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Recently, Michigan's Department of Treasury has issued several interpretive bulletins to provide guidance to taxpayers. In this article, Lynn A. Gandhi of Honigman Miller Schwartz and Cohn LLP discusses Revenue Administration Bulletin 2015–20 and its less-than-ideal guidance for where the benefit of a service is received for apportionment purposes.

Determining Where the Benefit of Services Is Received For Purposes of the Michigan Corporate Income Tax

BY LYNN A. GANDHI

In the past three months, the Michigan Department of Treasury (the department) has issued several Revenue Administration Bulletins (RABs) to provide guidance to taxpayers. One recent bulletin, RAB 2015-20,[1] focuses on where the benefit of services is received for purposes of apportionment for the Michigan Corporate Income Tax (CIT).[2] Revenue Administrative Bulletins are written pronouncements of the department's interpretation of tax laws. They are not promulgated under the state's Administrative Procedures Act,[3] and, therefore, do not have the force of law. The extent to which the Michigan courts follow the guidance contained in RABs is best summarized by *In re Complaint of Rovas*, which indicated that RAB's are given ''respectful consideration which is not the equivalent of ''

[1] Approved Oct. 16, 2015.

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[2] The CIT is contained at Michigan Compiled Laws 206.601—206.713. This is Part 2 of the Michigan Income Tax Act, which was added as Public Act 38 of 2011, effective Jan. 1, 2012. Part 1 of the Michigan Income Tax Act, MCL 206.1—206.532 applies to individuals, trusts, estates and flow-through entities, and uses a cost-of-performance sourcing methodology for sales other than sales of tangible personal property. *See* MCL 206.123.

[3] MCL 24.201.

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'deference.' ''[4]

Background

Prior to the enactment of the short-lived Michigan Business Tax (MBT),[5] Michigan followed a cost-of-performance apportionment methodology under the Single Business Tax.[6] Under Michigan's cost of performance method, sales of other than tangible personal property were sourced to the state if the income-producing activity was performed in the state.[7] If the income-producing activity was performed both within and without the state, and a greater proportion of the income-producing activity was performed in the state than outside the state, based on the costs of performance, all of the receipts from such services were sourced to the state.[8]

With the adoption of the MBT, Michigan moved to market-based sourcing. Under the MBT, sales from the performance of services were sourced to the state in proportion to the extent that the recipient receives the benefit of the services in this state.[9] The language of the CIT sourcing provision is identical to the language contained in the MBT. RAB 2010-5, *Michigan Business Tax Where Benefit of Services Is Received*, addressed how a taxpayer determines ''where the recipient of services performed receives the benefit of those services for purposes of calculating the apportionment sales factor.''[10] Disappointingly, RAB 2015-20 is almost an identical version of the guidance put forth by the department in 2010. The guidance it provides is limited, does not reflect any of the extensive market-based sourcing rules and regulations promulgated by other states, especially California, which also adopts a ''benefit received'' approach, and fails to address the more complex circumstances regarding ''benefit received,'' which are certain to arise in the future.

RAB 2015-20 Guidelines

RAB 2015-20 addresses how receipts from the performance of services are sourced under the CIT's single-sales factor apportionment.[11] Under the CIT, the numerator of the sales factor is the total sales of the taxpayer in the state, as well as the proportionate share of the total sales in the state of a flow-through entity that is unitary with the taxpayer.[12] For sales from the performance of services, Michigan adopts the version of market sourcing that looks to where ''the recipient receives [the] benefit of the services in this state.''[13] Specifically, the statute states:

> (2) Sales from the performance of services are in this state and attributable to this state as follows:
>
> (a) Except as otherwise provided in this section, all receipts from the performance of services are included in the numerator of the apportionment factor if the recipient of the services receives all of the benefit of the services in this state. If the recipient of the services receives some of the benefit of the services in this state, the receipts are included in the numerator of the apportionment factor in proportion to the extent that the recipients receives benefit of the services in this state.[14]

