STATE OF MICHIGAN

IN THE SUPREME COURT

HONIGMAN, MILLER, SCHWARTZ AND COHN LLP,

Petitioner-Appellee,
(Appellant below)

v.

CITY OF DETROIT,

Respondent-Appellant
(Appellee below)

Supreme Court No. 157522
Court of Appeals No. 336175
MTT Document No. 16-000202

CITY OF DETROIT'S REPLY BRIEF IN SUPPORT OF ITS APPLICATION FOR LEAVE TO APPEAL

May 16, 2018

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Taxpayer's opposition to the City's application does not confront the City's substantive arguments and, instead, relies on the court of appeals' unsound analysis. This response is limited to two discrete points.

1. Taxpayer's contention that the court of appeals' decision will cause only "limited" harm to the City is demonstrably unsound.

This case directly implicates, for this one taxpayer alone, roughly $1 million in past tax and additional millions of dollars in tax going forward. Taxpayer argues, however, that this published case's application will be limited because "few law firms file on a composite basis." Response, p. 10. Publicly available information, and the Taxpayer's own conduct, confirm that this decision will inflict serious financial harm to the City.

First, a few moments of internet research produced numerous accounting and law firms' websites broadly marketing the opinion to all service providers. In addition to Deloitte's marketing piece (City app'l, ex. 4), the City points to the following examples:

- Plante Moran, "Michigan city income tax act (CITA) apportionment: sales factor for service providers," ex. 18;
- Grant Thornton, "Michigan court of appeals applies market-based sourcing rule to services for Detroit city income tax," ex. 19;
- CCH Tax Group, "Detroit sales factor looks at delivery of services," ex. 20;
- Aprio LLP, "Michigan court ruling reveals refund opportunity for service providers paying city income tax," ex. 21.

Second, in support of its "limited application" argument, Taxpayer represents "there are no other pending cases on this issue pending at the Tax Tribunal." Response, p. 10. **But there is a pending court of appeals case for which, according to Taxpayer, the Honigman decision is relevant.** *Apex Laboratories International, Inc. v City of Detroit*, COA no. 338218.

In February 2018, the Honigman firm filed the lower court's opinion as "supplemental authority" in the *Apex* case. Ex. 22. The City denies the lower court's decision has any relevance to that case. Apex was a private equity investment vehicle. It was not a law firm and it made no sales of either good or services. But the Honigman firm's decision to inject the lower court's decision into the *Apex* case makes crystal clear that Honigman, and others, will broadly interpret the lower court's decision as applicable not only to all service providers, but in a myriad of other contexts.

2. Taxpayer continues to misrepresent its practices to this Court as it did to the court of appeals.

The opinion below relies entirely on the theory that the phrase "services rendered in the city" incorporates a physical delivery component – as if a law firm were delivering tangible goods rather than providing intangible services. Taxpayer has falsely represented that it treated revenue as "in-city" if the service was physically "delivered" in Detroit. City app'l, pp. 11 – 13. To the contrary, Taxpayer

treated all revenue as "out-city" **unless** (i) the services were rendered (performed) in the City **and** (ii) the client was coded as "in-city." City's app'l, pp. 11 – 14, 23 – 26.

Taxpayer continues to misrepresent its practices. Taxpayer's response (p. 1) argues: "The Court of Appeals held * * * that HMSC's computation of revenue from sales in the City was correct under the Act, when revenue from sales of legal services were designated "in-city" sales based on the client's receipt of legal services in the City." But Taxpayer does **not** treat revenue as "in-city" when "the client receives the services in the City," for example, at a state or federal court in Detroit. All such revenue is coded as "out-city" **unless** the client has **also** been coded as "in-city." Taxpayer has been forced to misrepresent its actual practices because those practices are flatly inconsistent with its physical delivery argument.

This Court exercises oversight of attorney conduct. The City simply cannot understand how an officer of the court can misrepresent his own Firm's affidavits and procedures central to this litigation and not acknowledge, let alone attempt to explain, his conduct.

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Incorporation of a physical delivery component in the phrase "services rendered in the city" contravenes the plain language of the act and makes no sense in the context of intangible legal services. Moreover, as shown by the City's

hypotheticals, the lower court's opinion produces absurd and unworkable results. App'l, pp. 23 – 26.

Taxpayer does not substantively address the hypotheticals, but argues that "the hypotheticals fail to note that time worked in the City would be captured in Appellant's payroll factor." Response, p. 10, fn 4. Even if true, that claim would provide no basis to ignore the controlling language of the revenue factor – services rendered in the city.

But the claim is false. Only Taxpayer's associate attorneys and support staff receive wages subject to the payroll factor. Taxpayer's partners do not receive wages, they receive distributions of profits.

As a result, the compensation of the Detroit partners is not captured in Taxpayer's payroll factor. Over 60% of Taxpayer's revenues were distributed as profits to its partners, most of whom worked in Detroit. So, not only is the partners' compensation not captured in the payroll factor but, because of Taxpayer's procedures at issue in this case, revenues generated by Detroit partners are largely excluded from the revenue factor as well.

The incongruous result is as follows: The City and Taxpayer agree on the property (~59%) and payroll (~65%) factors. However, the City computes a revenue factor of ~50% versus the Taxpayer's ~11%.

Conclusion and relief

For the reasons stated, the City asks the Court to grant its application for leave to appeal. The City also asks the Court to find the controlling phrase "services rendered in the city" unambiguous, and to hold the phrase synonymous with the phrase services performed in the City.

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