STATE OF MICHIGAN
DEPARTMENT OF LICENSING & REGULATORY AFFAIRS
MICHIGAN ADMINISTRATIVE HEARING SYSTEM
MICHIGAN TAX TRIBUNAL

Peaker Services, Inc.,
Petitioner,

MTT Docket No. 431800

v

Michigan Department of Treasury,
Respondent.

Tribunal Judge Presiding
Kimbal R. Smith III

FINAL OPINION AND JUDGMENT

A Proposed Opinion and Judgment ("POJ") was issued on October 4, 2012. The POJ provided, in pertinent part, "[t]he parties shall have 20 days from the date of entry of this Proposed Opinion and Judgment to file exceptions and written arguments with the Tribunal consistent with Section 81 of the Administrative Procedures Act (MCL 24.281)," and "exceptions and written arguments shall be limited to the matters addressed in the motions." In addition, "[t]his Proposed Opinion and Judgment, together with any exceptions and written arguments, shall be considered by the Tribunal in arriving at a final decision in this matter pursuant to Section 26 of the Michigan Tax Tribunal Act (MCL 205.726)."

Petitioner filed exceptions to the POJ on October 29, 2012. Respondent has not filed exceptions or a response to Petitioner's exceptions.

PETITIONER'S EXCEPTIONS

Petitioner states that the original POJ was issued on October 4, 2012, missing page 5. The POJ was subsequently reissued including this page on October 9, 2012, and as such, the exceptions are timely. Further, Petitioner

contends that the Findings of Fact should be modified because "[d]uring the audit period . . . Petitioner was not involved in the complete remanufacturing of locomotive engines." Petitioner also states that the Findings of Fact should be modified with regard to Mark Chapman's testimony. Specifically, Petitioner contends that the Tribunal misunderstood the testimony and that Mr. Chapman was not saying that the life of the engine could be extended by 20 to 40 years. Rather that, "a locomotive engine has a useful life of 20 to 40 years; good service, maintenance and replacing parts can extend the life of the locomotive engine **from 20 years, the minimum, to 30 years and even 40 years.**" (Emphasis added.)

In addition, Petitioner contends that the facts in the above-captioned case are distinguishable from the facts in *Midwest Bus Corp v Dep't of Treasury,* 288 Mich App 334; 793 NW2d 246 (2010), and that *PFG Enterprises, Inc v Dep't of Treasury,* Court of Claims, Docket No. 09-02-MT, July 14, 2011, indicates that the "*Catalina* 'incidental to service' test" should apply instead. Petitioner further contends that the parties agree that the factors set forth in *Catalina Marketing Services, Inc v Dep't of Treasury,* 470 Mich 13; 678 NW2d 619 (2004), apply to the facts at hand and that the proper analysis of the factors indicates that the assessment should be canceled because the "'essence of the transaction' [at] issue in this case is the sale of tangible personal property." Petitioner further enumerates its position regarding each factor of the incidental to service test.

CONCLUSION

The Tribunal has reviewed the exceptions and the case file and finds that the Proposed Opinion and Judgment was originally issued on October 4, 2012, and was reissued on October 9, 2012. The POJ provided that exceptions were to be

filed within 20 days (i.e. by October 29, 2012). As such, Petitioner's exceptions were timely filed.

Petitioner contends that the Proposed Opinion and Judgment contains errors in the findings of fact which are material to the final determination. Specifically, Petitioner contends that the Tribunal erred in finding that Petitioner "expanded into remanufacturing locomotive engines." Proposed Opinion and Judgment, p. 3. The testimony on record, however, supports this finding. Petitioner appears to contend that the Administrative Law Judge erred because he did not also state that Mr. Chapman further testified that Petitioner no longer "completely remanufacture[s] . . . the whole locomotive." Tr. p. 13. The Tribunal finds that Mr. Chapman specifically testified that the company was first started in 1971 and then in the '80s began remanufacturing locomotives. Thus, the Administrative Law Judge's finding that Petitioner expanded is proper and supported by testimony. Petitioner also contends that the Administrative Law Judge erred in finding that Mr. Chapman testified that the work performed by Petitioner extends the life of existing engines for 20 to 40 years and that Mr. Chapman truly meant that the engine life was extended from 20 years to 30 or 40 years. The Tribunal finds, again, that the Administrative Law Judge's finding is supported by the testimony on record. Here, Mr. Chapman very specifically testified that "you can extend the life for 20, 30, 40 years, depending on the kind of service it gets." Tr. p. 20. As such, the Tribunal finds that the findings of fact were not made in error and are supported by the testimony on record.

