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

USA Financial Marketing Corporation,
Petitioner,
v MTT Docket No. 341985

Michigan Department of Treasury,
Respondent.

Tribunal Judge Presiding
Patricia L. Halm

FINAL ORDER AND JUDGMENT

On November 4, 2009, Administrative Law Judge Thomas A. Halick issued a Proposed Order denying Petitioner's Motion for Summary Disposition and a Proposed Order granting Respondent's Motion for Summary Disposition. The Proposed Orders provided, in pertinent part:

> The parties have 20 days from date of entry of this Proposed Opinion to notify the Tribunal in writing if they do not agree with the Proposed Opinion and why they do not agree (i.e., exceptions). After the expiration of the 20-day time period, the Tribunal will review the Proposed Opinion and consider the exceptions, if any, and:
>
> a. Adopt the Proposed Opinion as a Final Decision.
> b. Modify the Proposed Opinion and adopt it as a Final Decision.
> c. Order a rehearing or take such other action as is necessary and appropriate.

Neither party filed exceptions to the Proposed Opinion within the allotted time.

The Tribunal, haven given due consideration to the Proposed Orders and the case file, adopts the November 4, 2009 Proposed Orders as the Tribunal's Final Decision 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 Orders in this Final Order and Judgment. Therefore,

IT IS ORDERED that Petitioner's Motion for Summary Disposition is DENIED.

IT IS FURTHER ORDERED that Respondent's Motion for Summary Disposition is GRANTED.

IT IS FURTHER ORDERED that this case is DISMISSED.

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

MICHIGAN TAX TRIBUNAL

Entered: March 17, 2010 By: Patricia L. Halm

STATE OF MICHIGAN
STATE OFFICE OF ADMINISTRATIVE HEARINGS AND RULES

USA Financial Marketing Corporation,
Petitioner,

v

Department of Treasury,
State of Michigan
Respondent.

MICHIGAN TAX TRIBUNAL
MTT Docket No. 341985

Administrative Law Judge Presiding
Thomas A. Halick

PROPOSED ORDER DENYING PETITIONER'S MOTION FOR SUMMARY DISPOSITION

PROPOSED ORDER GRANTING RESPONDENT'S MOTION FOR SUMMARY DISPOSITION

ORDER DENYING RESPONDENT'S MOTION FOR TELECONFERENCE OR BRIEFING TO CLARIFY CONTRACTUAL PROVISION DISCUSSED AT HEARING

This case comes before the Tribunal on cross motions for summary disposition under MCR 2.116(C)(10). Each party filed an answer. Oral argument was held on July 15, 2009.

Brief Statement of Judgment

Upon review of the motions, briefs in support, and oral argument, Petitioner's motion shall be denied. Respondent's Motion shall be granted, Petitioner's request for a refund of Single Business Tax is denied, and this case shall be DISMISSED.

Standard of Review

A motion for summary disposition under MCR 2.116(C)(10) tests the factual support of a claim. The Tribunal must consider the affidavits, pleadings, depositions, admissions, and other documentary evidence submitted or filed in the action to determine whether a genuine issue of any material fact exists requiring trial. *Spiek v Dep't of Transportation,* 456 Mich 331; 572 NW2d 201 (1998). When determining whether there is a genuine issue of any material fact, the admissible evidence must be viewed in the light most favorable to the non-moving party. *Heckman v Detroit Chief of Police*, 267 Mich App 480; 705 NW2d 689 (2005). If the "affidavits or other proofs show that there is no genuine issue of material fact, the court shall render judgment without delay." MCR 2.116(I)(1). "If it appears to the court that the opposing party, rather than the moving party, is entitled to judgment, the court may render judgment in favor of the opposing party." MCR 2.116(I)(2). Although the parties filed their motions under MCR 2.116(C)(10), they also submitted a Joint Stipulation of Facts and documentary evidence. As such, it is appropriate for the Tribunal to base its decision on MCR 2.116(A)(1) and (2), because

the parties submitted an "agreed-upon stipulation of facts" and the Tribunal has determined that the stipulated facts are "sufficient to enable the court to render judgment."

Procedural History

The parties stipulated to certain facts, set forth in a document entitled "Petitioner and Respondent Partial Joint Stipulation of Uncontroverted Facts" ("Stip.") dated November 15, 2008, which is incorporated herein by reference. The taxes in dispute are single business taxes for year 2002 only. Petitioner did not apportion its tax base on its original 2002 SBT return.

On or about April 26, 2007, Petitioner filed an amended SBT return, claiming the right to apportion its tax base using an apportionment percentage of 49.90681%. W. Bachert Affidavit #17. This resulted from the exclusion of certain "override commissions" from the sales factor numerator. The property factor and payroll factor are not at issue. Petitioner's amended 2002 SBT return reported that 100% of Petitioner's property is located in Michigan as well as 100% of wages paid to employees.

On or about June 5, 2007, Respondent requested that Petitioner provide information regarding how costs of performance were determined on a contract by contract basis.

On or about July 11, 2007, Petitioner wrote to Respondent that detail of revenue produced by each independent contractor (sales person) was set forth on a schedule of sales by state (Joint Exhibit X, pages 1-41). Petitioner further indicated that "Cost of performance was applied on a direct cost basis to the independent contractors providing the sales services that produced the income." Joint Exhibit X, p. 1.

Thereafter, Respondent denied the refund request by issuance of a "Single Business Tax Annual Return Notice of Adjustment" dated August 21, 2007.

On September 24, 2007, Petitioner appealed the department's denial to the Tax Tribunal.

Post Hearing Motion

On July 22, 2009, Respondent filed a Motion for Teleconference or Briefing to Clarify Contractual Provision Discussed at Hearing.

On August 7, 2009, Petitioner filed an untimely response to Respondent's motion.

Respondent's motion addresses language in a contract that was attached to Respondent's Motion for Summary Disposition (also identified as Joint Exhibit III – Managing General Agent / Brokerage General Agent Agreement). Respondent claims that Section II(1.)(a.) of Joint Exhibit III pertains to Petitioner's authority to solicit insurance applications in Michigan, which is not at issue in this matter. Respondent states that the "sales" at issue in this case arise from Petitioner's performance of services for insurance companies.

