STATE OF MICHIGAN

COURT OF APPEALS

MICHIANA METRONET, INC.,	UNPUBLISHED November 8, 2012
Petitioner-Appellee,	
v	No. 306219 Tax Tribunal
DEPARTMENT OF TREASURY,	LC No. 00-383664
Respondent-Appellant.	

Before: SHAPIRO, P.J., and GLEICHER and RONAYNE KRAUSE, JJ.

PER CURIAM.

This case involves petitioner Michiana Metronet, Inc.'s single business tax (SBT) calculations for the years 2003-2006. We affirm the Michigan Tax Tribunal (MTT)'s summary dismissal in petitioner's favor. When calculating the portion of petitioner's "sales other than sales of tangible personal property" that occurred in Michigan, respondent Michigan Department of Treasury conceded that the statutory "cost of performance" method had to be employed. Respondent's own policies directed it to examine the nature of the specific service performed. As such, respondent's insistence during the audit and the MTT proceeding that petitioner's sales should be based solely on the customer's billing address was unavailing.

I. BACKGROUND

Petitioner is a "regional wireless services provider" that operates in Indiana, Ohio, and Michigan. Before May 2005, petitioner's Michigan investments were limited to cellular towers and retail stores. Petitioner's administrative and business operations were located in Fort Wayne, Indiana. After May 2005, petitioner installed additional infrastructure in Michigan to meet growing customer demand.

As petitioner earns a portion of its income in Michigan, it is subject to Michigan income taxes. Respondent audited petitioner's income tax filings for the tax years ending on May 31 between 2003 and 2006. The only items challenged after the audit related to the SBT. The Single Business Tax Act (SBTA), MCL 208.1 *et seq.*, was repealed effective January 1, 2008. 2006 PA 325. While in effect, the SBTA required taxpayers to engage in a complicated computation of the costs and profits of engaging in business in Michigan. At issue in this case is the apportionment of "sales other than sales of tangible personal property" in Michigan. The now-repealed MCL 208.53 provided that such sales "are in this state," and therefore subject to Michigan income tax, if certain alternative conditions are met:

(a) The business activity is performed in this state.

(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.

Former MCL 208.3(2) defined "business activity" as including the "performance of services." MCL 208.7(a)(*ii*), in turn, included as a "sale" "the amounts received by the taxpayer as consideration from . . . [t]he performance of services, which constitute business activities[.]"

The SBTA did not define "costs of performance." In Internal Policy Directive 2006-8, available at <http://www.michigan.gov/treasury/0,4679,7-121-44402_44419-134787--,00.html> (accessed October 24, 2012), respondent provided its own guidance:

> [D]irect costs that are determined in a manner consistent with a taxpayer's method of accounting for federal income tax purposes. A costs of performance analysis is not applied to the total business activity of a taxpayer, but to each sale separately . . . . In other words, those costs directly related to the activity performed for the client. [*Id.* at 1.]

The policy directive continues:

> The determination of direct costs is dependent on an examination of the nature of the service performed. Direct costs may include labor costs of those employees directly related to the performance of the service in question; materials, equipment, and supplies directly related to the performance of the service; and payments to an independent contractor who performs services directly related to the contractual obligations. [*Id.* at 2.]

Respondent questioned petitioner's exclusion "from the sales factor numerator" of its SBT calculation receipts "related to long distance calls, international long distance, enhanced features and incollect roamer charges."[1] The auditor rejected that "the greater cost of

[1] As explained by our Supreme Court in *Fluor Enterprises, Inc v Dep't of Treasury*, 477 Mich 170, 175; 730 NW2d 722 (2007):

> When business activity is partially performed out of state, the statute establishes a system of apportionment, MCL 208.40 *et seq.*, so that only those receipts appropriate to be taxed in Michigan are taxed here. Apportioning is based on a formula whereby a fraction reflecting the ratio of Michigan activity to out-of-state activity, i.e., Michigan sales/total sales, is established. . . . In this case, where the sales factor is at issue, the question is which sales of plaintiff's total sales should be included in its "Michigan sales" numerator.

MCL 208.51(1) described the sales factor as:

performance was performed outside the state," given petitioner's "substantial activity in Michigan," citing the number of cell towers located in this state and the proportion of petitioner's property and wages here. Respondent's auditor noted that the disputed "'services' are the same as the normal features of the telephone." Ultimately, the auditor determined that the disputed services had to be assessed "on a transaction by transaction basis," not "based on [petitioner's] total business activity . . . . The billing address is the best method for sourcing; there is no way of determining direct costs for cost of performance." Under respondent's calculation, petitioner owed taxes to the state of Michigan; petitioner's calculations led to a tax refund.

