STATE OF MICHIGAN
DEPARTMENT OF LABOR & ECONOMIC GROWTH
MICHIGAN TAX TRIBUNAL
SMALL CLAIMS DIVISION

McCartney Enterprises, Inc.,
Petitioner,

v

MTT Docket No. 321164

Michigan Department of Treasury,
Respondent.

Tribunal Judge Presiding
Jack Van Coevering

ORDER DESIGNATING DECISION AS PRECEDENT

Pursuant to MCL 205.765, the Michigan Tax Tribunal declares the July 20, 2006 decision rendered in this case precedential for defining whether certain compensation to a leased employee should be included in calculating the single business tax base of the lessee entity, pursuant to MCL 208.9.

MICHIGAN TAX TRIBUNAL

Entered: November 3, 2006

By: Jack Van Coevering
Patricia L. Halm
Judith R. Trepeck
Rachel J. Asbury

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FINAL OPINION AND JUDGMENT

A hearing was held in the above-captioned case on June 29, 2006, in Lansing, Michigan. Petitioner was represented by Richard Miller. Respondent was represented by Lance Wilkenson (Bureau of Tax Policy).

SUMMARY OF JUDGMENT

The Tribunal, having considered the evidence properly submitted and the file in the above-captioned case, finds that the tax and interest are assessed in Final Assessment N638277 with interest accrued pursuant to the statute. As of February 20, 2006 the total of tax and interest was $279.30.

BACKGROUND

Petitioner is a corporation located in East China, Michigan. In 2001 Petitioner signed a contract with Orbis Management Group, L.L.C., an unrelated employee leasing company. The contract stated that Orbis was to provide employee management services for Petitioner, which included maintaining and providing for payroll and payroll deductions, employee information and benefits, and workers' compensation insurance. Orbis also took control of personnel decisions including hiring, supervising, disciplining and firing employees.

Mr. Michael McCartney is the sole shareholder and only member of the Board of Directors of McCartney Enterprises, Inc. He also manages the business full time. When Mr. McCartney signed the contract with Orbis Mr. McCartney became an employee of Orbis who was leased back to Petitioner and received wages and a W-2 from Orbis as would any other employee.

In 2004, Petitioner filed an amended single business tax return relating to tax year 2002 in response to the Court of Appeals holding in *Herald Wholesale* v *Dep't of Treasury,* 262 Mich

App 688; 687 NW2d 172 (2004). Petitioner sought to reduce its SBT tax liability stating that Mr. McCartney's wages paid by Orbis were not includable for SBT calculations.

A. *Petitioner's Statement of Facts*

Petitioner contends that:

- Mr. McCartney is an employee of Orbis Management Group, L.L.C.
- Because Mr. McCartney is an employee of Orbis and because his duties as the sole Officer and Director of McCartney Enterprises, Inc. are minimal his compensation should not have to be included as part of Petitioner's SBT calculations.

Petitioner presented the following documentary evidence:

- Final Notice of Assessment – Single Business Tax 2004
- Single Business Tax Annual Return Notice of Adjustment – 2004
- Copy of Form C-8000 as filed – 2004
- Single Business Tax Notification (Denial of amended return) – 2002
- Correspondence stating Petitioner's position in response to notice
- Single Business Tax Annual Return Notice of Adjustment – 2002
- Copy of Single Business Tax Amended Return as filed – 2002
- Copy of Single Business Tax Amended Return as filed – 2003
- Power of Attorney Forms

At the June 29, 2006 hearing Petitioner offered the following testimony:

- The 2002 tax year was the first year Petitioner sought to amend based on *Herald Wholesale, supra.*
- Petitioner contracted with Orbis because the "economic reality" is that Mr. McCartney "doesn't want to manage the workforce, payroll taxes, benefits administration."
- Petitioner spends most of his time directly involved in landscaping jobs.
- Petitioner's salary is not dependent on Orbis but on his own company of which he is the owner and president.
- *Herald Wholesale, supra,* involved a captive employee leasing company – both entities were under common control. Here, Orbis is owned and controlled by an unrelated 3rd party. According to Petitioner, Orbis is a large company with numerous employees and contracts with many other companies.
- Petitioner, as owner of his company, negotiated the lease agreement with Orbis and is the only signatory of his company to the lease agreement.

