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

North American Bancard Inc.,
Petitioner,

MTT Docket No. 16-003703

Michigan Department of Treasury,
Respondent.

Tribunal Judge Presiding
Steven H. Lasher

FINAL OPINION AND JUDGMENT

INTRODUCTION

Petitioner, North American Bancard Inc., appeals the denial of its refund request by Respondent, Michigan Department of Treasury, issued on June 7, 2016. Respondent conducted a use tax audit of Petitioner for the periods from May 1, 2010, through April 30, 2014, and as a result of that audit, Petitioner paid $540,161.22 in deficient use tax to Respondent for those periods. Thereafter, Petitioner stated it was owed a refund of $486,847.30 as a result of that payment. Gregory A. Nowak, Attorney, represented Petitioner, and Emily C. Zillgitt, Attorney, represented Respondent.

A hearing on this matter was held on November 30, 2017. Petitioner's witnesses were Ryan Malloy and Dhirein Patel. Respondent's sole witness was Sunita Rana.

Each party filed a post-trial brief on January 12, 2018, and each party filed a response to the opposing party's post-trial brief on January 26, 2018.

Based on the evidence, testimony, and case file, the Tribunal finds that Petitioner's request for refund shall be denied.

PETITIONER'S CONTENTIONS

Petitioner seeks a refund for use tax paid resulting from Respondent's audit of the periods at issue. Petitioner contends only 9.87% of the property identified and taxed by Respondent's audit is subject to use tax because the property constitutes inventory prior to deployment and because 90.13% of the free-placement terminals it deploys are shipped to customers outside of Michigan. Petitioner contends all terminals stored in Michigan are inventory because each has

the potential to be sold and that terminals are regularly resold to customers. Petitioner further contends that the Court of Appeals decision in *Brunswick Bowling & Billiards Corp v Treasury* should be followed.[1] Petitioner contends that Respondent erred in applying the incidental to service test in this instance because that test only applies when a single transaction involves both the rendering of services and the transfer of tangible personal property, and in this case, Petitioner engages its customers in two separate transactions.

PETITIONER'S ADMITTED EXHIBITS

P-1 February 12, 2016 Claim for Refund of Sales and Use Taxes
P-la Certified Mail Receipt
P-lb Power of Attorney
P-lc Use Tax Refund Summary
P-1d Final Audit Determination
P-1e Audit Summary
P-lf Detail of Terminal Purchases for 2012
P-1g Detail of Terminal Purchases for 2013
P-lh Detail of Terminal Purchases for 2014
P-li Detail of Terminal Sales for 2014
P-3a Request to Admit/Interrogatory 2 — Examples of primary variations of form agreements including 1) terminal provided free of charge, 2) terminal leased, and 3) terminal sold (NAB 0000001-0000118) and supplemented by NAB 0011062-0011544, including but not limited to any other additional sample faun agreements that are located for purposes of the hearing
P-3b Request to Admit/Interrogatory 5 — Spreadsheets: NAB 0000119 —NAB 0011045
P-3d Redacted samples in Invoices NAB 0011056 — NAB 0011059

PETITIONER'S WITNESSES

Petitioner presented the testimony of Ryan Malloy, Petitioner's vice president of partner relations, and Dhirein Patel, Petitioner's tax manager.

Mr. Malloy testified that Petitioner's business is to provide electronic payment processing capabilities to merchants? Petitioner supplies the equipment needed to facilitate those transactions,[3] either via the customer purchasing that equipment or through "free placement."[4] Equipment disbursed by these two transaction types is indistinguishable prior to its deployment

[1] *Brunswick Bowling & Billiards Corp v Treaszny,* 706 NW2d 30; 267 Mich App 682 (2005).
[2] Transcript at 17.
[3] Transcript at 18.
[4] Transcript at 18-19.

to Petitioner's customers.[5] Although both customer types must sign a service agreement, Petitioner utilizes different agreement forms depending on the equipment-placement transaction. Equipment sales are documented by an equipment-sale invoice, and free-placement transactions are documented by a free placement invoice.[6] Petitioner does not offer either transaction type unless the merchant also agrees to purchase Petitioner's services, although a merchant could choose to have the equipment "unlocked" for future use with another service provider.[7]

Mr. Patel testified that he joined Petitioner after the conclusion of Respondent's audit and helped to initiate this appeal.[8] He stated that his analysis indicates that 9.87% of Respondent's equipment deployments during the audit period were to Michigan customers and that the remainder of the deployments were to merchants outside Michigan.[9] There is no way to determine prior to deployment whether a specific terminal shall be sold to a customer or distributed through a free-placement agreement.[19] He testified that Petitioner should not owe sales tax on any equipment distributed under either agreement type but concedes that Petitioner owes use tax on any equipment deployed in Michigan."