In response, Petitioner states that the authorization to solicit applications for products is not exclusive and does not necessarily extend to all of the products of the insurance company. Petitioner states that it has contractual authority to solicit applications for insurance company

products in Michigan and in other states. Petitioner reiterates its position that "each and every solicitation made by an independent sales agent for and on behalf of Petitioner and the sale of financial product which results is an independent transaction separate from other such sales made by the same independent sales agent or by other agents. Solicitation and sales of financial products in Michigan are not different in any manner or form from such solicitation and sales made outside of Michigan." Petitioner further states that the commission income that it earns from sales by independent sales agents is separate from other income earned by Petitioner for supervision, training and otherwise assisting the sales agents. Petitioner asserts that the independent sales agents (and general agents) are assigned to Petitioner and "their efforts are for and on behalf of the Managing Agent" (Petitioner), and that commission income at issue relates to the sales of financial products made by independent sales agents located in Michigan and outside Michigan.

The Tribunal determines that the contracts at issue do not contain a geographical limitation upon the authority granted to Petitioner to solicit applications for products. However, there is no factual dispute that Petitioner did not solicit applications outside Michigan by its own employees. The dispute centers upon whether the "independent sales agents" solicited applications "for and on behalf of" Petitioner. The Tribunal rules that this issue can be resolved from an examination of the contractual relationship between Petitioner and the insurance companies, and the contractual relationship between the independent sales agents and the insurance companies, as well as reliance upon the stipulated facts and oral argument. Therefore, there is no need for further oral argument, briefing, evidentiary hearing, or counsel conference in this regard.

Respondent's Motion for Teleconference or Briefing to Clarify Contractual Provision Discussed at Hearing is DENIED.

Brief Statement of Issues

The first issue is whether Petitioner was subject to the apportionment provisions of the Single Business Tax Act ("SBTA") for the tax year at issue or whether it must allocate its tax base completely to Michigan. The question is whether Petitioner had "nexus" with another state.

If Petitioner had nexus with another state, the issue becomes whether certain "override commissions" are excluded from the numerator of the sales factor.

Summary of Facts

Petitioner, USA Financial Marketing Corporation, is a Michigan Corporation with its principal offices in Ada, Michigan. All of Petitioner's property is located in Michigan. Stip 23. Petitioner's employees are all Michigan residents who work at the Ada, Michigan office site. Stip 24.

During the year at issue, Petitioner provided services for insurance companies (under contracts with each insurance company) by recruiting, training, motivating, managing, and supervising "agents" who solicited sales for the insurance companies. All of Petitioner's business activity occurred within Michigan. Stip14. Joint Exhibit III ("Managing General Agent / Brokerage General Agent Agreement") provided that Petitioner shall "recommend licensed agents or General Agents to the Company for appointment and assignment to [Petitioner]" and that

Petitioner shall "recruit, train, motivate, supervise, service and support Agents and General Agents assigned to you *to represent the Company* in accordance with Company policies. . . ." Joint Exhibit III, P-2, Section II – Authority 1. d. [Italics added]. The sales agents represented the insurance company, and not Petitioner.

The parties stipulated to certain Joint Exhibits, which are offered as examples of the various contracts between Petitioner and the insurance companies. Petitioner also submitted copies of 32 contracts under seal. The contracts generally describe Petitioner as a "wholesaler" or independent marketing organization ("IMO"). Joint Exhibit III is offered by Petitioner as being representative of the various contracts under which it operated. Petitioner's Motion, page 4, paragraph 17. That contract describes Petitioner as a "Managing General Agent." Other contracts refer to Petitioner as a Field Marketing Organization, a General Agent, a Wholesaler, Marketing Company, General Agent, Regional General Agent, and National Marketing Organization. Petitioner's duties under the various contracts are substantially the same regardless of the title.

Under the various contracts, Petitioner had authority to solicit sales for the insurance companies through its own efforts. The contracts also granted Petitioner authority to recruit and recommend sales representatives (generally referred to as agents) who entered into separate contracts with the insurance companies, in which case, the independent agents solicited applications for products for the insurance companies. The contracts provide that the applications for products must be forwarded to the insurance company for approval by the insurance company. The agent earned a commission from the insurance company for each approved application – that commission is not at issue in this case.

Petitioner recruited, trained, managed, and supervised the independent sales agents. Stip 13. For these services, the insurance companies paid Petitioner an "override commission" calculated as a percentage of the premiums from an approved sale of an insurance company product that was generated by the agent that Petitioner supervised. The "sales" at issue are the override commissions related to "applications for products" that the agents solicited from customers outside Michigan.

Under the various contracts, Petitioner is granted authority to solicit sales and to recruit and recommend to the insurance company individuals to be appointed as agents of the insurance company. In general, Petitioner entered a contract that appointed it as an agent to solicit for the insurance company, and also authorized Petitioner to recruit other agents who entered contracts with the insurance company to solicit sales for the insurance company. (It is this dual authority that lies at the center of this dispute.) When Petitioner recruited, trained and supervised other agents, *it did not act as a sales agent*, but acted in its capacity as an IMO. Petitioner did not solicit applications for products outside Michigan. This demonstrates a clear delineation between the solicitation activity of the agents that occurred in other states, and the IMO activity that occurred within Michigan.

The independent agents were engaged in their own business activity and "market and sell the insurance company financial products from their offices located in their market states." Petitioner's Motion, page 2, paragraph 9 and page 3, paragraph 12.

There is no example of any agreement where Petitioner entered a contract with an agent where the agent did not also enter an agent contract with the insurance company. The only example of a

contract entered into between an "agent" and Petitioner is Joint Exhibit IV, which is the "Corporate Licensing/Commission Assignment Form," the contents of which are described further below. In other words, Petitioner did not enter into an agreement directly with the independent sales agents that defined their respective duties. Rather, the agents and Petitioner entered separate contracts with the insurance companies.

Petitioner characterizes its relationship with each agent and insurance company as a "three way contract with Petitioner that creates a three-way relationship." This is not an accurate description of the contracts. There is no evidence of a contract executed between three parties: Petitioner, an agent, and an insurance company. Rather, the insurance company entered into a contract with Petitioner and a separate contract with the agent. There is evidence that the agent signed a document acknowledging that Petitioner was appointed to supervise the agent and would be entitled to an override commission, but this does not create a "three-way contract." Joint Exhibit IV, page 7, Stip 38.

Sealed Exhibit 2 is a Field Marketing Organization Addendum between Petitioner and an insurance company. This exhibit indicates that the insurance company directly paid commissions to Petitioner's "agents" and the insurance company thereby discharged its obligations to Petitioner and the agents. That agreement further states that the commissions that are paid to the sales agent and to Petitioner "vest immediately" under the terms of Petitioner's agreement with the insurance company and under the Agent Agreement of the agents. (Sealed Exhibit 2). Petitioner's override commissions vested "immediately" at the time the insurance product application took effect between the customer and the insurance company (and when the premiums were paid to the insurance company). Therefore, it cannot be concluded that Petitioner earned the gross commission, given this description that indicates that the agent's commission is vested with the agent "immediately" and that the override commission is vested immediately with Petitioner. Even if the gross commission was paid to Petitioner (who was under a duty to pay it to the agent), the agent's portion already was "vested" in the agent.

