STATE OF MICHIGAN
DEPARTMENT OF ENERGY, LABOR & ECONOMIC GROWTH
MICHIGAN TAX TRIBUNAL

Meristar Management Company, LLC,
Petitioner,

MTT Docket No. 320548

v

Michigan Department of Treasury,
Respondent.

Tribunal Judge Presiding
Rachel J. Asbury

FINAL OPINION AND JUDGMENT

INTRODUCTION

Petitioner is appealing Final Assessment L796338 issued by Respondent, Michigan Department of Treasury, for single business tax (SBT) liability. The assessment is the result of Respondent's reconsideration of its original acceptance of Petitioner's amended SBT returns utilizing a revised apportionment method. In the amended return, Petitioner claimed a refund for each of the years at issue. Respondent issued the refunds and subsequently determined the refunds were distributed in error and issued the assessments at issue to recoup the refunds paid. To resolve these issues, a hearing was held in the above-captioned case on October 30, 2008. Petitioner was represented by Mike Alvarez and Terry Conley, Grant Thornton LLP. Respondent was represented by Michael R. Bell, Assistant Attorney General. Post hearing briefs were filed by both parties on January 30, 2009 and post hearing reply briefs were filed by both parties on February 27, 2009.

The Tribunal, having considered the case file, filings, testimony, and evidence presented, determines that Petitioner has failed to meet its burden to prove that Respondent issued Final Assessment No. L796338 in error. Respondent's Assessment No. L796338 is affirmed.

BACKGROUND

Petitioner is a limited liability company that is predominantly owned by MeriStar Hotels and Resorts, Inc., formerly a public C-corporation. Petitioner, "which was the principle employer entity in the family would contract directly with owners to do management, provide management services, or would contract internally to the family depending on what the nature of the business transaction was."[1] The tax liability at issue originates from income earned from management contracts Petitioner entered with Michigan-based hotels. Specifically, Petitioner revised its 1998, 1999, 2000, and 2001 tax year SBT returns after it determined that the income earned pursuant to hotel management contracts in which Petitioner managed individual hotels within and outside Michigan was not attributable to Michigan because the business activity involved with the Michigan hotels was less than the total business activity not attributable to Michigan. For the tax years at issue, Petitioner filed amended returns after it recalculated its sales factor and excluded Michigan sales. Respondent contends that it erroneously issued the refunds, as reflected in Petitioner's amended returns, and issued Intent to Assess L796338, requiring Petitioner to repay the refunds. Petitioner requested an informal conference which was held on June 14, 2005. The Hearing Officer recommended that Assessment L796338 be assessed as originally determined. On October 24, 2005, Daniel Greenberg, Administrator of Respondent's Office of Hearings, issued a Decision and Order in which he adopted the Hearing Referee's

[1] Transcript, page 18, ll 6-12

recommendation and issued Final Assessment L796338, which specifies that Petitioner's Michigan SBT tax due is as follows:

Assessment	Tax Due	Interest*
L796338	$113,264.00	$40,039.76

*Interest accruing and to be computed in accordance with sections 23 and 24 of 1941 PA 122.

PETITIONER'S CONTENTIONS

Petitioner offered the following proposed exhibits:

P-1 Lease Agreement, 08/03/1998
P-2 First Amendment to Lease, 11/17/1997
P-3 Hotel Management Agreement, 11/17/1997
P-4 Assignment of Management Agreement
P-5 Master Fee Agreement
P-6 Amendment to Management Agreement, 01/01/2002
P-7 Amendment to Master Fee Agreement and Management Agreements, 07/01/2004
P-8 Amendment to Master Fee Agreement and Management Agreements, 08/01/2006

Petitioner's exhibits one through four were admitted without objection. Respondent initially objected to the admission of the remaining exhibits on the basis that "these proposed exhibits all were signed at least one year or more years after the audit period, [an] irrelevant time frame."[2] Respondent withdrew its objection at the close of Petitioner's case. As such, all of Petitioner's exhibits were admitted.

Petitioner offered the testimony of Stephen Lawrence, former Senior Vice-President of Tax of MeriStar Hotels and Resorts, Inc., Petitioner's Parent Corporation. Mr. Lawrence was a corporate officer, tax preparer, and tax manager for Petitioner during the tax years at issue.