B. *Respondent's Statement of Facts*

Respondent contends that:

- The Department's position is that the holding of *Herald Wholesale. supra,* is fact specific and the Department will apply *Herald Wholesale, supra,* to other taxpayers only where the facts are substantially identical to those in *Herald Wholesale, supra*.

Respondent presented no documentary evidence.

Respondent offered the following testimony:

- *Herald Wholesale* should be limited to the facts where there exists exclusive control of employees and officers not compensated for their roles as officers. The case does not alter existing precedent that applied before the statutory change in the definition of compensation.
- The agreement between the two entities in this case lacks substance as any action taken against Mr. McCartney would "require consultation" with Mr. McCartney, who not only signed the lease agreement but has, entirely within his control, the ability to break the agreement at any time. Further, Mr. McCartney sets his own salary and, practically speaking, all conditions of his own employment and his business.
- The contract is illusory because Mr. McCartney is the only officer and director of Petitioner.

FINDINGS OF FACT

The Tribunal's factual findings must be supported by competent, material and substantial evidence. *Antisdale* v *Galesburg*, 420 Mich 265; 362 NW2d 632 (1984). In that regard, the Tribunal finds:

Mr. McCartney is the sole shareholder and director of McCartney Enterprises, Inc., Petitioner. Mr. McCartney no longer desired to perform the administrative duties of an employer and contracted with Orbis Management Group, L.L.C., a third party employee leasing company, to provide employment services. Mr. McCartney became an employee of Orbis and was leased back to Petitioner. Although Mr. McCartney was an employee of Orbis, he controlled the relationship because he had the ability to terminate the contract with Orbis.

CONCLUSIONS OF LAW

Generally, assessments issued by the Department of Treasury are presumed to be accurate and valid. It is the taxpayer's burden to demonstrate that the Department of Treasury's assessment is incorrect or invalid. Petitioner has the burden of going forward to overcome the presumptions of accuracy and validity.

Calculation of the Single Business Tax Act begins with business income, subject to statutory adjustments enumerated in MCL 208.9. One of those adjustments is the addition of compensation to the tax base, MCL 208.9 (5). Compensation is defined in MCL 208.4(3), in part:

> Except as otherwise provided in subsection (4), 'compensation' means all wages, salaries, fees, bonuses, commissions, or other payments made in the taxable year on behalf of or for the benefit of employees, officers, or directors of the taxpayers. Compensation includes, but is not limited to, payments that are subject to or specifically

> exempt or excepted from withholding under sections 3401 to 3406 of the internal revenue code. …

In 2002, the Legislature amended the definition by adding subsection 4 to address "professional employer organizations." 2002 PA 603. Subsection 4 states:

> For tax years that begin after December 31, 2003, for purposes of determining compensation of a professional employer organization, compensation includes payments by the professional employer organization to the officers and employees of an entity whose employment operations are managed by the professional employer organization. Compensation of the entity whose employment operations are managed by a professional employer organization does not include compensation paid by the professional employer organization to the officers and employees of the entity whose employment operations are managed by the professional employer organization. As used in this subsection, "professional employer organization" means an organization that provides the management and administration of the human resources and employer risk of another entity by contractually assuming substantial employer rights, responsibilities, and risk through a professional employer agreement that establishes an employer relationship with the leased officers or employees assigned to the other entity by doing all of the following:
> (a) Maintaining the right of direction and control of employees' work, although this responsibility may be shared with the other entity.
> (b) Paying wages and employment taxes of the employees out of its own accounts.
> (c) Reporting, collecting, and depositing state and federal employment taxes for the employees.
> (d) Retaining the right to hire and fire employees.

The 2003 tax year at issue in this case falls outside of the 2002 amendment and subsection 4 does not apply.