Petitioner's primary contention is that the Administrative Law Judge's findings of fact led to the incorrect conclusion that Petitioner's contracts are legally indistinguishable from the transactions at issue in *Midwest Bus*. With regard to the contracts at issue, the Proposed Opinion and Judgment indicated that Mr. Chapman

testified that when customers purchased parts with installation the engine was sent to Petitioner

> and Petitioner then disassembled the engine, cleaned it, and installed the new parts. Petitioner then tested the reassembled engine and shipped it back to the customer. Tr. pp. 16 – 19. Petitioner bore the risk of loss. The customer had the right to reject the engine. TR p 67. Mr. Chapman indicated that Petitioner did not deliver a new engine; the work extended the life of the existing engine for 20 to 40 years. Tr. pp. 19 – 20.

The Proposed Opinion and Judgment also describes the contracts in *Midwest Bus,* indicating that

> the contracts at issue in *Midwest Bus* stated that the object of the transaction was the "rehabilitation" of buses, including 1) reconditioning the buses and parts to the original manufacturer's specifications, 2) disassembly of an assembly into its component parts, 3) cleaning, inspection, and qualification for repair or replacement of the component parts, and 4) the reassembly of the component parts into complete assemblies. The court concluded that "the sale of the bus parts was incidental to the service of actually performing the rehabilitation of the buses." *Midwest Bus* at 346. Therefore, it was held that the transactions were essentially services that were to be apportioned based on the location of the majority of the cost of performance.

Thus, in comparison, Petitioner's work extends the life of the engine for at least 20 years. This fact is very similar to the "reconditioning . . . to the original manufacturer's specifications" in *Midwest Bus.* Even if Petitioner's exception regarding Mr. Chapman's testimony is correct and the life of the engine is only extended by 20 years (i.e., from 20 to 40) rather than extended by "20, 30, 40 years" as Mr. Chapman actually testified, then, at minimum, the work performed by Petitioner *doubles* the life of the engine so that it has at least an additional 20 years. Extending the life of the engine by 20 years when the original life is only 20

years is making the engine almost like new. The testimony also indicates that the engines were disassembled, cleaned, tested, and reassembled with new parts. This is the same as in *Midwest Bus*, where the bus was disassembled, cleaned, inspected, replacement parts were installed, and the bus was reassembled. Therefore, the Administrative Law Judge did not err in finding that "the remanufacturing contracts are legally indistinguishable from the transactions at issue in *Midwest Bus*." POJ, p. 9. Petitioner relies only on the testimony that the company no longer "completely remanufacture[s] . . . the whole locomotive." Tr. p. 13. This testimony, however, cannot not distinguish the work actually performed by Petitioner, which Mr. Chapman testified to, from the work described in *Midwest Bus*.

Petitioner further contends that the parties agree that the factors from *Catalina* apply and that the Tribunal should examine the six factors and how they apply to this case. The Administrative Law Judge did not specifically enumerate this discussion and found that "[t]here is no reason to force the type of transaction at issue in our present case into the *Catalina* test." The Proposed Opinion and Judgment, however, by analogy to *Midwest Bus*, found that the factors from *Catalina* indicate that the contracts are for services and not the sale of parts, and therefore, are subject to taxation in Michigan. More specifically, the contracts at issue in this case were properly found to be factually indistinguishable from those in *Midwest Bus*. The Court of Appeals in *Midwest Bus* performed the analysis as required under *Catalina* and found that "the contract[s] at issue . . . are predominately for the provision of a service and are allocated to Michigan, where the service was performed, under MCL 208.53." *Midwest Bus* at 348-349. The Tribunal finds that the Administrative Law Judge's finding that a specific *Catalina* analysis was not necessary is not in error. The Tribunal will, nevertheless, provide

specific analysis of the six-factor test due to the parties' agreement that the test should apply.