[2] Transcript, page 32, ll 6-8

Mr. Lawrence testified that "MeriStar Hotels and Resorts, Inc., was a public C-corporation. . . . There was a substantially-wholly-owned partnership underneath that and that partnership owned, again, substantially all of the ownership interest of another limited liability company called MeriStar Management Company, LLC, which was the principle employer entity in the family."[3] Mr. Lawrence further testified that:

> MeriStar Management Company managed at that point in time probably 220 hotels throughout the country. Seven hotels were within the state of Michigan, three were single contracts, meaning I manage for individuals that may own a one-off hotel, the other four, two of which were owned by MeriStar Hospitality Corporation which was a public REIT. . . . Underneath it, it had a partnership and underneath that partnership there was a myriad of entities. One of which was CapStar Detroit, which is the owner of one of the properties that fit within the bucket of the four that were part of contracts that were aggregate in nature.[4]

Mr. Lawrence testified that the lease agreement between owner CapStar Detroit Airport Company, LLC and lessee dated 08/03/1998,[5] governs the types of services provided. Mr. Lawrence testified that the services provided under the agreement were ". . . services that would occur in the normal course of the operation of the hotel at the property itself, as well as accounting support and managerial support for both the vision and direction of the property."[6] The lease agreement involved approximately 110 hotels.[7] Mr. Lawrence testified that hotel number 22, Hilton Hotel – Grand Rapids and number 99, Detroit Metro Airport Hilton Suites, were two of the hotels located in Michigan and were covered under the lease agreement. Of the 110 hotels, only two were located in Michigan.

[3] Transcript, page 17-18, lines 24-25, 1-7
[4] Transcript, page 21, ll 9-22.
[5] Petitioner's exhibit 1
[6] Transcript, 26, ll 2-5.
[7] Petitioner's exhibit 1, exhibit A

Mr. Lawrence testified as to the amendment to the lease agreement between Winn Limited Partnership as lessor and CapStar Winston Company as lessee dated November 17, 1997,[8] the Hotel Management Agreement between CapStar Winston Company as lessee and CapStar Management Company, L.P. dated November 17, 1997,[9] and the Assignment of Management Agreement "among CapStar Management Company, L.P. . . . 'Assignor' . . . MeriStar Management Company LLC . . . 'Assignee' . . . and CapStar Winston Company, LLC 'Owner.'"[10] Mr. Lawrence testified that the Hotel Management Agreement[11] provides for "the provision of hotel management services . . . substantially similar to those services that are governed by the contract in P1 depending on the type of hotel, meaning a full service, limited service, et cetera."[12]

Mr. Lawrence testified that:

> Winston Hospitality was also a real estate investment trust, and as such, in order to maintain its status as a real estate investment trust, Winston Hospitality had to enter into a lease agreement. As was the practice at that time, there was a private lessee involved in the structure and a third party manager then managing for that private lessee. These documents were what was used to effect that by MeriStar Hotels and Resorts, Inc. with the acquisition of the lessee and the lease is in effect, and then the management of the hotels that Winston Hospitality at that point in time owned.[13]

Mr. Lawrence further testified that the Hotel Management Agreement between CapStar Winston Company and CapStar Management Company, L.P.[14] involves multiple hotels, also lists the two Michigan hotels, Courtyard by Marriott and Fairfield Inn, both of which are

[8] Petitioner's exhibit 2
[9] Petitioner's exhibit 3
[10] Petitioner's exhibit 4
[11] Petitioner's exhibit 3
[12] Transcript, page 36, ll 4-10
[13] Transcript, page 33, ll 12-23.
[14] Petitioner's exhibit 3

located in Ann Arbor, Michigan. Mr. Lawrence testified Petitioner and its subsidiaries had organized and structured business the way they had under the contract:

> [i]n order to be attractive to a broad base of hotel owners, specifically hospitality REITs, . . . which could not manage hotels for themselves unlike other real estate investment firms. So MeriStar Management Company [decided] they would accept the risk transfer associated with a lease agreement in conjunction with management to be an attractive manager to as broad a base of hotel owners as possible.