Once again, Michigan takes a unique approach as to ''benefit received'' by looking to where the ''*recipient of the service*'' receives the benefit. RAB 2015-20, as did RAB 2010-5, provides that while the recipient of the services sold will often be the purchaser of those services, the use of the term ''recipient'' within the statute indicates that the recipient may, in some circumstances, be ''someone other than the purchaser of the services.''[15] This is in contrast to California's sourcing provision for sales of other than tangible personal property, which looks to where the *purchaser of the service* receives the benefit.[16] Curiously, the CIT does not define the term ''recipient,'' and there is no indication of whether the receipt of services must have a direct relationship with the service provider, or whether an indirect relationship would suffice.[17] Indeed, no further guidance is provided, and within all of the examples contained in RAB 2015-20, the purchaser of the services is the recipient of the services.

The RAB guidelines can be summarized as follows. Guidelines 1–6 pertain to services received solely in the state. Guidelines 7–10 pertain to services in which the recipient receives only a portion of the benefit in the state. Services will be deemed to be received in Michigan if:

[4] 482 Mich. 90, 108; 754 N.W.2d 259 (2008).

[5] Enacted by Public Act 36 of 2007, and replaced effective Jan. 1, 2012, with the CIT (but for those taxpayers who had received certificated credits and have elected to remain on the MBT through the life of the certificated credit). *See* MCL 206.680.

[6] MCL 208.53 et. seq. The SBT was replaced with the MBT effective Jan. 1, 2008.

[7] MCL 208.53.

[8] MCL 208.53

[9] MCL 208.1305(2).

[10] RAB 2010-5, p 1.

[11] MCL 206.661.

[12] MCL 206.663(1).

[13] MCL 206.665(2)(a).

[14] MCL 206.665.

[15] RAB 2015-15 p 2.

[16] Cal. Rev. & Tax Cd. §25136.

[17] Under the California regulations, ''Benefit of a service received'' means the location where the taxpayer's customer has either directly or indirectly received value from delivery of that service. Cal. Code Regs. 25136-2.

No.	Guideline
1	The service relates to real property that is located entirely in this state.
2	The service relates to tangible personal property that (a) is owned or leased by the purchaser and located in this state at the time that the service is received, or (b) is delivered to the purchaser or the purchaser's designee(s) in this state.

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No.	Guideline
3	The service is received in this state and provided to a purchaser who is an individual physically present in this state at the time that the service is received.
4	The service is received in this state and is in the nature of a personal service, such as consulting, counseling, training, speaking, and providing entertainment, that are typically conducted or performed first-hand, on a direct, one-to-one or one-to-many basis.
5	The service is provided to a purchaser that is engaged in a trade or business in this state and relates only to the trade or business of that purchaser in this state.
6	The service relates to the use of intangible property such as custom computer software, licenses, designs, processes, patents, and copyrights, which is used entirely in this state.
7	If the service relates to real property that is located in this state and in one or more other states, the benefit of the service is received in Michigan to the extent that the real property is located in Michigan.
8	If the service relates to tangible personal property that (a) is owned or leased by the purchaser and located in this state and in one or more other states at the time that the service is received, or (b) is delivered to the purchaser or the purchaser's designee(s) in this state and in one or more other states, the benefit of the service is received in Michigan to the extent that the tangible personal property is located in Michigan, or is delivered to the purchaser or the purchaser's designee(s) in Michigan.
9	If the service is provided to a purchaser that is engaged in a trade or business in this state and in one or more other states, and the service relates to the trade or business of that purchaser in this state and in one or more other states, the benefit of the service is received in Michigan to the extent that it relates to the trade or business of the purchaser in Michigan.
10	If the service relates to the use of intangible property such as custom computer software, licenses, designs, processes, patents, and copyrights, which is used in this state and in one or more other states, the benefit of the service is received in Michigan to the extent that the intangible property is used in Michigan.