In *Catalina*, the Michigan Supreme Court indicated a six-part test should be applied in "categorizing a business relationship that involves both the provision of services and the transfer of tangible personal property." The factors to be considered are: 1) what the buyer sought as the object of the transaction, 2) what the seller or service provider is in the business of doing, 3) whether the goods were provided as a retail enterprise with a profit-making motive, 4) whether the tangible goods were available for sale without the service, 5) the extent to which intangible services have contributed to the value of the physical item that is transferred, and 6) any other factors relevant to the particular transaction.

Both Petitioner and Respondent have applied these factors to reach alternate conclusions. Petitioner contends that the percentage of the contracts relating to parts is vastly greater than the service, and thus, the buyer was truly purchasing parts. The Tribunal disagrees. In *Midwest Bus*, the Court of Appeals held that the "rehabilitation" of the bus is what the purchaser sought. Similarly here, the purchaser likely sought to extend the life of the engine, and therefore, sought the service of rehabilitating the engines. With regard to the second factor, it is clear that Petitioner is both in the business of selling parts and rehabilitating engines. Like the facts in *Midwest Bus*, the contracts at issue indicate that Petitioner was not acting as a retailer but rather as the servicer. For example, the Amtrak contract was found to involve "substantial services, including disassembling the engine, diagnosing problems, cleaning, reconditioning, repairing damaged tapped holes, welding, re-assembly, and painting." POJ, p. 6. Although the parts were approximately 69% of the total cost, the Tribunal finds that Amtrak was truly seeking the rehabilitated engine and not merely parts. Similarly, the Amtrak

contract illustrates that, in considering the third factor, the purchase of parts was "merely a means to accomplish the contractual objective," which was rehabilitating the engines. *Midwest Bus* at 348. Further, the Court of Appeals specifically held in *Midwest Bus* that "Plaintiff is in the business of selling bus parts, but it also sells rehabilitation services that require the installation of bus parts as well as the provision of other services to meet its contractual obligations." *Id*. The same is true for Petitioner in the above-captioned appeal. Finally, the fifth factor is whether the services have contributed to the value. In our case, the service of rehabilitation adds, at minimum, 20 years to the life of the engine. It is clear that doubling the life of the engine adds substantial value. While it is clear that a large percentage of each transaction was for parts, as properly determined by the Administrative Law Judge, it is clear that the contracts under *Catalina* can also be found as primarily for the service of rehabilitation. Therefore, as the contracts are factually indistinguishable from those in *Midwest Bus,* it is appropriate to analogize to the facts in *Midwest Bus* where it was found that the contracts for rehabilitation and installation are primarily for the service and should be allocated to Michigan.

The Administrative Law Judge also properly held that the SBTA also authorizes the department to permit or require an alternative apportionment method if the standard formula does not "fairly represent the extent of the taxpayer's business activity in this state." MCL 208.69(1). The department has broad discretion to diverge from the standard formula and permit or require apportionment by "any other method to effectuate an equitable allocation and apportionment of the taxpayer's tax base." MCL 208.69(1)(d). POJ, p. 13-14. As such, the Proposed Opinion and Judgment properly affirmed the assessment at issue.

Given the above, the Tribunal adopts the October 4, 2012, Proposed Opinion and Judgment as the Tribunal's Final Opinion and Judgment in this case, pursuant to MCL 205.726. The Tribunal also incorporates by reference the Findings of Fact, and Conclusions of Law in the Proposed Order in this Final Opinion and Judgment.

IT IS ORDERED that the Administrative Law Judge's Proposed Opinion and Judgment is AFFIRMED and adopted by the Tribunal as the Final Opinion and Judgment.

IT IS FURTHER ORDERED that Assessment Nos. R996212 is AFFIRMED.

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

MICHIGAN TAX TRIBUNAL

By: Kimbal R. Smith III

Entered: December 05, 2012