Mr. Lawrence testified that the contracts involved were negotiated as a whole in that all hotels included in the attachments were part of the negotiation even though a single lease agreement was drafted for each hotel. Mr. Lawrence further testified that "[i]f they had been negotiated singularly, the differences would be principally in terms of pricing and what the owners obtained."[15] Further, concessions were made to the Lessor because there were many hotels included within one transaction. Mr. Lawrence testified that the transaction was a single transaction and ". . . was reported in SCC (sic) filings as a segregated group because of the relationship."[16] Mr. Lawrence stated that:

> [i]n the case of the contracts with MeriStar Hospitality, in working with the executive group of MeriStar Hotels and Resorts, Inc., for MeriStar Management Company, there were concessions made to MeriStar Hospitality Corporation because it brought to the table 110 contracts in a transaction. . . . because, while there was large acceptance of risk through the lease transaction, that was necessitated in order to obtain 110 contracts.[17]

Mr. Lawrence testified that he had no knowledge of the provision of services being governed under a statement of work. Mr. Lawrence testified that ". . . the direction provided in the contract is, generally, fairly broad in terms of directed that the hotel be operated in a manner consistent with either a full service or limited service hotel. . . . that MeriStar, the operator or petitioner in

[15] Transcript, page 37, ll 15-17
[16] Transcript, page 40, ll 5-6
[17] Transcript page 37, l 18-page 38, l 3

this case, would have discretion, broad discretion, to do and run and manage the hotel."[18] There was "very little in terms of restriction on how we could operate the hotel as long as it was consistent with being a hotel."[19]

Mr. Lawrence testified that "[a]s a business activity, the overarching 110 hotels was a sale for us. . . . consummated as part of a transaction between two public companies. It was a single transaction."[20]

On cross examination, Respondent questioned Mr. Lawrence as to his knowledge of whether the First Amendment to Lease[21] was full and complete. Mr. Lawrence responded that it was. Respondent then pointed out that the exhibit references an Exhibit E and Exhibit F which were not attached. Respondent questioned Mr. Lawrence relative to the Hotel Management Agreement.[22] Respondent asked Mr. Lawrence specifically to explain how paying basic rent would have worked. Mr. Lawrence replied that:

> Each contract . . . because they are different hotels, would have a separate exhibit for determining base rent as well as participation rent that would be defined by tiers both for rooms and generally food and beverage. The aggregate that we looked for when we negotiated and when I executed was not more than two and a half percent net leakage for the portfolio for 110 hotels.[23]

Mr. Lawrence testified that the agreements were subject to "very vigorous negotiations"[24] in which he did not participate. He testified that he "was directed to execute [the agreements]

[18] Transcript, page 38, lines 14-23
[19] Transcript, page 39, ll 14-16
[20] Transcript, page 39, ll 20-23
[21] Petitioner's exhibit 2
[22] Petitioner's exhibit 3
[23] Transcript, page 47, ll 9-17
[24] Transcript, page 44, l 19

consistent with those negotiations."[25]Mr. Lawrence further testified that the lease agreements involving multiple hotels are considered ". . . portfolio transactions because they are a number of assets that are part of effectively a single transaction. They are done on the same day. They are part of an overarching negotiation that we enter into."[26]

RESPONDENT'S CONTENTIONS

Respondent offered the following proposed exhibits:

R-1 Single Business Tax Audit
R-2 Single Business Tax Returns 1999-2000 years
R-3 Final Assessment L796338
R-4 Internal Policy Directive 2006-2008

All of Respondent's exhibits were admitted without objection. Respondent asserts that ". . . the Department stands behind its audit and it was not incorrectly done with regard to how these particular hotels were treated, and we're asking that this Tribunal ultimately affirm the final assessment that was issued."[27]

At the close of Petitioner's case in chief, the parties agreed to the facts in this matter as reflected in the transcript. That being the situation, the parties asked to file post-hearing briefs in lieu of continuing with the hearing. Respondent's representative stated at the hearing:

> [the parties] see that we could file post trial briefs, the transcript of the testimony this morning and the exhibits that were entered, and we now just had a discussion of the law as it applies to the contracts and the testimony that was given this morning, because essentially the department today at this hearing was going to present its interpretation of the law and how it applied to these agreements and the testimony.