Ommissions From Prior Guidance

What is not included in RAB 2015-20, but was included in RAB 2010-5, may be insightful to taxpayers. Part III of RAB 2010-5 provided two additional guidelines, labeled as Nos. 7 and 12, which have been excluded from RAB 2015-20. Both of these guidelines pertained to services that are professional in nature, such as legal or accounting services. In guideline No. 7, such services were provided to a purchaser that was an individual domiciled in the state or to a purchaser with business operations only in Michigan. Pursuant to this example, RAB 2010-5 stated that ''all of the benefit'' was received in the state.[18]

In guideline No. 12 in RAB 2010-5, services were provided to a purchaser with business operations in Michigan, as well as one or more other states, and the services related to the purchaser's operations in multiple states. Pursuant to this guideline, RAB 2010-5 stated that the benefit of the services is received in Michigan ''to the extent that the services relate to the purchaser's Michigan operations.''[19] Professional services are not addressed at all in RAB 2015-20. Such an omission cannot be a mere oversight, and must be a result of the department's reconsideration of the positions stated in RAB 2010-5. However, as RAB 2015-20 provides no guidance at all regarding these services, taxpayers are left to wonder what position the department will take.

Ironically, RAB 2015-20 states that ''If a fact pattern encountered by a taxpayer is not addressed by a specific guideline, the taxpayer should use the guideline that is most closely applicable to the fact pattern at issue.'' Following this analogy, guideline 9, which was in both RABs, would most likely produce the same result. Example 9 provides:

> If the services is provided to a purchaser that is engaged in a trade or business in this state and in one or more other states, and the services relates to the trade or business of that purchaser in this state and in one or more other states, the benefit of the service is received in Michigan to the extent that it relates to the trade or business of the purchaser in Michigan.

Perhaps the department merely realized that this example includes all forms of professional and nonprofessional services, and there was no need to further delineate sourcing for the provision of professional services.

Determining ''to the Extent''

The one area in which RAB 2015-20 does provide guidance not previously provided in RAB 2010-5 is in determining to what extent a benefit is received in Michigan when the benefit is received in more than one state. RAB 2015-20 provides that a taxpayer may use any ''reasonable method'' which is ''appropriate in light

[18] RAB 2010-5 p 3.
[19] RAB 2010-5 p 4.

of all existing facts and circumstances.''[20] Such method must be applied uniformly and consistently, and must be used to apportion services that are substantially similar.[21] In addition, the chosen method ''must be supported by the taxpayer's business records as they existed at the time that the service was provided or the revenue therefrom was received by the taxpayer.''[22] Note, there is no requirement of preapproval by the department for the method selected by the taxpayer, and the burden of proof upon the taxpayer to maintain adequate documentation to support its chosen method appears reasonable.[23] This burden will only be met if a taxpayer receives such necessary information from its customer, which, of course, is the biggest challenge under market-based sourcing that looks to ''benefit received.''

[20] RAB 2015-20, p 4.
[21] RAB 2015-20, p 4.
[22] RAB 2015-20, p 4.
[23] Specifically, RAB 2015-15 requires: ''The taxpayer must maintain adequate documentation, through its books and records, supporting its determination regarding where the benefit of a service performed was received, and the means or method used by the taxpayer to determine the extent of the benefit received in Michigan.''

Specific Examples

To illustrate the application of the guidelines provided, RAB 2015-20 provides specific examples. Again, the majority of these examples are the same as were provided in RAB 2010-5, but for Example M which has been omitted and pertained to the providing of legal services.[24] As seen in other RABs, Michigan borrows heavily from California guidance. The majority of the examples are straightforward and regard services performed in the state related to either tangible personal property or real property located fully or partially in the state.

These examples can be summarized as follows:

[24] RAB 2010-5

Example	Service Provided
A	Survey work for land development in the state[25]
B	Engineering services for building construction in the state[26]
C	Pest control services for apartment buildings located both in and outside of the state[27]
D	Machine repairs performed in the state
E	Mail services performed outside the state attributable to the state based on percentage of total mailings delivered to the state
F	Machine testing performed both in and outside of the state
G	Haircut performed in the state
H	Entertainment services performed in the state
I	Training services provided via a teleconference to listeners both in and outside the state
J	Book binding services performed outside the state attributable to the state based on the purchaser's business being solely in the state
K	Use of custom software in the state[28]
L	Tech support center services sourced to the state based on the percentage of tech support calls originating in the state

[25] *See* Cal. Code Regs. 25136-2(b)(1) Ex. A.
[26] *See* Cal. Code Regs. 25136-2(b)(1) Ex. B.
[27] *See* Cal. Code Regs. 25136-2(b)(1) Ex. D.
[28] *See* Cal. Code Regs. 25136-2(b)(1) Ex. C (partially).