Whether compensation to a leased employee should be included in calculating the SBT tax base of the lessee entity or should remain in the SBT tax base of the leasing entity has been the subject of interpretation, litigation and statutory amendment. See *Bandit Industries v Dep't of Treasury,* Dkt. No. 99-17260-CM, unpublished opinion of the Court of Claims (September 7, 2000)*; Herald Wholesale* v *Dep't of Treasury,* 262 Mich App 688; 687 NW2d 172 (2004), *BL Rentals, Inc v Dep't of Treasury,* Dkt. No. 257578, unpublished decision per curiam, (February 14, 2006); 2006 Mich. App. LEXIS 375*;* 2002 PA 603. Prior to the Legislature's amendment of the definition of compensation in 2002 (see above), SBT treatment of employee leasing companies was addressed by reference to the Internal Revenue Code, 26 USC § 3401 (c) and (d), as construed and applied by the Court of Appeals in *Mid-America Mgt Corp v Dep't of Treas,* 153 Mich App 446, 461; 395 NW2d 702 (1986). In applying a "common-law test, the *Mid-America* decision cited with approval the Department's reliance on 26 CFR 31.3401 (c)-1 and (d)-1 which provided:

> Generally the relationship of employer and employee exists when the person for whom services are performed has the right to control and direct the individual who performs

> the services, not only as to the result to be accomplished by the work but also as to the details and means by which that result is accomplished. That is, an employee is subject to the will and control of the employer not only as to what shall be done but how it shall be done. In this connection, it is not necessary that the employer actually direct or control the manner in which the services are performed; it is sufficient if he has the right to do so. The right to discharge is also an important factor indicating that the person possessing that right is an employer. Other factors characteristic of an employer, but not necessarily present in every case, are the furnishing of tools and the furnishing of a place to work to the individual who performs the services. In general, if an individual is subject to the control or direction of another merely as to the result to be accomplished by the work and not as to the means and methods for accomplishing the result, he is not an employee.

Mid America, supra, applied a very practical, fact-intensive test, which Petitioner has not met. In no practical way does Orbis direct any aspect of Mr. McCartney's actions as owner and president of his business. Mr. McCartney has complete control of the terms of his employment under the contract with Orbis. He can cancel the contract with Orbis. He sets his own hours. He sets his own pay. He decides what customers to work for and provides the tools to do the work. Petitioner went so far as to state that Mr. McCartney spent his time managing landscaping jobs. That is, he operates his business like any other owner. Orbis cannot discharge Mr. McCartney from his business. As applied to Mr. McCartney, no risks of any employment have been transferred to Orbis. Under *Mid America,* Mr. McCartney received compensation from himself.

Though facts for subsequent years—to which the amendment would apply—are not known, the result may be the same. Subsection 4 does not sanction form over substance. The statute could not be more specific in precluding the use of "professional employer organizations" under MCL 208.4 as a method of tax accounting:

> '[P]rofessional employer organization' means an organization that provides the management and administration of the human resources and employer risk of another entity by contractually assuming substantial employer rights, responsibilities, and risk through a professional employer agreement that establishes an employer relationship with the leased officers or employees assigned to the other entity… MCL 208.4

In *Herald Wholesale,* the court honored the agreement of the parties, but recognized the concept that tax-dependent considerations (resulting in tax avoidance) may require a court to look to the substance of a transaction rather than the form imposed by the parties. See also *Signature Villas Apartments, LLC v City of Ann Arbor,* 2005 MTT Docket No. 284431, WL 1798349. Orbis is not a "professional employer organization" as applied to Petitioner. It assumed no "employer risk" and certainly assumed no "*substantial* employer rights, responsibilities and risk" as required by the statutory definition with respect to Mr. McCartney.

For the reasons stated above, the adjustments made by Respondent were correct. Mr. McCartney's compensation should be included on the SBT return of his own business, Petitioner McCartney Enterprises Inc.

JUDGMENT

IT IS ORDERED that the taxes, interest, and penalties shall be as set forth in the Summary of Judgment section of this Final Opinion and Judgment.

IT IS FURTHER ORDERED that Respondent shall cause its records to be corrected to reflect the taxes, interest, and penalties as finally shown in the Summary of Judgment section of this Final Opinion and Judgment within 90 days of the entry of this Final Opinion and Judgment.

IT IS FURTHER ORDERED that the officer charged with collecting or refunding the affected taxes, interest, and penalties shall collect the taxes, interest, and penalties as required by this Order within 90 days of the entry of this Final Opinion and Judgment.

MICHIGAN TAX TRIBUNAL

Entered: July 20, 2006

By: Jack Van Coevering