RESPONDENT'S CONTENTIONS

Respondent contends that Petitioner is not due a use tax refund for the periods at issue. Respondent contends that Petitioner is a service provider and that its credit card processing terminals are incidental to its services. Respondent relies upon the incidental to service test adopted by the Michigan Supreme Court in *Catalina Marketing Sales Corp v Treasury*[12] in its determination that Petitioner must pay use tax on credit card terminals stored in Michigan.

RESPONDENT'S ADMITTED EXHIBITS

R-1 Pre-Audit Confirmation Letter dated 04/01/2014
R-2 Tax Audit Questionnaire

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[5] Transcript at 20.
[6] Transcript at 21-22.
[7] Transcript at 28-29.
[8] Transcript at 46, 48.
[9] Transcript at 49-51.
[10] Transcript at 53.
[11] Transcript at 54-55.
[12] *Catalina Marketing Sales Corp v Treasury*, 678 NW2d 619; 470 Mich 13 (2004).

R-3 Audit Confirmation Letter dated 04/18/2014
R-4 Tax Compliance Bureau Records Request
R-5 Workpapers for the period 05/01/2010 — 04/30/2012
R-6 Workpapers for the period 05/01/2012 — 04/30/2014
R-7 Audit Report of Findings for the period 05/01/2010 — 04/30/2012
R-8 Audit Report of Findings for the period 05/01/2012 — 04/30/2014
R-9 Notice of Preliminary Audit Determination for the period 05/01/2010 — 04/30/2012
R-10 Notice of Preliminary Audit Determination for the period 05/01/2012 — 04/30/2014
R-11 North American Bancard website
R-13 Auditor memo regarding refund dated 04/12/2016
R-15 North American Bancard website pages
R-16 Merchant agreement with Merchant Number 219550
R-17 Merchant agreement with Merchant Number 323403
R-18 Merchant agreement with Merchant Number 328640
R-19 Merchant agreement with Merchant Number 224813
R-20 Merchant agreement with Merchant Number 338884
R-21 Refund request dated 02/12/2016
R-22 Use tax refund summary
R-23 Detail of Terminal Purchases for 2012
R-26 Detail of Terminal Sales for 2014
R-27 Terminal shipments summary and details
R-28 Petitioner's Responses to Respondent's Request to Admit and Interrogatories
R-29 North American Bancard Annual Returns for Sales, Use, and Withholding Taxes
R-31 Transcript of deposition of Dhirein Patel

RESPONDENT'S WITNESS

Respondent presented the testimony of Sunita Rana, senior auditor at Michigan Department of Treasury.

Ms Rana testified that she was assigned to conduct Respondent's 2014 audit of Petitioner's sales and use tax liability.[13] She stated that Respondent identified itself as a provider of payment processing services prior to commencement of the audit.[14] She stated that she determined during the audit that Petitioner paid use tax on expense purchases and was spending a lot of money on terminal purchases.[15] She testified that she was informed by Petitioner's former tax manager that Petitioner paid use tax when a terminal was withdrawn from storage; however, she determined that Petitioner is instead liable for use tax at the time Petitioner acquires the

[13] Transcript at 95.
[14] Transcript at 96.
[15] Transcript at 99.

terminal because it is the user and not the seller of the equipment.[16] She testified that Petitioner agreed with the preliminary audit results at the time.[17] Upon a later review of the determination resulting from Petitioner's refund request letter, she states she determined Petitioner still did not qualify because it still provides terminals free of cost.[18]

FINDINGS OF FACT

1. Petitioner is a merchant of credit card processing services.
2. Petitioner's customers are primarily retail merchants.
3. Petitioner sells its credit card processing services to its customers.
4. A credit card processing service is an entity that collects a fee for facilitating rapid electronic communications between financial institutions of the two parties to a retail transaction and reporting the result to those parties and their banks.
5. Petitioner deploys credit card processing equipment to its customers for operation in those customers' businesses.
6. Petitioner's customers can obtain Petitioner's services, after Petitioner's approval, by signing a service agreement in addition to either an equipment sales invoice or a free placement invoice.
7. Equipment provided by Petitioner to its customers must be "unlocked" before it can be used by that customer with Petitioner's competitors.
8. Petitioner deployed 90.13% of its equipment to customers outside of Michigan during the audit period.
9. Petitioner cannot reasonably determine whether equipment will be delivered in an equipment sales agreement or free placement agreement prior to deployment.