Although not typical of the contracts, Sealed Exhibit 2 provides that Petitioner had the "rights and responsibilities" to "solicit applications for insurance policies…through your agents appointed with our approval." Sealed Exhibit 2 also provides that the insurance company must approve each agent, and must enter into a separate contract with each agent that Petitioner recruited. Regardless of slight differences in the language, each agreement provides that the agent earned a sales commission from the insurance company and Petitioner earned its override commission from the insurance company. In cases where Petitioner received the agent's commission, it was under a duty to deliver it to the agent on behalf of the insurance company. The override commission was consideration for Petitioner's own business activity and the agent's commission was consideration for the agent's sales activity. These facts show that the agents solicited applications on behalf of the insurance company and received separate remuneration for that service. The agents did not perform this activity for Petitioner.

Sealed Exhibit 24 provides that commissions "shall be fully vested to you as they accrue." This provision applies whether or not the agent is supervised by an "independent marketing organization" such as Petitioner. This provision is not altered in cases where the agent is supervised by an IMO and where the IMO is said to earn the gross fee.

Under the Managing Agent Agreement (Joint Exhibit III), the agent's portion belongs to the agent, is earned by the agent, and becomes vested in the agent "immediately upon accrual," and the Managing General Agent receives it under a duty to pay it to the agent. This establishes that the sales agents solicited applications for products directly for and on behalf of the insurance companies and received a separate commission for that business activity. Petitioner received the override commission from the insurance company for its distinct business activity (recruitment, training, managing, and supervision of the agents). This is not a case where Petitioner engaged sales representatives to solicit applications for sales of Petitioner's own products. The parties to the sale are the consumer of the insurance product and the insurance company.

The overall tenor of the agreements is that the insurance companies contracted with Petitioner to recruit, train, and supervise sales agents who solicited applications for sales of insurance company products. Petitioner is considered a "wholesaler" or "independent marketing organization" and not a sales agent when acting in this supervisory capacity.

Petitioner did not engage in solicitation activities outside Michigan. Petitioner did not meet with clients or develop contacts with new clients outside Michigan, nor did it perform any business activity outside Michigan related to out of state solicitation activities of the agents.

The parties stipulated to the admissibility and authenticity of the following documents:

Joint Exhibit I – "USA Financial Organization Listing," three pages. This document identifies five affiliated companies: USA Financial Marketing (Petitioner); USA Financial Team, LLC (an employee leasing company); USA Financial Securities (a securities broker/dealer); USA Financial Formulas, LLC (a registered investment advisor); and, GET 2 W, LLC (a real estate holding company).

Joint Exhibit II – "Services Provided by USA Financial Marketing at no charge." This document lists various training and support services that Petitioner provides to independent sales persons. Petitioner does not charge the independent sales representatives for these services. However, the services described in Joint Exhibit II coincide with the various duties that Petitioner undertakes in the contracts that it enters with the insurance companies, for which it is compensated by the override commission from the insurance company.

Joint Exhibit III, P-1 through P-8, is a "Managing General Agent / Brokerage General Agent Agreement" entered into by Petitioner as "General Agent" and Genworth Life Insurance Company." The agreement states that Petitioner "is hereby appointed as the Company's Managing General Agent and authorized: a. To solicit applications for Products." Although the contract authorized Petitioner to solicit applications for products, it is undisputed that Petitioner did not solicit applications for products outside Michigan, although it may have exercised that authority within Michigan. It is stipulated that Joint Exhibit III is representative of and consistent with the various contracts that Petitioner enters into with different insurance companies.

The parties to the agreement are an insurance company ("the Company" -- in the case of this Agreement, Genworth Financial) and Petitioner, as Managing General Agent/Brokerage Agent. This agreement was signed by Petitioner's chairman and CEO at Ada, Michigan and by an officer of the insurance company who signed the agreement at Lynchburg, Virginia.

Joint Exhibit III states that the "Managing General Agent" has authority to recommend licensed agents to be appointed by the insurance company and "assigned" to Petitioner; and that Petitioner shall "recruit, train, motivate, supervise, service and support Agents and General Agents assigned to you." Joint Exhibit III, P-2, Section II, 1. c. and d. Also see, Joint Exhibit III, page 3, Section III, 1, which further indicates that Petitioner may "recommend or the Company may appoint Agents and General Agents to be assigned to you [Petitioner]." The power to appoint or terminate an agent lies with the insurance company. Another duty expressly assumed by Petitioner is "To provide sales and marketing support for General Agents and Agents assigned to you to help them sell the Products." Joint Exhibit III, P-2, Section II, 2. q. (It is these support and supervisory services for which Petitioner earned its override commission).

Petitioner's Motion explains that the Agreement lists the commission to be paid to the agent of 8.0% (Joint Exhibit III, page 7) and the total commission of 11.2% (Joint Exhibit III, page 8). The commissions are calculated based on the "commissionable premium paid" to the insurance company from its customers. The difference between the agent's commission (8.0%) and the total commission (11.2%) is the 3.2% "net commission" (or, "override commission") to be paid to Petitioner from the insurance company. The definition of "overrides" is found in Joint Exhibit III, P-1, Section I, 1. e. The contract states that "the Company shall either pay directly to General Agents or Agents assigned to you all commissions earned thereby, or pay such commissions to you, as you and the Company shall mutually agree." Joint Exhibit III, P-3, Section V, 2.

In practice, Petitioner and the insurance companies have mutually agreed that the insurance company pays the agent directly. "As an administrative convenience, the insurance company may pay the agent's portion of the commission directly to the agent." Petitioner's Motion, page 8, paragraph 28, also, page 5, paragraph 18.

Joint Exhibit III, P-1, states that the "override commission" is the "difference between commissions payable to you [Managing General Agent] under your Sales Compensation Plan(s) and corresponding commissions payable to Agents and General Agents." The contract describes the entire commission (the gross commission) as "payable to" Petitioner. However, the contract further refers to the "corresponding commissions payable to Agents…." Joint Exhibit III, P-1, Section I, 1. e. In cases where the insurance company paid the 8% commission to Petitioner, it received it under a duty to pay it to the agent. Petitioner has no claim to the 8% portion. Petitioner does not earn the 8% portion as consideration for its services. The 8% portion is consideration for the agent's solicitation activities.