A few of the examples are worth reviewing in greater detail due to the rationales given for sourcing a percentage of the receipts from the performance of such services to the state. Example I provides:

> A small consulting company based in State T that provides consulting and training services to businesses is retained by a Michigan company to speak to its sales force about improving customer service. To lower costs, the speech is delivered via teleconference. The speaker remains in State T, while the sales force listens to the speech from their regular work locations at the company's two sales offices, located in Michigan and in State O. The consulting company's receipts from the speaking services are apportionable to Michigan and to State O, and are included in the numerator of the apportionment factor in proportion to the extent that the benefit of the services is received in Michigan. Apportioning between the states by the number of telephone participants may be one, but not necessarily the only, reasonable and appropriate method. See guideline 9 above.[29]

To refresh, guideline 9 sourced services to the state to the extent that the purchaser is engaged in a trade or business in the state and one or more other states, and the benefit of services relates to the trade or business.

[29] RAB 2015-20, p 6.

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Applying this guideline to Example I raises a host of questions. Before we address these questions, the assumption of nexus must be considered. Clearly, the department has assumed that for purposes of Example I, the small consulting company located in another state that provides sales consulting via telephone has established nexus with the state. While Michigan has adopted a statutory standard for the establishment of economic nexus,[30] it has not yet been reviewed by the courts, and it is unclear if such standard would withstand judicial scrutiny. The ability of the department to police the apportionment factors of non-physically present service providers will certainly be a challenge.

However, for purposes of focusing on apportionment, let us suspend disbelief that nexus has been established. The consulting company is tasked with improving customer service. The two groups of company employees listening are located in Michigan and in State O. The example indicates that the receipts should be apportioned to Michigan in ''proportion to the extent that the benefit of the services is received in Michigan.''[31] Clearly, headcount is one option, as suggested by the department in the example. Does headcount indicate the true ''benefit of the services?'' What if the speech had little or no impact on the listeners? What if the employee group in State O was able to quantify an improvement in their group of employees, while the group of employees in Michigan had no improvement? What if by the time the tax year ended, all of the employees listening in Michigan had left the company? What if the employees listening in Michigan were assigned to service territories across the world? While they may have been sitting at a location in Michigan to hear the speech, what if the benefit of the speech was applied to the services that such employees conducted in their service territories? Such an example is difficult to apply in a practical sense and provides little guidance. Does it really matter what the topic of the training was? What if the training was for international travel safety, would the recipients of the benefit of such service be the employees, and not the business, and then, wouldn't the benefit be received when the employee was able to utilize the knowledge taught?

Example J also raises practical concerns. Example J provides:

> A Michigan widget manufacturer hires a book-binding company located in State N to bind the instruction manuals for the company's widgets. The bindings and printed materials are supplied by the widget manufacturer. The book-binding company's receipts from the services are attributable to Michigan and included in the numerator of the apportionment factor because the services were provided to a purchaser engaged in business only in Michigan, and relate to the business of the purchaser in Michigan. See guideline 5 above.

Guideline 5, while similar to guideline 9, pertains to when the service is provided to a purchaser that is engaged in a trade or business in the state, and the service related only to the trade or business of that purchaser in the state.

Reading Example J, one is immediately assaulted with the notion of external consistency. How does the State of Michigan include in its sales factor numerator receipts received by the book-binding company for performing its services in State N? Even if we accept that somehow the book-binding company has nexus with Michigan, the RAB summarily states that simply because the books were sent to a Michigan widget manufacturer whose sole operations existed in Michigan, the book-binding services were performed in State N even though Michigan is entitled to the receipts from this service. This example appears to be inapposite to the first part of guideline 2, which would source such sales to Michigan, but only if ''the tangible personal property [owned by the purchaser of the service][is] *located in this state at the time that the service is received*.''[32] However, continued reading of guideline 2 indicates that such receipts are sourced to the state if the tangible personal property to which such services applied was merely ''delivered to the purchaser in this state.''[33] How does Michigan reconcile these two parts of guideline 2? If every state imposed a similar guideline, would there not be inherent internal consistency issues?

