹⁰

The Appellate Court also rejected, as "dubious and unnecessarily convoluted," the Tax Tribunal's conclusion that the dictionary interpretation of "rendered" is "synonymous with performed."¹¹ Instead, the Appellate Court determined that a Webster's definition "to transmit to another: DELIVER" provided a more logical construction.¹²

Ultimately, the Appellate Court held that the relevant consideration for purposes of computing the sales factor percentage for purposes of the CITA is "where the service is delivered to the client, not where the attorney performs the service."¹³

Considerations

The City of the Detroit does have appeal rights, though it is unclear currently if such rights will be invoked. During the interim, taxpayers that provide services should discuss this decision with their tax advisors relative to its potential impact on their City of Detroit income tax liability as well as for the potential impact in other cities in Michigan that impose an income tax pursuant to the CITA.¹⁴

⁸ *Id.* at 3.

⁹ *Id.* at 3.

¹⁰ *Id.* at 4.

¹¹ *Id.* at 4.

¹² *Id.* at 4.

¹³ *Id.* at 5.

¹⁴ In addition to Detroit, the following cities in Michigan currently levy an income tax: Albion, Battle Creek, Big Rapids, Flint, Grand Rapids, Grayling, Hamtramck, Highland Park, Hudson, Ionia, Jackson, Lansing, Lapeer, Muskegon Heights, Pontiac, Port Huron, Portland, Saginaw, Springfield, and Walker. (Michigan Department of Treasury information available [here](#).)

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