Petitioner states that it "will earn a gross commission, of which part of that gross commission is paid to the independent contractor." T 19. Petitioner pays the agent its portion of the commission from this gross commission, and Petitioner earns the "net commission." "So the net commission is what is earned by USA Financial Marketing." T 19. Petitioner earned the 3.2% commission as consideration for its business activity of recruiting, training, motivating, managing, and supervising the agents.

In practice, the agent agreed to receive payment directly from the insurance company and Petitioner is paid its 3.2% "override commission." Petitioner's representative stated that "It is kind of backward from the way it is laid out in the legal documents." T 19-20.

Joint Exhibit III, P-3, provides that the insurance company shall pay Petitioner "commissions and/or overrides." The agreement provides that the company shall either pay commissions earned by agents directly to the agents, or it may pay such commissions to Petitioner, as mutually agreed by the parties. If the insurance company pays the entire commission to Petitioner, it is obligated to pay the agent's portion to the agent. Petitioner has no right to retain any portion of the commission earned by the agent. Joint Exhibit III, P-3, Section IV, 2. For commissions paid on products solicited by out of state agents, Petitioner is entitled to only the "override commission."

Joint Exhibit III, P-9 through P-13 is an "Agent's Agreement with Power to Appoint," which was entered into between Petitioner and an insurance company (Great American Life Insurance Company), effective October 27, 2006. This Agreement is not part of the "Managing General Agent / Brokerage General Agent Agreement" described above, which was entered into between Petitioner and a different company. This "Agent's Agreement" is very similar to the "Managing General Agent / Brokerage General Agent Agreement." By the "Agent's Agreement," the insurance company appoints Petitioner as its "agent to solicit and procure applications/order tickets/request forms for the insurance coverage listed . . . ." The "Agent's Agreement" provides that the insurance company appoints Petitioner as its "agent to solicit and procure applications/order tickets/request forms for the insurance coverage listed…." The authority to solicit applications is not exclusive, but the insurance company has the right to appoint other agents, brokers, or subproducers in any location or territory. This agreement grants Petitioner power "to appoint subordinate agents with the Company's consent and subject to any conditions and limitations that it may require." Page 12, paragraph 16. Petitioner undertakes a duty to "train, supervise, and be solely responsible for all subordinate agents."

Reading the above provisions, Petitioner has nonexclusive authority to solicit applications for products in the various territories. Petitioner is also authorized to appoint subordinate agents (with the insurance company's consent) to solicit applications for products. Petitioner is "responsible for the faithful performance" by the subordinate agents.

Joint Exhibit III, P-14 through P-19, is an "Independent Marketing Organization Contract" between Petitioner and an insurance company (American Investors Life). The material terms are substantially similar to the above described agreements with Genworth Financial and Great American Life Insurance Company. This contract appoints Petitioner as the company's agent to solicit insurance products. *Id*. P-14. Petitioner is granted authority to "recruit and recommend to us individuals to be appointed as our agents," with approval by the insurance company. The contract specifically identifies such "agents" as agents of the insurance company, but also refers to them generally as "such agents on whose production you are entitled to receive and/or have received compensation from us" and also refers to the agents as "your agents" – meaning Petitioner's agents (meaning agents that Petitioner supervises). Petitioner is responsible for "providing proper and adequate supervision and training of your agents…." *Id*. p 15. Under this contract, Petitioner is paid a commission "for production by you or your agents." "Amounts payable to you on sales by your agents shall be reduced by the amount payable to such agent(s), so that you will receive only the override on such sales." *Id.* p 16.

As described in Joint Exhibit III, P-16, the Company pays Petitioner an amount that is "reduced by the amount payable to such agent(s), so that you will receive only the override on such sales." The override commission is defined in Exhibit III as ". . . the difference between commissions

payable to you under your Sales Compensation Plan(s) and corresponding commissions payable to Agents and General Agents."

Under the Agent's Agreement with Power to Appoint (Joint Exhibit III, P-9), the payments from the company to Petitioner are handled as follows:

> The Company will pay you overrides on business produced by subordinate agents. Overrides will be equal to the commissions the Company would pay to you if you produced the same business, less the aggregate commissions paid on that business to subordinate agents. Joint Exhibit III, P-12, paragraph 16 b.

As stated above, regardless of whether the agent's commission is paid to Petitioner, who then passes it through to the agent, or whether the insurance company pays the agent directly, Petitioner earns only the "override on business produced by subordinate agents." It is also notable that the language distinguishes between "business produced by subordinate agents" and business produced by Petitioner. "Business produced by Petitioner" refers to a sales commission that would be earned by Petitioner if Petitioner solicited the sale (as distinguished from a sale solicited by an independent sales agent).

The Agent's Agreement with Power to Appoint further provides:

> At your request, the Company may terminate the agreement of a subordinate agent…The Company may reappoint a subordinate agent on any basis that it sees fit at any time and without your consent and without notice to you. . . . Joint Exhibit III, P-12.

The subordinate agent has a contractual relationship directly with the insurance company that can be terminated by the insurance company. (See, Joint Exhibit IV, "Agent Agreement") The authority to terminate an Agent Agreement lies with the insurance company who "may" terminate an agreement upon Petitioner's request. The Company is not required to terminate the Agent Agreement, and retains the right to reappoint the subordinate agent, without Petitioner's consent. Therefore, it is clear that although Petitioner has the ostensible power to appoint a subordinate agent, it may only do so with the insurance company's consent. The insurance company has superintending control over the subordinate agents, notwithstanding the fact that Petitioner is responsible for direct supervision of the subordinate agent.

Joint Exhibit III, P-14 through P-19 (Independent Marketing Organization Contract) specifies that Petitioner "may designate agents on whose production you are to receive compensation from us." That agreement also refers to the agents as "your agents" (meaning Petitioner's Agents). Petitioner is responsible to ensure that the agents comply with the terms of the agent's contract with the insurance company. In such case, it is clear that Petitioner performs services for the insurance company, and has a duty to supervise the agents. As used in the various agreements, the phrase "your agents" refers to the sales agents that Petitioner supervises, and cannot be taken to establish an agency relationship between Petitioner and the "agent."