Respondent decided not to offer the testimony of any witnesses.

[25] Transcript, page 44, ll 24-25
[26] Transcript, page 62, ll 18-22.
[27] Transcript, page 7-8, lines 25, 1-4.

PETITIONER'S POST HEARING BRIEFS

In its post-hearing brief, Petitioner contends that where sales are considered to have been performed for purposes of the sales factor portion of the apportionment factor[28] for a taxpayer with business activity both within Michigan and outside this state, is determined in section 53 of the single business tax act, repealed, as:

> Sales, other than sales of tangible personal property, are in this state if:
> (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.

Petitioner asserts that Respondent has, by issuance of Internal Policy Directive 2006-8, determined that cost of performance, as used in section 53(b), "means *direct costs* that are determined in a manner consistent with the taxpayer's method of accounting for federal income tax purposes."[29] (Emphasis in original) Petitioner contends that, "because Petitioner's business activity is the provision of hotel management services, the Department would view Petitioner's direct costs as the wages it pays to those providing services, whether . . . direct employees or third-party contractors."[30] Further, "because the majority of the direct costs for Petitioner's services under the two transactions occurred outside of Michigan, gross receipts attributable to these two sales will not be includable in the sales factor numerator for Michigan,"[31] which leads to a zero sales factor numerator for each transaction. Petitioner states "[m]oreover, because the overwhelming majority of costs were for the provision of services outside of Michigan, such sales will not be considered Michigan sales."[32]

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[28] Section 45 of the single business tax act, repealed
[29] Petitioner's post hearing brief, page 8
[30] Petitioner's post hearing brief, page 8
[31] Petitioner's post hearing brief, page 9
[32] Petitioner's post hearing brief, page 9

Petitioner asserts that it ". . . entered into [a] single transaction in which it negotiated the services provided to all 110 hotels.[33] As such, this transaction constituted a single 'sale' of management services for single business tax purposes."[34] Petitioner further asserts that it disagrees with how the Department of Treasury defines "Cost of Performance" in its Internal Policy Directive 2006-8.

RESPONDENT'S POST HEARING BRIEFS

In its post hearing brief, Respondent asserts that the Department takes an approach to the question of whether the receipts in this matter are Michigan sales. The Department first reviews:

> each contract . . . for whether it is a individual integrated transaction or whether based on the contractual language there are several discrete transactions occurring. Second, if the contract is exclusively for business activity occurring in Michigan then section 53(a) applies rather than 53(b). Third, if the contract is for business activity that occurs within and without Michigan then the cost of performance analysis is applied. MCL 208.53(b). Fourth, the cost of performance analysis requires looking at the cost of performing that business activity by the taxpayer which gave rise to the revenue constituting consideration from sales.[35]

Based on this analysis, the Department determined that Petitioner entered into individual contracts for individual hotels and that business activity occurred exclusively in Michigan and was therefore a Michigan sale. "[T]he greater of the costs of performing that service at those Michigan hotels occurred within Michigan."[36] Respondent asserts that the fact that "there were individual contracts for every hotel"[37] is supported by the testimony of Mr. Lawrence and the actual lease.

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[33] Petitioner's exhibit 1
[34] Petitioner's post-hearing brief, page 6.
[35] Respondent's post hearing brief, page 2
[36] Respondent's post hearing brief, page 3
[37] Respondent's post hearing brief, page 7

Respondent contends that its ". . . internal guidance intended for its personnel concludes that '[s]ales are attributed to this state if, *with respect to a particular sale*, the greater proportion of the business activity is performed in this State than is performed outside this state based on costs of performance."[38] (emphasis in original). Respondent contends that the cost of performance analysis is applied to each individual sale. Further, a single contract may not necessarily constitute a single sale; therefore, Respondent ". . . looks behind the contract to identify the sale or sales for apportionment purposes."[39] Respondent states that it utilizes a facts and circumstances test to determine where the sales should be sourced. As such, Respondent contends that Petitioner's three contracts involving only Michigan hotels are:

> discrete sales transactions from which it received consideration from each hotel based on the revenues it generates by operating each hotel located in Michigan, therefore, those 'sales' for that business activity being performed in this state must be included in both the numerator and denominator of the sales factor under MCL 208.51 and 208.53(a).[40]

Respondent contends that the other four hotels located in Michigan and operated by Meristar are also Michigan sales. Respondent argues that ". . . each hotel had its own account into and from which each hotel's revenues were either deposited or withdrawn for that specific hotel's needs, whether it was for renovations, employee wages, base rent, or for MeriStar's management fee."[41] Respondent argues that "[i]n this context each hotel stood alone as to operations, revenues, and costs of operations. Clearly, MeriStar's hotel management services to each of those 4 hotels and the costs associated with operating each hotel are discrete as to each."[42] Respondent concludes

[38] Respondent's post-hearing brief, page 15 (citing Internal Policy Directive (IPD) 2006-8).
[39] Respondent's post-hearing brief, page 15.
[40] Respondent's post-hearing brief, page 17.
[41] Respondent's post-hearing brief, page 18.
[42] *Id.*

that "[u]nder §53(b), the greater the cost of performance to operate each hotel occurred in Michigan and are therefore Michigan sales includable in the numerator of the sales factor."[43]

FINDINGS OF FACT

Petitioner is a wholly owned subsidiary of MeriStar Hotels and Resorts, Inc. that manages various hotels and resorts throughout the United States, Canada, and the Caribbean. Petitioner provides hotel management services to MeriStar Hotels and Resorts, Inc. for hotels within and outside the state of Michigan. For the single business tax period of July 1, 1998 through December 31, 2000, Petitioner filed tax returns that included income attributable to Michigan that was earned from the management contracts in the course of its business.

Petitioner subsequently filed amended tax returns to change its previously applied apportionment method. Specifically, Petitioner excluded the receipts from the management contracts based on its determination that there was a greater proportion of business activity that was not attributable to Michigan as opposed to business activity that occurred in Michigan.

At the conclusion of the informal conference, Respondent's referee concluded that the assessment was proper. The Referee stated that the record lacked information pertaining to the terms of the contract and that ". . . if MeriStar's agreement with the hotels in Ann Arbor, Detroit and Grand Rapids is treated as an individual contract rather than part of a master contract

[43] *Id.*

governing hotels inside and outside of Michigan, it would appear that MeriStar's business activity related to those hotels should be considered to be 'performed in this state.'"[44]

In regard to the contracts at issue, Petitioner provided services to 110 hotels owned by MeriStar Hospitality Corporation, two of which were located in Michigan.[45] Petitioner also managed thirty-two hotels owned by CapStar Winston Company, LLC, two of which were located in Michigan.[46]

Only the apportionment of income earned from the hotels located in Ann Arbor, Detroit, and Grand Rapids are the subject of the contracts offered as Petitioner's Exhibits 1 and 3 are at issue in this appeal. Mr. Lawrence testified, and the Tribunal does not disagree, that the large transactions involved in the contracts at issue were beneficial to Petitioner ". . . in terms of pricing, in terms of the waiver of an accounting fee, [and] there were concessions made in order to be attractive because, while there was a large acceptance of risk through the lease transaction, that was necessitated in order to obtain 110 contracts, which was very attractive."[47] Further, it is undisputed that there would be identical, individual contracts for every hotel listed under the exhibit attached to the contract.[48]

Petitioner hired the employees for the hotels and paid the employees' wages. Petitioner was reimbursed by the owner or the lessee of the individual hotel for those payments. Petitioner, as

[44] Informal Conference Recommendation, issued by Department of Treasury.
[45] Petitioner's Exhibit P1, Exhibit A.
[46] Petitioner's Exhibit P3, Exhibit A.
[47] Transcript, page 37-28, lines 24-25, 1-4.
[48] Transcript, page 41.

the operator, would have an account for which it was an authorized agent on behalf of each owner or lessee and the owner or lessee would deposit monies into that account to be used to pay for daily operations.[49] In addition, Petitioner was paid a management fee that would be part of a separate management agreement and was typically a flat percentage of gross revenues from the hotel's operations.[50]

Respondent issued Internal Policy Directive 2006-8 for purposes of providing direction to departmental personnel related to the cost of performance analysis for apportionment purposes. The Directive is not authoritative or binding on taxpayers or the Tribunal. Further, the Directive was issued five years after the last tax year at issue in this matter.

