Michigan: Court of Appeals addresses situsing of revenue from the sale of legal services

David M. Kall | Thursday, February 15, 2018

In the case *Honigman Miller Schwartz and Cohn LLP v. city of Detroit*, the Michigan Court of Appeals examined whether attorney income, from a client located outside of Detroit, was in-city or out-of-city income for purposes of the City Income Tax Act (Act). The law firm's office is located inside the city of Detroit.

The case turned on whether the relevant factor was where the client received the services, as the law firm argued, or where the work was performed, as was the city's position. Under specific facts and law at issue, the court agreed with the firm and reversed the Tax Tribunal.

Background facts

In the opinion, the court explained that the law firm's primary office is inside Detroit, and it also has offices outside the city. It represents clients both inside and outside of Detroit.

In accordance with the Act, the firm must determine the percentage of its income that is attributable to Detroit under three different factors, and then use the average of the results. These factors are the following:

1. The property factor, which considers what percentage of the business's tangible personal and real property is located within the city

2. The payroll factor, which considers what percentage of the payroll is attributable to "work done or services performed within the city"
3. The sales factor, which considers the gross revenue derived from sales made and services rendered in the city compared to all gross revenue.

There was no dispute about the law firm's computation under the first two factors. Instead, there was a fact-specific dispute regarding the specific language of the City's Act with respect to the sales factor. That is, the disagreement turned on whether the "services rendered" language in the third factor refers to where the client receives the services, or where the work is performed. For the tax years at issue, 2010-2014, the law firm calculated its "in-city" gross revenue by summing the gross revenue collected from clients located within the city of Detroit, as it had done in the past. In contrast, the city calculated the firm's sales factor revenue by using the firm's billable hours for work performed within Detroit, regardless of the location of the client.

The firm's computation resulted in in-city income of just under 11 percent of its total income. In Detroit's computation, the firm's in-city income was just over 51 percent.

Analysis

Finding that the statutory language was unambiguous, the court determined that its job was to "interpret the plainly expressed meaning of the statute as contained in the words utilized by the Legislature." In so doing, it noted that the Act provided this "explicit guidance" as to the meaning of "sales made in the city":

> For the purposes of this section, "sales made in the city" means all sales where the goods, merchandise or property is received in the city by the purchaser, or a person or firm designated by him. In the case of delivery of goods in the city to a common or private carrier or by other means of transportation, the place at which the delivery has been completed is considered as the place at which the goods are received by the purchaser.

The guidance also included several illustrations:

> (a) Sales to a customer in the city with shipments to a destination within the city from a location in the city or an out-of-city location are considered sales made in the city.
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> (b) Sales to a customer in the city with shipments to a destination within the city directly from the taxpayer's in-city supplier or out-of-city supplier are considered sales made in the city.
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> (c) Sales to a customer in the city with shipments directly to the customer at his regularly maintained and established out-of-city location are considered out-of city sales.
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> (d) Sales to an out-of-city customer with shipments or deliveries to the customer's location within the city are considered sales made in the city.
>
> (e) Sales to an out-of-city customer with shipments to an out-of-city destination are considered out-of-city sales.

The court opined that these offer "a very obvious common thread," such that "what is relevant is not the location of the taxpayer (or even the customer), but the destination of the goods…This utilizes a 'destination test' for the sales factor."

The court additionally discussed the delivery of services, as opposed to goods. Acknowledging that

services are not the same as tangible items, the court nevertheless asserted that this “does not mean that services cannot be delivered.” Thus, “a lawyer’s time and advice can result in a tangible item,” like a will, complaint, contract or brief, which could “well be delivered to the client in a different location [from] where the lawyer performs the drafting.”

For example, the court reasoned, “a lawyer in Detroit may have a telephone conversation with a client located in Ann Arbor. The lawyer’s advice during that conversation is delivered to the client in Ann Arbor.”

Conclusion

The court ultimately determined that for purposes of the applicable section of the Act, when a service is provided to a client that is located outside the city of Detroit, “it is to be considered an “out-of-city” service. Conversely, services provided to a client located inside Detroit are “in-city” services.

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