Joint Exhibit IV, P-1 to P-6, is an "**Agent Agreement**" that was entered into October 2, 2006. Under this agreement, the insurance company grants the sales person ("agent") authority to solicit applications for products. Joint Exhibit IV, P-1, Section II, 1(a). The "Agent Agreement"

is an example of the contracts that the insurance companies enter into with the "independent sales persons" ("agents"). The independent sales person has a contractual relationship directly with the insurance company. The Agent Agreement states that the sales representative (referred to as an "Agent") is appointed as the insurance "Company's agent and authorized to solicit applications for Products in your Assigned Territory." Joint Exhibit IV, P-1, Section II – Authority, 1. (a). The agent collects the initial premium payments for products that he or she solicits. Solicitations are forwarded to the company for approval. The payments of premiums from the customer are made by checks payable to the insurance company, and the agent holds the checks in a fiduciary capacity and remits such amounts directly to the insurance company. Joint Exhibit IV, P-1, Section II, 1. (b).

In some cases, Petitioner entered an agreement authorizing the insurance company to pay the commission directly to the agent. **Joint Exhibit IV, P-8 and P-9**. Petitioner states that this agreement "is used to execute an assignment of commission income where payments required to be paid by Marketing will be paid by the insurance company." In any case, it is clear that the insurance company pays the agent's commission to the agent – either directly from the insurance company or through Petitioner as its "duly authorized representative." Joint Exhibit IV, page 2. Also see, Petitioner's Motion, page 6, paragraph 21.

Joint Exhibit IV, P-7 is a Hierarchy Transmittal for Genworth Financial. Petitioner states that this form is used by the agent "to identify the wholesaler he or she is working with and who will receive the general agent commission." This exhibit is essentially an acknowledgment by the agent that the company has placed the agent under the direct supervision of Petitioner, and that Petitioner is entitled to receive an override commission.

Joint Exhibit IV, P-8 and P-9, is a USA Financial - Corporate Licensing / Commission Assignment Form, which "Executes an assignment of income where payments required to be paid by Marketing will be paid by the insurance company." Petitioner's Brief in Support, page 7, paragraph 22. It appears that this agreement authorizes the insurance company to pay the Agent its 8% commission directly, rather than paying the gross commission (11.2%) to Petitioner, who then pays the 8% to the Agent. Petitioner claims that "as an administrative convenience, the insurance company may pay the agent's portion of the commission directly to the agent." Petitioner's Brief in Support, page 8, paragraph 28 [W. Bachert Affidavit #12].

Joint Exhibit IV, P-10 and P-11, is an "Advisor Engagement Letter & Intellectual Property Licensing" application, by which a prospective agent provides information to Petitioner and indicates his or her desire to establish a relationship with an insurance company that works with Petitioner as a wholesaler.

Joint Exhibit IV, P-12, is a USA Financial "Intellectual Property Licensing" document that would be executed between the "undersigned Licensee and USA Financial." The agreement authorizes the agent to use copyrighted material, registered trademarks and proprietary materials. The Licensee acknowledges that he or she shall receive services "as a professional courtesy in return for ALL, or SIGNIFICANTLY ALL (as agreed upon by both parties), of my immediate and future production and financial services sales." In addition, the Licensee agrees to "all terms and conditions set forth in any and all applicable company contracts and agreements." The main import of this agreement is to protect Petitioner's intellectual property rights.

Summary of Petitioner's Argument

Petitioner argues that it is taxable both within Michigan and outside Michigan by virtue of the activities of independent sales persons (referred to as "agents") operating in other states. Stip 7. "Marketing has nexus outside of Michigan by virtue of the physical presence of independent sales persons residing outside of the state of Michigan and carrying on business activity for and on behalf of Marketing." Petitioner's Motion, paragraph 30. "Marketing's only out of Michigan involvement is the use of independent sales persons to market and sell financial products." Petitioner's Motion for Summary Disposition, page 2, paragraph 8.

Petitioner submitted with its Motion the Affidavit of Michael D. Walters and the Affidavit of William C. Bachert, both of which have been reviewed for purposes of deciding this motion.

Petitioner characterizes its activity as selling through the independent agents approximately 271 different products. Petitioner's Motion, page 8, paragraph 26. Petitioner "recruits, trains and supervises prospective independent sales persons and provides ongoing management and control over the independent sales persons." Stip 13.

"In the case at hand, the business activities of Marketing, through their independent sales agents, acting for and on behalf of Marketing, resulted in the commission income. Marketing earns commission income through the business activities of the independent sales agents working both within and outside Michigan." Petitioner's Brief, page 14, 15, paragraph 19.

Petitioner states that the independent sales agents "market and sell the insurance company financial products from their offices located in their market states." [W. Bachert Affdivit #7]. Petitioner's Brief, page 2, paragraph 9.

"The agents are responsible for sales production and the end client relationship. The agents are independent contractors. Marketing is only responsible for the activity of the agents and the products sold where Marketing is a party to a three way contract." Petitioner's Brief, page 3, paragraph 12.

"The sales to be apportioned by marketing are the override commissions received from the insurance companies for sales made by the independent contractors. The sales are a direct result of the marketing and sales efforts performed by the independent sales persons from their agency offices." "To the extent that marketing and sales efforts performed by the independent contractor occurs outside of Michigan, the override commission income would not be sourced to Michigan pursuant to Section 53." Petitioner's Brief, page 14, 15.

The amounts in dispute are "sales" that Petitioner received as a "net commission" also referred to as an override commission. Petitioner's Motion, page 5, paragraph 18, and Stip, paragraph 17. Petitioner claims it "earns commission income through the business activities of the independent sales agents. . . ." Petitioner's Motion, page 15, paragraph 16. Petitioner claims these commissions are excluded from the numerator of the sales factor "because none of the [agents'] business activity is performed in Michigan." Petitioner further claims that "the cost of

performance measure is only applicable when the business activity is performed both in and outside of Michigan." MCL 208.53(b).

Petitioner states "the independent sales persons pay a charge to Petitioner Marketing for services." Stip 16. This charge, which is not at issue in this case, is acknowledged to be a "Michigan sale" for apportionment purposes. Petitioner also alleges that it performs certain other services for the independent sales persons "at no additional cost." Stip 34. Petitioner also addresses these charges at page 5 of its Answer to Treasury's Brief in Support, claiming that Respondent "continues to confuse the facts." (The Tribunal finds these charges to be largely irrelevant to the nature of Petitioner's business activity as it relates to the solicitation activities of the sales agents. Regardless of whether Petitioner received other compensation for certain services that it provided to the agents, the override commission was consideration for Petitioner's business activity that occurred in Michigan.)