CONCLUSIONS OF LAW

Petitioner enters into contracts with various hotels to provide its management services both within and outside of Michigan. As a multi-state entity, Petitioner is required to apportion its tax base pursuant to section 45 or 45a. Only the determination of Petitioner's sales factor is at issue in this matter. Sales, for purposes of determining the sales factor are defined in section 53 of the single business tax, repealed.[51] Section 53(b) provides:

> Sales, other than sales of tangible personal property, are in this state if:
>
> * * *
>
> (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.

[49] Transcript, page 46.
[50] Transcript, page 48.
[51] See page 6

The sourcing of the sale of services and the application of the cost of performance test to the sales of management services under Section 53(b) is the issue in this matter.

In *ANR Pipeline Co v Dep't of Treasury,* 226 Mich App 190, 198-200; 699 NW2d 707 (2005), the Michigan Court of Appeals held that "[t]he SBTA employs a value-added measure of business activity, but its intended effect is to impose a tax on the privilege of conducting business activity within Michigan and is not to impose a tax upon income." (citing *Trinova Corp v Department of Treasury,* 433 Mich 141, 149; citing former section 31(4), which was later amended and compiled as 31(3)). Thus, the initial inquiry is whether Petitioner's services constitute business activities within Michigan and are therefore subject to tax.

Section 7(1)(a) of the single business tax act, repealed, defines sale, in pertinent part, as follows:

> (a) "Sale" or "sales" means the amounts received by the taxpayer as consideration from the following:
> . . .
> (ii) The performance of services, which constitute business activities other than those included in subparagraph (i), or from any combination of business activities described in this subparagraph and subparagraph (i).[52]

Section 3(2) of the single business tax act, repealed, defines business activity, in pertinent part, as:

> A transfer of legal or equitable title to or rental of property, whether real, personal, or mixed, tangible or intangible, or the performance of services, or a combination thereof, made or engaged in, or caused to be made or engaged in, within this state, whether in intrastate, or foreign commerce, with the object of gain, benefit, or advantage, whether direct or indirect, to the taxpayer or to others
> . . . .

[52] For tax years that began before January 1, 2001, section 7(1)(b) provided, " Sale" or "sales" means gross receipts arising from a transaction or transaction in which gross receipts constitute consideration : . . . (b) for the performance of services, which constitute business activities other than those included in (a), or from any combination of (a) or (b)."

The service and business activity that Petitioner offers its lessees is the management of their hotels. Based on the above definitions, the performance of these services are considered business activity and thus sales for purposes of the single business tax act. After establishing that the activity involved is sales, the Tribunal must decide how to determine costs of performance under section 53(b).

The single business tax act does not provide a definition of "costs of performance" as used in section 53(b) and there is no formal interpretation by Respondent in rule or Revenue Administrative Bulletin defining the term for the tax years at issue. While it is true that in 2006, Respondent issued Internal Policy Directive 2006-8, that document was issued subsequent to the tax years here at issue and, as an Internal Policy Directive, is not a "binding interpretation of a statute."[53] Although Respondent asserts that this document "happens to embody a correct interpretation of the statute," and Petitioner agrees with that interpretation of direct costs, Petitioner and Respondent must support their positions independently of that document.

Petitioner contends that its direct costs are the wages it pays to those providing the services. Petitioner then argues that after applying a "costs of performance" analysis the next step is to look at the proportion of the performance of the business activity. Specifically, Petitioner asserts that when more than 50% of the costs of performance, as Petitioner determined those costs to be, are incurred within Michigan, all receipts should be sourced to Michigan. Alternatively, when 50% or less of the costs of performance are incurred outside Michigan, no receipts should be sourced to Michigan.

[53] Respondent's brief, page 2.