CONCLUSIONS OF LAW

The assessment at issue was imposed under the UTA, MCL 205.91 *et seq.* Use tax is a `. . . specific tax for the privilege of using, storing, or consuming tangible personal property in

[16] Transcript at 107-108.
[17] Transcript at 99.
[18] Transcript at 110.

this state at a rate equal to 6% of the price of the property. .. ."[19] MCL 205.97(1) provides that "[e]ach person storing, using, or consuming in this state tangible personal property or services is liable for the tax levied under this act and that liability shall not be extinguished until the tax levied under this act has been paid to the department." However, "property purchased for resale" is exempt from Michigan's use tax[20] if it is held for "sales at retail.'

The issue to be considered in this case is whether Petitioner's card processing equipment deployed to Petitioner's customers outside of Michigan is entitled to an exemption from use tax. The key facts are mostly not in dispute. Further, each party essentially relies on a sole precedential decision in its argument: Respondent relies on *Catalina,* and Petitioner relies on *Brunswick.*

The Michigan Supreme Court in *Catalina* adopted the "incidental to service" test to determine categorization of a business relationship involving both the provision of services and transfer of tangible personal property.[22] "[S]ales tax will not apply to transactions where the rendering of a service is the object of the transaction, even though tangible personal property is exchanged incidentally. . . . The 'incidental to service' test looks objectively at the entire transaction to determine whether the transaction is principally a transfer of tangible personal property or a provision of a service."[23] Respondent contends *Catalina* provides the applicatory guidance upon which the Tribunal's determination must rest, while Petitioner contends the case is not precedential in this analysis because Petitioner engages its customers in two separate transactions, and is therefore, not within the scope of *Catalina.*

Specifically, Petitioner contends that *Catalina* is not applicable in this instance because:

> when a single transaction involves both services and the transfer of tangible personal property, it must be categorized as either a service or a tangible property transaction.... However, *Catalina* only applies when a single transaction involves both the rendering of services and the transfer of tangible personal property. Here, [Petitioner's] sales of credit card terminals are not incidental to the Petitioner's credit processing service, but rather are separate transactions from those service transactions with separate invoices. While upon withdrawal from

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[19] MCL 205.93(1).
[20] MCL 205.94(1)(c)(i).
[21] MCL 205.51(6).
[22] *Catalina Marketing,* supra at 621.
[23] Id. at 626, quoting 85 C.J.S. 2d, Taxation, Section 2018, p 976.

> inventory [Petitioner] does provide the majority of the terminals to customers free of charge in connection with the rendering of services and therefore is the consumer of those terminals, that consumption does not occur until the terminals are shipped, and under *Brunswick* the terminals shipped outside of Michigan are not subject to Michigan use tax.[24]

Petitioner contends that, like the petitioner in *Brunswick*, it withdrew the subject equipment from its inventory prior to shipping that equipment out of state. The Tribunal finds that *Brunswick* is not applicable, in this case, both because the property at issue is not inventory and because Petitioner engages its customers in a single transaction manifest in separate contracts.

Petitioner's reliance on *Brunswick* necessarily invokes a claim that Petitioner's property is inventory prior to being withdrawn for use in a free placement agreement. The testimony of Petitioner's witnesses generally supports Petitioner's contention.[25] However, the Tribunal relies on two reasons in determining that Petitioner's property stored at its Troy facility is not inventory — Petitioner does not engage in retail sales, and only a minor portion of the property stored in Petitioner's inventory is actually sold at retail.

A party in Michigan engaged in the business of making sales at retail, by which ownership of tangible personal property is transferred for consideration, must pay a tax equal to 6% of the gross proceeds of the business.[26] A sale at retail means a sale of tangible personal property for any purpose other than resale, sublease, or subrent.[27] Here, Petitioner submitted evidence indicating that sales tax is not levied upon its equipment sold to its customers in those transactions[28] and that Petitioner treats the terminals as a deductible expense of its business.[29] Petitioner's former tax manager informed Respondent's auditor that it previously collected sales tax on units sold at retail but had ceased that practice.[30] Respondent's auditor thereafter agreed with Petitioner's position, concluding that conducting a sales tax audit of Petitioner was not

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[24] Petitioner's Post Hearing Brief dated January 12, 2018, at 7.
[25] Transcript at 19-20, 50.
[26] MCL 205.52(1).
[27] MCL 205.51(1)(b).
[28] Petitioner's Exhibit P-3D.
[29] Transcript at 99.
[30] Transcript at 106.

necessary because Petitioner was the user and not the seller of the terminals.[31] Further, Petitioner apparently does not even have a set business process or metric in place to determine which terminals are sold and which are placed for free; instead, it records all terminal transactions at cost and must "backtrack" from those individual transactions to determine whether a specific terminal is sold or placed for free.[32] The Tribunal has no jurisdiction in this use tax refund appeal to determine whether Petitioner should owe sales tax as a result of its equipment sales to its customers. Notwithstanding, the record indicates that, unlike a traditional retail seller of a product such as bowling balls, Petitioner lacks many of the key features of a person engaged in retail sales.