Petitioner further argues that under MCL 208.53(a), the sales arising from the business activity of the agent (that produced the override commission) are "in this state" if the "business activity is performed in this state" and that the "numerator of the sales factor only includes commission income where the sales agent performed the business activity in Michigan." Under Petitioner's view, override commissions that it received in relation to sales solicited by agents outside Michigan are not Michigan sales, but override commissions related to sales solicited by agents within Michigan are Michigan sales.

Initially, in correspondence with Respondent, Petitioner argued that MCL 208.53(b) applied, and that based on cost of performance, "all of the direct cost associated with the sales persons is sourced to the state of residence." Respondent's Exhibit X, p-2. At the time of the oral argument, Petitioner took the position that the override commissions must be apportioned outside Michigan under MCL 208.53(a), because the sales activities took place outside Michigan, and not based on "costs of performance" under MCL 208.53(b).

Summary of Respondent's Argument

Respondent argues that Petitioner did not conduct business activity outside Michigan through the independent sales representatives or anyone else and that the entire tax base is properly allocated to Michigan. Petitioner's business activity consisted of services performed within Michigan. Stip 14. "Business activity" means the taxpayer's business activity under MCL 208.3 and MCL 208.40.

Respondent contends that Petitioner lacks nexus with any other state under Michigan's nexus standards set forth in RAB 1998-1.

Assuming that Petitioner performed business activity both within and outside Michigan, Respondent claims that under a "cost of performance" analysis pursuant to MCL 208.53(b), only the business activity of Petitioner would be considered, and therefore, all of the cost of performance of such business activity occurred in Michigan, in which case, all the sales are Michigan sales.

Respondent further argues that the independent sales persons' actions are not attributable to Petitioner through an agency theory.

Assuming *arguendo* that a portion of Petitioner's business activity occurred outside Michigan, then it must be concluded that all of Petitioner's costs associated with that activity occurred within Michigan. For example, to the extent that Petitioner directed the activities of the sales persons, provides support or advice, or otherwise worked with the sales representatives in soliciting a sale, then Petitioner's "costs of performance" (Petitioner's direct costs associated with earning the override commission at issue) were all within Michigan. The costs incurred by the agents cannot be attributed to Petitioner. Petitioner performed none of its activity outside Michigan and none of Petitioner's costs of performance were outside Michigan.

Law and Analysis

Nexus

The first issue is whether Petitioner was "taxable both within and without this state" within the meaning of MCL 208.41. Under the Single Business Tax Act ("SBTA"), a taxpayer apportions its tax base only if it is subject to taxation both in Michigan and in another jurisdiction. If not taxable outside Michigan, then 100% of the tax base is allocated to Michigan, and the apportionment formula does not apply.

Petitioner does not claim to have nexus through its own employees outside Michigan, but rather through independent sales representatives only. "[Petitioner's] only out of Michigan involvement is the use of independent sales persons to market and sell financial products." [M. Walter's Affidavit #9]. Petitioner's Motion, p 2, paragraph 9.

The same standards that apply to determine whether an out-of-state taxpayer has nexus with Michigan apply to determine whether a taxpayer is "taxable in another state" under MCL 208.41. RAB 1998-1, II. Petitioner was "taxable" outside this state if it had "nexus" with another state. Nexus exists if a taxpayer "regularly and systematically conducts in-state business activity through its employees, agents, representatives, independent contractors, brokers or others acting on its behalf …." RAB 1998-1 I, 6. In this case, the sales representatives acted under contracts with the insurance companies to "solicit applications for products" on behalf of the insurance companies. The insurance companies had the power to accept or reject an application. For purposes of determining nexus in another state, Petitioner did not solicit applications for products outside Michigan. Petitioner owed a contractual duty to the insurance companies to recruit, train, manage, and supervise the sales representatives, and it received a fee ("override commission") for those services, not for solicitation of products. Petitioner's business activity occurred completely within Michigan.

Having so ruled, Petitioner's refund claim fails. Petitioner is not taxable in another state within the meaning of MCL 211.41. Petitioner did not establish nexus in any other state by virtue of the activities of the sales representatives, and therefore judgment for Respondent is required because Petitioner had no right to apportion its tax base.

Although not typical of the contracts, Sealed Exhibit 2 provides that Petitioner had the "rights and responsibilities" to "solicit applications for insurance policies…*through your agents* appointed with our approval." [Italics added]. However, Sealed Exhibit 2 also provides that the insurance company must approve each agent, and must enter into a separate contract with each

agent that Petitioner recruited and supervised. Although that contract states that Petitioner was authorized to solicit applications "through your agents appointed with our approval," this does not mean that Petitioner engaged in "business activity" (solicitation) in other states for nexus purposes. Sealed Exhibit 2 also provides that Petitioner's business activity was to recruit and supervise the sales agents, for which it earned an override commission. The agent's business activity was to solicit applications for products, for which it earned a sales commission. The contractual language of Sealed Exhibit 2 does not alter the overall description of Petitioner's duties and the nature of its contacts with other states. The relevant fact is that the agents solicited applications for insurance companies in other states under separate contracts with the insurance companies and Petitioner supervised that activity. The overall nature of Petitioner's contacts with the other states involved supervision of the agents, which occurred in Michigan. The Tribunal rules that these "contacts" did not create nexus.

The Agent Agreement (Joint Exhibit IV, P-1) plainly states that the sales representative (referred to as an "agent") is appointed as the insurance "Company's agent and authorized to solicit applications for Products in your Assigned Territory." Joint Exhibit IV, P-1, Section II – Authority, 1. (a). The authority to solicit applications for products was granted directly from the Company to the sales representative (Agent). Therefore, the sales representative's business activity that occurred outside Michigan (soliciting applications) is independent of Petitioner's business activity (recruitment, training, management, and supervision). Although Petitioner also had authority to solicit applications for products, it did not delegate that authority to the agents; the agents derived their authority directly from the insurance companies. Further, there is no dispute that Petitioner did not itself (through its own employees) solicit insurance products outside Michigan.

During oral argument, Petitioner stated that the authority to solicit applications for products "flows from the insurance company [that] has a contract with the wholesaler who has a contract with the sales agent and they are, collectively, marketing and selling insurance company products." T 16. However, the documentary evidence establishes that the authority to solicit applications for products was not granted from Petitioner to the agents. Rather, the insurance company entered a contract directly with the agents authorizing them to solicit applications.