It seems highly impractical (let alone constitutional) to take the position that services provided to tangible personal property in one state that is sent to a purchaser in another state could, would, or should be included in the Michigan numerator of a service provider who didn't perform such services in Michigan. Especially as it is likely that the state in which the service provider is located, in which such services are actually performed, would include the receipts from such services performed within its state in its numerator. Following the reasoning of Example J, wouldn't all services used by Michigan businesses and residents be subject to apportionment to Michigan? If you sent an item to be specially dry cleaned to a leather cleaner in Iowa, is that Iowa dry cleaner really going to apportion those receipts to Michigan? According to guideline 2, both Iowa and Michigan could claim such receipts.

When Unable to Determine Where the Benefit Is Received

The RAB concludes with guidance as to what to do when a taxpayer is unable to determine where the recipient of a service received the benefit of that service. Rather than the precise ordering rules provided by other states that have adopted market-based sourcing, the department provides a set of ordering rules that appear to be thus:

First to be applied are the special sourcing rules provided in MCL 206.665(2) which pertain to specific services, mainly brokerage services, loan serving fees, credit card receivables, trading activities, oil and gas pipeline services, telecommunications and live radio or television programming. Some of these special souring rules may have their own sub rules, which should also be applied.

Second, if the special sourcing rules do not apply, taxpayers are instructed to use the guidelines provided in the RAB. Only after a taxpayer has attempted to apply the RAB guidelines (which, again, do not constitute promulgated rules or regulations), can a taxpayer resort to the default provision.

[30] See, MCL 206.621.
[31] RAB 2015-20, p 6.
[32] Guideline 2, RAB 2015-20, p 3. [emphasis added].
[33] RAB 2015-20, p 3.

Third, a taxpayer is to use the default provision, which is the customer's billing address.[34]

RAB 2015-20 states that the default provision cannot be used unless a taxpayer first makes ''a reasonable and demonstrable effort, based on its books and records, to determine the location where the recipient of the service received the benefit of the service.''[35] No guidance is provided as to what would constitute a ''demonstrable effort.'' The RAB also provides that there is no exclusion from the apportionment factor if the location of the recipient's benefit cannot be determined. Only after this effort is made can a taxpayer proceed to use the default provision. The default would be the customer's billing address.[36]

Based upon these ordering guidelines, the department appears to give the RAB guidelines priority before the clear language of the statutory default provision. There is no statutory language for any of the guidelines or examples articulated in RAB 2015-20, and the department's attempt to place a ''demonstrable effort'' requirement prior to the usage of the default provision is not supported by the plain language of the statute. This appears to be an attempt to establish a burden of proof not contained within the statute. One wonders how Michigan's ''rule of law''[37] Supreme Court would define, and uphold, such a requirement, especially as tax statutes in Michigan are interpreted in favor of taxpayers.[38] Coupled with the guidance proffered by RAB 2015-20, taxpayers will likely find continued challenges in sourcing receipts from the performance of services to Michigan.

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[34] MCL 206.669, RAB 2015-20, p 7.
[35] RAB 2015-20, p 7.
[36] RAB 2015-20, p 7.

[37] The ''Rule of Law'' has its origins in the Magna Carta, and has been defined as ''The rule of law reaquires that all persona and authorities within the state . . . , should be bound by, and entitled to, the benefit of publicly made laws which are administered by public courts. *See* John Locke ''whenever law ends tyranny begins,'' J. Locke, 1690.

[38] Tax statutes are construed such that any ambiguities are resolved in favor of the taxpayer. *In re Dodge Bros*, 241 Mich at 669; *Int'l Business Machines Corp. v. Dep't of Treasury*, 220 Mich Ct. App. 83, 86; 558 N.W.2d 456 (1996).

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