Petitioner's inventory argument also relies on its assertion that all its processing equipment is inventory because it has the potential to be sold to customers. Petitioner's witnesses did not testify as to the frequency of those sales, although Mr. Patel indicated the frequency of those sales are not closely tracked.[33] Respondent's witness testified she was told by Petitioner's agent that a "very small portion" of the terminals were sold by Petitioner to its customers.[34] Petitioner's reliance on the sale of a very small portion of its terminals to support its contention that all of its terminals could potentially be inventory, and its use of business processes highly uncustomary for a retail seller, are not sufficient to convince the Tribunal that the processing equipment is inventory prior to being shipped to Petitioner's customers.

Petitioner also argues that *Brunswick* and not *Catalina* is precedential because *Catalina* is applicable to only persons engaged in a single transaction. After approving customers, Petitioner works with its customers to make a determination as to whether to provide processing equipment to those customers through equipment sales or free placement.[35] The price of Petitioner's processing services, in which the services are identical in all other ways, are negotiable depending upon which equipment acquisition method its customer chooses.[36] The customers who purchase Petitioner's equipment can use that equipment with other service providers; however,

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[31] Transcript at 106-107.
[32] Transcript at 53.
[33] *Id.*
[34] Transcript at 112.
[35] Transcript at 19.
[36] Transcript at 21.

in order to do so, it is required that Petitioner first "unlock" that equipment.[37] Further, and without regard to equipment acquisition method, Petitioner's customers also typically enter into a service agreement[38] because the equipment will not work without Petitioner's services.[39] Petitioner's witness testified that, although Petitioner's customers can have that equipment unlocked for use with another service provider, they would typically only do that "later," meaning after a period in which the customer uses the equipment to utilize Petitioner's processing services.[40]

Although Petitioner contends that it engages its customers in two separate transactions, as evidenced by separate contracts, the Tribunal finds that these contracts are complementary, intertwined, and that one is rarely, if ever, entered without the other. Petitioner presented no evidence that these purported separate contracts are ever individually entered into by Petitioner's customers. Instead, the record evidence supports the conclusion that the purported separate contracts are part of a single, two-part transaction which Petitioner's customers dually enter in order to obtain Petitioner's services. As such, the Tribunal finds that these contracts represent a single transaction within the scope of Petitioner's regular business customs.

As Petitioner's contracts together represent a single transaction, the Tribunal finds application of the incidental to service test is appropriate.

The "incidental to service" test considers:

- what the buyer sought as the object of the transaction;
- what the seller or service provider is in the business of doing;
- whether the goods were provided as a retail enterprise with a profit-making motive;
- whether the tangible goods were available for sale without the service;
- the extent to which the intangible services have contributed to the value of the physical item transferred, and;
- any other factors relevant to the transaction.'

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[37]Transcript at 22-23.
[38] Transcript at 22, 28.
[39] Transcript at 32.
[40] Transcript at 29.
[41] Revenue Administrative Bulletin 2015-25, approved December 2, 2015.

Here, Petitioner's customers acquire both processing services and equipment, but the Tribunal finds that the services are the object of the buyers' transactions. As an example, it is simple to envision Petitioner's customers wanting to purchase Petitioner's services through another physical or electronic means if and when the processing equipment becomes obsolete, but it is less obvious what would be the demand for the processing equipment if the buyer has another method by which to authenticate its own customers' transactions. The Tribunal finds that Petitioner's customers seek Petitioner's services, and not its equipment, as the object of their transactions with Petitioner.

Petitioner described itself as a seller of credit card processing services to retail merchants[42] through various iterations and phrases throughout the proceedings in this appeal. Petitioner's website supports this characterization as the website describes the superiority of Petitioner's services but provides no links or detailed information relating solely to the sale of equipment. The Tribunal finds that Petitioner holds itself out as a service provider but not as a retail seller of credit card processing equipment.