The Court of Appeals recently addressed a similar issue in *Honigman Miller Schwartz and Cohn LLP v Department of Treasury*, unpublished opinion per curiam of the Court of Appeals issued July 31, 2009 (Docket No. 282768). In that case, the taxpayer was a law firm that provided services to clients in Michigan and in other states. The taxpayer's offices were all located within Michigan. The taxpayer's attorneys kept detailed reports on where the services were performed and amounts billed ("sales") related to those services. For single business tax purposes, the taxpayer included sales arising from services performed by an attorney while physically located outside Michigan in the sales factor denominator only. The taxpayer included sales arising from services performed within Michigan in the sales factor numerator and denominator. The court refers to time "billed in Michigan" and time "billed outside Michigan" and states that Petitioner allocated personal services that were performed outside Michigan to the state that the service was performed in. Petitioner in *Honigman* calculated that 3.5% to 3.99% of its sales occurred outside Michigan.

The court further held that each service, i.e. individual billing, must be considered separately for apportionment purposes. Each service billed by the lawyer was a "business activity" within the meaning of MCL 208.53 and the location of that activity, either in Michigan, or outside Michigan, determined whether the business activity was performed in this state, or performed both within and outside this state. Because the individual "sale" at issue in that case arose from a service that the taxpayer performed completely outside this state, the business activity was not performed "both in this state and outside this state" and the "cost of performance" rule under MCL 208.53(b) did not apply. It was irrelevant that the law firm was located in Michigan and

conducted "business activity" in Michigan for the same client. The "business activity" as that term is used in MCL 208.53 applies to a specific service for which a fee is charged, rather than the overall business activity of the taxpayer or the totality of services performed for a client. The court in *Honigman* rejected the view that calls for an analysis of the overall business activity of a multistate taxpayer, or an analysis of the totality of services performed for a particular client under an ongoing attorney-client relationship.

In the instant case, Petitioner entered into formal contracts to provide management services for various entities. Petitioner asserts that it was the master contract that the sale was made, and not when the individual contracts were entered into. However, the facts and testimony support the finding that Petitioner earned compensation for performance of the individual contracts. That compensation was based on the individual hotel's profits and was a percentage of gross receipts independently determined and specified in each of the separate contracts. Although Petitioner negotiated the contracts in one large master transaction, the agreements between Petitioner and the Lessees was memorialized in individual contracts.

The Tribunal agrees with Respondent that Petitioner's hotel management services to each of the hotels at issue and the costs associated with operating each hotel are discrete as to each other. Thus the greater of the cost of performance to operate each hotel occurred in Michigan.[54]

Further, there was no single stream of income. The separate contracts set up distinct spending accounts and outlined distinct compensation and rents. Petitioner's witness testified that although

[54] Respondent's post hearing reply brief, page 6

the calculation or formula to determine reimbursement was a function not necessarily different for every hotel, the percentage of gross revenues on which Petitioner's compensation was based was dependent on each individual hotel and its earnings for the relevant period. This distinction supports the conclusion that each individual management agreement was separate, distinct, and should be independently examined to determine the location of the business activity for purposes of the cost of performance analysis of the management services. *Honigman* further supports the conclusion that it is necessary to examine each individual management agreement and examine each individual agreement's fee structure as consideration for each of the separate and distinct business activities.

Based on the analysis under section 53, the inquiry must next focus on whether the taxpayer's business activity was "in this state" or "both in and outside this state." The Tribunal concludes that the "sale" at issue here, i.e., the management service, was, based on the reasoning in *Honigman*, consideration for Petitioner's services performed in this state within the meaning of MCL 208.53(a). Petitioner's "business activity" is viewed as the totality of services performed under each contract. The hotels at issue were all located within Michigan, in Ann Arbor, Grand Rapids, and Detroit, and Petitioner performed its management services at the location of the Michigan hotels. As such, Petitioner's "business activity" was performed "in this state" under MCL 208.53(a). This conclusion, that Petitioner's business activity took place in Michigan, requires that the income from the services provided is attributable to Michigan and must be included in both the numerator and denominator of Petitioner's sales factor for the tax years at issue.

JUDGMENT

IT IS ORDERED that Assessment No. L796338 is AFFIRMED.

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

MICHIGAN TAX TRIBUNAL

Entered: August 31, 2010 By: Rachel Asbury