Petitioner challenged the tax assessment to the MTT. Following a May 2011 scheduling conference, the MTT characterized respondent's position as follows:

> Pursuant to Respondent's Internal Policy Directive 2006-8, Respondent treats these services as normal cellular phone call features, even though Petitioner itemizes separate charges for each service. In addition, Respondent asserts that the most accurate and appropriate method for sourcing each sales [sic] is based on the billing address of the cell phone subscriber. This method of sourcing sales it [sic] consistent with Respondent's treatment of other cellular phone companies.

The MTT characterized the issues before it as:

> 1. Factual Issues –
>
> > Were greater than 50% of the direct costs incurred related to the sale of other than tangible personal property for the applicable tax periods incurred outside Michigan for the applicable SBT tax years?
> >
> > Does Petitioner perform services within this State by providing cellular phone service to subscribers who [sic] billing addresses are in Michigan?
>
> 2. Legal Issues –
>
> > Is the business activity performed solely in the State of Michigan, such that MCL 208.53(a) applies to the sourcing of Petitioner's sales of other than tangible personal property?
> >
> > Is the business activity performed both in and outside the State of Michigan, such that MCL 205.53(b) [sic] applies to the sourcing of Petitioner's sales of other than tangible personal property?
> >
> > If MCL 205.53(b) [sic] applies, how is the greater proportion of business activity and costs of performance determined?

The sales factor is a fraction, the numerator of which is the total sales of the taxpayer in this state during the tax year, and the denominator of which is the total sales of the taxpayer everywhere during the tax year.

The MTT then directed the parties to file cross motions for partial summary disposition regarding the applicability of MCL 208.53(a) and (b).

Petitioner filed its motion for partial summary disposition, urging the application of subsection (b) as its business occurred both in Michigan and Indiana. Therefore, petitioner argued for the use of the "costs of performance" calculation method. In its motion, petitioner also argued the factual basis for why the majority of the costs of performance occurred outside of Michigan. Respondent made no reply to petitioner's factual arguments. Instead, it submitted a letter to the MTT conceding that MCL 208.53(a) was inapplicable.

The MTT found:

> Fort Wayne, Indiana is the corporate center of Petitioner's Midwest cluster and equipment based in Fort Wayne is used to service the Michigan market. Specifically, the engineering, billing, and customer service departments that support the entire cluster are located in Fort Wayne. All Michigan services were provided through the network and other equipment located in Indiana. Prior to May 2005, the only investments made in Michigan were cellular towers and retail stores. In May 2005, additional network assets were built in Michigan. However, the infrastructure that provided services such as internet access, e-mail delivery, billing, text messaging, and other services remained in Indiana.

In relation to the law, the MTT concluded:

> The [MTT] does not find that Respondent's approach to sourcing Petitioner's receipts based on the billing address of the customer is supported by statute. The law clearly and unambiguously provides that a sale is sourced to Michigan only if a greater proportion of the business activity is performed in Michigan than is performed outside Michigan **based on costs of performance**. Petitioner has proven that its service is performed through the completion of wireless calls and the provision of the network to the subscriber. Because Petitioner's entire wireless network is necessary to complete Petitioner's service, looking to the billing address of the customer may have no direct correlation to where the costs were incurred to generate the sales. Rather, the costs to perform the services include the use of the network equipment and the manpower to support the wireless services, not some arbitrary attachment to a customer billing address. [Emphasis in original.]

The MTT summarily dismissed the claims in petitioner's favor only in relation to the 2003-2005 tax years. Petitioner's Michigan infrastructure expansion in 2005 created a genuine issue of material fact whether the majority of its costs of performance remained outside Michigan in 2006.

The parties proceeded toward the MTT hearing to resolve the factual basis for petitioner's 2006 SBT calculation. Prior to the hearing, petitioner filed a motion to amend its petition and withdraw its challenge to the 2006 assessment. Respondent quietly sat back and

raised no objection before the MTT granted petitioner's motion and dismissed the action in its entirety.