Petitioner did not submit any evidence to indicate whether and how much upcharge or profit results from the sale of its equipment. However, as Petitioner's evidence indicates its equipment is regularly placed with its customers without charge, the Tribunal finds that there is sufficient evidence to conclude that earning a profit from the sale of its equipment is not a primary consideration in Petitioner's business model, but is weighed, on a by-customer basis, against the terms of its service agreements. Petitioner does not even specifically track these sales in the normal course of its business.[43] The Tribunal further finds that, for the reasons already stated, Petitioner is not a retail seller.

The Tribunal finds that Petitioner, a for-profit entity, would likely consider an arrangement to sell the tangible goods without the services but did not present any evidence that it does so in the normal course of its business.

The Tribunal further finds the intangible services contribute almost all of the value to the physical item being transferred. As discussed previously, Petitioner's customers are far more likely to purchase Petitioner's services through another physical mechanism than to purchase

[42] Transcript at 7.
[43] Transcript at 53.

Petitioner's equipment without its processing services. Further, Petitioner must perform an uncustomary "unlocking" of the tangible goods if its customers wish to utilize the equipment with another service provider, which indicates that the value of the physical goods is entirely intertwined with being able to receive processing services.

Another factor relevant to this analysis is Petitioner's contention that the transactions are separate. Petitioner established as a fact that its customers enter a service agreement as well as either a free-placement invoice or equipment-sales invoice once approved for Petitioner's services. However, the Tribunal finds that there is another reason for Petitioner to separate this transaction into two contracts. As discussed at length, Petitioner's customers negotiate to acquire the equipment either through title purchase or free placement. A processing service agreement, identical in all or most other pertinent ways, is signed regardless of which option the customer selects. The Tribunal finds that separating this single transaction into two contracts simplifies Petitioner's business processes. As such, there are non-sales reasons why Petitioner may choose to provide its services through the use of multiple contracts rather than a single integrated customer agreement. Petitioner also failed to present any evidence of customers entering into only one of the two agreements; the record instead indicates that it is standard for Petitioner's customers to concurrently enter both agreements.

After considering and weighing all factors relevant to the incidental to service test, the Tribunal finds that Petitioner's equipment transactions are incidental to its credit card processing services, and as such, *Catalina Marketing* is precedential in determining whether Petitioner's processing equipment is incidental to its processing services.

The Tribunal finds, based upon the Findings of Fact and Conclusions of Law set forth herein, that Petitioner does not engage its customers in separate transactions when those customers sign a service agreement in addition to a free-placement contract. Petitioner has valid business reasons for using two separate documents to enter the transaction, but the lack of evidence that Petitioner regularly engages in one transaction without the other necessitates the conclusion that it is a single transaction. As a result, the transfer of card-processing machines is incidental to Petitioner's rendering of processing services, and as such, Petitioner's equipment sent to out-of-state customers is not exempt from Michigan's use tax.

JUDGMENT

IT IS ORDERED that Petitioner's Request for Refund is DENIED as set forth in the Introduction section of this Final Opinion and Judgment.

This Final Opinion and Judgment resolves the last pending claim and closes this case.

APPEAL RIGHTS

If you disagree with the final decision in this case, you may file a motion for reconsideration with the Tribunal or a claim of appeal with the Michigan Court of Appeals.

A Motion for reconsideration must be filed with the required filing fee within 21 days from the date of entry of the final decision." Because the final decision closes the case, the motion cannot be filed through the Tribunal's web-based e-filing system; it must be filed by mail or personal service. The fee for the filing of such motions is $50.00 in the Entire Tribunal and $25.00 in the Small Claims Division, unless the Small Claims decision relates to the valuation of property and the property had a principal residence exemption of at least 50% at the time the petition was filed or the decision relates to the grant or denial of a poverty exemption and, if so, there is no filing fee.[45] A copy of the motion must be served on the opposing party by mail or personal service or by email if the opposing party agrees to electronic service, and proof demonstrating that service must be submitted with the motion.[46] Responses to motions for reconsideration are prohibited and there are no oral arguments unless otherwise ordered by the Tribunal."

A claim of appeal must be filed with the appropriate filing fee. If the claim is filed within 21 days of the entry of the final decision, it is an "appeal by right." If the claim is filed more than 21 days after the entry of the final decision, it is an "appeal by leave."" A copy of the claim must be filed with the Tribunal with the filing fee required for certification of the record on

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[44] See TTR 261 and 257.
[45] See TTR 217 and 267.
[46] See TTR 261 and 225.
[47] See TTR 261 and 257.
[48] See MCL 205.753 and MCR 7.204.

appea1.[49] The fee for certification is $100.00 in both the Entire Tribunal and the Small Claims Division, unless no Small Claims fee is required.[50]

By Steven H. Lasher

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[49] See TTR 213.
[50] See TTR 217 and 267.