Joint Exhibit III, P-2, authorizes Petitioner to recommend "licensed agents or General Agents to the Company for appointment and assignment to [Petitioner]." Under the agreement, the power to appoint or terminate an agent lies exclusively with the insurance company. In reading the contracts together, it is clear that in cases where an "agent" was appointed to solicit applications in other states, Petitioner did not solicit applications in those states. Although the contracts granted Petitioner authority to solicit in other states, they did not exercise that authority when an agent was appointed for that purpose. When an agent was appointed, Petitioner's duties were supervisory in nature. Notwithstanding verbiage in a few of the agreements that Petitioner had authority to solicit sales "through" agents, when read as a whole, the agreements do not establish a delegation of authority from the insurance company to Petitioner, and a sub-delegation of authority from Petitioner to the "agents." The contracts clearly delineate the respective "solicitation" activities of the agents and the recruitment, training, and supervisory activities of Petitioner.

Petitioner asserts that "The contract specified that USA Financial Marketing is responsible to solicit sales of the product. For that USA Financial Marketing will earn a gross commission, of

which part of that gross commission is paid to the independent agent." T 19. As discussed above, the contract authorizes Petitioner to solicit applications for products. However, that clause must be read in context. The contract specifies that "You are hereby appointed as the Company's Managing General Agent and authorized: To solicit applications for products." Joint Exhibit III, P-1. The contract also states that the Managing General Agent has authority to recommend agents to be appointed by the insurance company, and to "recruit, train, motivate, supervise, service and support Agents and General Agents assigned to you." Joint Exhibit III, P-2. When an agent was appointed, Petitioner's activity was supervisory. Petitioner performed a service for the insurance company by supervising the insurance company's sales agents, who solicited on behalf of the insurance companies. This is true under all the contracts reviewed for these motions.

Petitioner cites *Tyler Pipe Industries, Inc v Washington*, 483 US 232; 107 S Ct 2810; 97 L Ed 2d 199 (1987) and *Scripto Inc v Carson*, 362 US 207; 80 S Ct 619; 4 L Ed 2d 660 (1960), claiming that nexus was created through the actions of independent contractors who solicited sales on behalf of another. Both *Tyler Pipe* and *Scripto* involved an out-of-state seller of tangible personal property that made sales to customers in the taxing state by the solicitation activities of in-state representatives. Our present case involves a service firm, not a seller of tangible or intangible property. Stip 3. Furthermore, the sales persons ("agents") solicited applications for products offered by insurance companies, not Petitioner. The authorities cited do not support Petitioner's claim that nexus existed outside Michigan through the activities of the sales persons.

Respondent cites *Magnetek Controls, Inc v Dep't of Treasury*, 221 Mich App 400; 562 NW2d 219 (1997). In that case, the independent sales representatives solicited sales directly for the taxpayer, thus creating nexus for the taxpayer. The sales were Magnetek's sales. The court cited the well-established principle that nexus may be established by "the conduct of economic activities in the taxing State performed by the vendor's personnel or on its behalf." *Id.* 412. The economic activities were solicitation of sales *for the taxpayer* by the "independent sales representatives."

In our case, the sales agents solicited applications for the insurance companies, and did not solicit on behalf of Petitioner. This is not a case where Petitioner undertook to solicit sales outside Michigan through its own efforts, and carried out that duty by hiring independent sales representatives to solicit sales on its behalf. Petitioner recruited the agents who entered a contractual relationship directly with the insurance companies. This delineates separate business activities for the sales persons and Petitioner.

Under the various contracts, Petitioner's duties were to recruit, train, and supervise the agents and these services all occurred within Michigan. Petitioner has cited no case holding that nexus was created for a service firm under similar circumstances. The cases cited by Petitioner are not on point. Therefore, it is concluded that Petitioner is not taxable outside Michigan within the meaning of MCL 208.41 and may not apportion its tax base.

Business Activity

Based upon the above ruling that Petitioner lacked nexus with another state, the Tribunal need not decide whether the sales at issue would be Michigan sales for sales factor purposes. However, even assuming that Petitioner was "taxable" both within and outside Michigan so as to

be subject to the formulary apportionment provisions of the SBTA, all of its sales would be properly assigned to Michigan under MCL 208.53:

> 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.
> (c) Receipts derived from services performed for planning, design, or construction activities within this state shall be deemed Michigan receipts. MCL 208.53.

Petitioner argues that MCL 208.53(a) applies to the sales at issue because all the "business activity" of the *sales agents* was NOT "performed within this state" but rather the agents acted outside Michigan only. In Petitioner's view, subsection 53(b) does not apply because the sales representatives' activities were not performed both within Michigan and outside Michigan, so cost of performance is irrelevant, and the commissions are allocated 100% outside Michigan.

Petitioner has cited no statute, rule, or case law for the proposition that the business activity of a representative can be attributed to the taxpayer for purposes of apportionment under MCL 208.53. As described above, under the theory of "representational nexus" a state may assert taxing jurisdiction over a taxpayer based on activities of an independent contractor (or other representative) that conducts business activity in that state on behalf of that taxpayer; but, there is no analogous principle under which the "business activity" of the representative is deemed to be the taxpayer's "business activity" for purposes of applying the apportionment provisions relating to services under MCL 208.53.

The nexus cases cited by the parties involve the taxpayer's sales of tangible personal property by the sales efforts of sales persons. It is irrelevant whether the sales person is an employee, agent, or independent contractor who solicits sales for the taxpayer. Such contacts with the taxing state have been held to create nexus. In such cases, the taxpayer's sales factor numerator consists of sales arising from the sale of tangible personal property shipped or delivered to customers in the taxing state. MCL 208.52. The taxpayer is deemed to have conducted business activity in the taxing state by virtue of its sales of its products shipped to customers in the taxing state, not merely by virtue of the presence of the representative in the taxing state. The tax base is apportioned to that other state because the taxpayer avails itself of the economic benefits of that state and earns income from sales of tangible property shipped to that state. Our present case is distinguishable because Petitioner did not sell tangible personal property to customers in other states. Petitioner performed services within Michigan for the insurance companies. Therefore, even if Petitioner were to establish nexus outside Michigan by virtue of the activities of the sales agents under a representational nexus theory so as to be taxable in the other state under MCL 208.41, the relevant "sourcing" statutes dictate that *Petitioner's* business activity must be considered, not the business activity of the independent agents. MCL 208.53; MCL 208.7(1); MCL 208.51. "Sales" means ". . . the amount received by the taxpayer as consideration . . . for the performance of services, which constitute business activities. . . ." MCL 208.7(a)(ii). In our present case, the taxpayer's business activity is described by the contracts that it enters with insurance companies.