II. ANALYSIS

Respondent now challenges the MTT's resolution in its initial partial summary disposition order of the factual questions underlying the case and its failure to conduct an evidentiary hearing on the issue in violation of respondent's due process rights. We review de novo a lower tribunal's summary disposition decision under MCR 2.116(C)(10). *Maiden v Rozwood*, 461 Mich 109, 118; 597 NW2d 817 (1999). For a motion under MCR 2.116(C)(10), the tribunal must consider the "affidavits, pleadings, depositions, admissions, and other evidence submitted by the parties, MCR 2.116(G)(5), in the light most favorable to the party opposing the motion. Where the proffered evidence fails to establish a genuine issue regarding any material fact, the moving party is entitled to judgment as a matter of law." *Rozwood*, 461 Mich at 119-120. "A genuine issue of material fact exists when the record, giving the benefit of reasonable doubt to the opposing party, leaves open an issue upon which reasonable minds might differ." *West v General Motors Corp*, 469 Mich 177, 183; 665 NW2d 468 (2003).

Review of an MTT decision is governed by Article 6, § 28 of the Michigan Constitution. *Meadowlanes Ltd Dividend Housing Ass'n v City of Holland*, 437 Mich 473, 482; 473 NW2d 636 (1991). When there is no allegation of fraud, this Court's review is "limited to whether the tribunal made an error of law or adopted a wrong principle. [This Court accepts] the factual findings of the tribunal as final, provided they are supported by competent, material, and substantial evidence." *Dow Chem Co v Dep't of Treasury*, 185 Mich App 458, 462-463; 462 NW2d 765 (1990); see also Const 1963, art 6, § 28. "Substantial evidence must be more than a scintilla of evidence, although it may be substantially less than a preponderance of the evidence required in most civil cases." *Dow Chem Co*, 185 Mich App at 463.

We discern no error in the MTT's resolution of this case. Respondent concedes that former MCL 208.53(b) applies as petitioner performs "long distance calls, international long distance, enhanced features and incollect roamer charges" both in Michigan and Indiana. The question then becomes how one must determine the "costs of performance" related to the subject services. As this question was put before the MTT as noted in the scheduling conference memorandum and the MTT did not direct the parties to address this issue in their cross motions for partial summary disposition, the MTT arguably should not have reached this issue. 1979 AC R 205.1270(8) ("The summary of results [after the pretrial conference] controls the subsequent course of the proceeding unless modified at or before the hearing by the [MTT] to prevent manifest injustice.").

However, respondent's procedural and due process challenges are off the mark. Respondent's position during the audit was that petitioner could not provide factual support for its costs-of-performance analysis or support its reliance on the total cost of the business activity rather than on a call-by-call basis. These were the reasons respondent urged that the costs of performance should be sourced by customer billing address. Respondent's challenge before the MTT is limited to its "theory of recovery" during the audit and it could argue no alternative grounds based on different "operative facts" supporting its tax assessment. *Montgomery Ward & Co, Inc v Dep't of Treasury*, 191 Mich App 674, 682-684; 478 NW2d 745 (1991); MCL

205.21(2)(b) (providing that in a disputed tax case, the Department must notify the taxpayer of "the reason for [the specific] deficiency"). As respondent could not change its position, further hearing on the issue was unnecessary.

The MTT's conclusion that respondent's position on the sourcing of the challenged services lacked merit is not legally erroneous and is supported by competent, material, and substantial evidence. Respondent concedes that the equipment and personnel necessary to provide the challenged services lie in both Michigan and Indiana. Yet, respondent argues that the entirety of the costs of performance should be sourced in Michigan based solely on the billing address of petitioner's Michigan customers—a factor bearing no automatic relation to the costs of performance of these services. This position is inconsistent and insupportable under Internal Policy Directive 2006-8. As respondent never challenged petitioner's factual assertions regarding the location of the equipment and personnel necessary to these services and the cost allocation involved, the MTT had no grounds to question the accuracy of petitioner's evidence. Accordingly, the MTT properly determined that petitioner was entitled to judgment as a matter of law in relation to the 2003, 2004, and 2005 tax year challenges.

The MTT also committed no error in granting petitioner's request to amend its complaint. 1996 AC 205.1225(2) provides that a party may amend its pleading before the MTT "only by leave of the tribunal." If the taxpayer seeking a refund decides to pay the tax while the matter is pending before the MTT, however, the pleading "may be amended as of right." *Id.* Petitioner sought amendment to withdraw its challenge to the 2006 tax assessment and paid the challenged tax. This was an amendment as of right. Accordingly, the MTT was bound to grant the amendment and dismiss the action in its entirety.

Affirmed.

/s/ Douglas B. Shapiro
/s/ Elizabeth L. Gleicher
/s/ Amy Ronayne Krause