Petitioner's business activity was "supervision and training of such Agents and General Agents." Petitioner's Motion, page 4, paragraph 17. Petitioner cites language from Joint Exhibit III, page 3, which specifies that Petitioner assumes "full responsibility for the supervision and training of such Agents and General Agents, for their compliance with Company Advertising and Confidentiality of Information Guidelines, and, unless you and your Agents and General Agents are required by the Company to maintain liability insurance as provided in Section 11.2(n) of this Agreement, for any damages the Company may incur as the result of their misconduct." Petitioner owed a duty to the Company to supervise and train the sales agents.

An examination of the relevant contracts and stipulated facts indicates that the insurance company paid Petitioner for its recruitment, management, and supervision of the sales representatives, not for the "sales efforts performed by the independent sales persons." The "sale" at issue is the 3.2% override commission that Petitioner received as consideration for its services. Petitioner essentially argues that the solicitation activity was Petitioner's "business activity." As such, in cases where the solicitation activity related to a specific override commission occurred outside Michigan, that amount would not be a "Michigan sale" under MCL 208.53(a). However, Petitioner supervised, assisted, or supported the solicitation activities from its base in Ada, Michigan. The 3.2% override commission was consideration for these services, not for the actual solicitation by the agent, who received a separate 8% commission from the insurance company.

Petitioner acknowledged during oral argument that "The management and support of the solicitation activities of the agents…is compensated by these so-called override commissions." T 19. Although the override commission was calculated as a percentage of the business generated by the sales representatives, it was not consideration for out of state sales activity by the sales persons, but rather was consideration paid to Petitioner for its contractual services performed within this state for the insurance companies. Under this analysis, because no part of Petitioner's business activity occurred outside Michigan, MCL 208.53(a) applies, and the disputed amounts are Michigan sales. There is no sound rationale for apportioning Petitioner's tax base merely because the agents solicited sales outside Michigan for the insurance companies as part of their separate business activity. Therefore, assuming that Petitioner has the right to apportion, the amounts in dispute would be included in the numerator of the sales factor.

Petitioner's refund request is premised on its theory that the override commission is excluded from the sales factor numerator. The Tribunal concludes that each override commission at issue was consideration for Petitioner's business activity that was performed within this state. As such, assuming that the apportionment provisions apply to Petitioner, the override commission would be included in the sales factor numerator under MCL 211.53(a). Respondent properly denied Petitioner's refund request.

Analysis of Case Law

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 SBT 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 further states that Petitioner "allocated personal services that were performed outside Michigan to the state that the service was performed in." Petitioner calculated that 3.5% to 3.99% of its sales occurred outside Michigan.

The court held that each service (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" 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 211.53 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.[1]

Applying the reasoning in *Honigman* to our present case, it is concluded that the "sale" at issue here (the override commission) was consideration for Petitioner's services that it performed in this state within the meaning of MCL 208.53(a). It is not consistent with the statute to attribute the agents' solicitation activities to Petitioner for purposes of "sourcing" the override commission earned by Petitioner.

The Honigman attorneys were employees of the law firm. The firm was the taxpayer, not the individual attorneys. This is an important distinction between *Honigman* and the present case. In our case, the out-of-state sales activity is the business activity of the independent sales representatives and not Petitioner.

The court rejected the opposing 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 case of a service firm that never travels outside the borders of Michigan, all of its business activity is allocated to Michigan. In the case of a service firm that performs services both in Michigan and outside Michigan, the location where the services are performed must be analyzed. Specifically, the statute calls for an examination of the "costs of performance" of those services under MCL 208.53(b).

The probable intent of MCL 208.53 is to generally apportion sales from services to the taxpayer's home state, unless the taxpayer has a significant presence in another state or if the taxpayer's employees spend the greater proportion of their time on an annual basis performing services out of state, such that a majority of the direct costs related to the performance of the services can be fairly sourced to that other state. Under this interpretation, the amount of time

[1] Under this analysis, it appears that a taxpayer can avoid the "cost of performance" method by billing for services based on the location where the employee performed the service. Under such circumstances, there would never be business activity "performed both within and without this state" under MCL 208.53(b).

spent either within or outside Michigan is not the sole factor, but rather, the statute calls for an analysis of "costs of performance." In a case where an employee based in Michigan travels to another state and performs a service, the "greater portion" of the costs of performance of the entire contract could be associated with the Michigan office, especially if a majority of the hours worked occurred in Michigan. Under this view, sales from multistate services are to be attributed 100% to the home state, or 100% to the state where the services were performed, depending on where the majority of the costs of performance are sourced to. For example: an attorney performs "a service" and bills 20 hours. The attorney worked 18 hours at an office in Michigan preparing pleadings, motions, and briefs for a two-hour court proceeding in another state. The greater proportion of the costs of performance of the entire service (representing the client in a civil action) occurred in Michigan. Under this interpretation, the entire fee charged for that representation would be included in the sales factor numerator, notwithstanding that some of the work was performed in the other state. If all of the taxpayer's out-of-state work followed a similar pattern, its sales factor would be 100% (Michigan), notwithstanding that the service was performed partly in Michigan and partly outside Michigan. However, under the ruling in *Honigman*, if the fees are billed separately for time spent in court outside Michigan, thus constituting a separate "business activity," those fees are excluded from the sales factor numerator. Only the fees billed for services performed within Michigan are included in the numerator. In the aforementioned example, the taxpayer's sales factor would be 90% (per the "*Honigman* approach") rather than 100% under the opposing view.

The court rejected Treasury's view that "every 15-minute increment of service to a client must be tallied, and if the majority of those increments are properly credited to Michigan, the other increments must also be credited to Michigan pursuant to MCL 208.53(b)." The Court of Appeals found that the factual record was insufficient to find that "the income received by plaintiff for the out of state billings were in fact the product of work that was performed partially within this state and partially outside of it."

The court took guidance from the Multistate Tax Commission Model Uniform Regulation IV.17(4)(B)(c) (2004), under which services are sourced based upon single items of income. (The department of treasury generally follows the principle that the costs of performance analysis must be undertaken on a "transactional basis." See, Internal Policy Directive 2006-8, September 29, 2006 – Single Business Tax Sales Apportionment – Costs of Performance.") If a service contract provides for "service as needed, the income is generated and sourced both when and where the service is performed."

In *Honigman*, the court noted that, "Plaintiff does not enter into a formal contract for services with its clients." This influenced the court's determination that each individual billing represented a separate "business activity," such that it could be determined that time billed for a service performed outside Michigan fell outside the purview of MCL 208.53(b). The "business activity" (time billed outside Michigan) was not "performed both in Michigan and outside this state." Furthermore, the sales were not "Michigan sales" because the business activity was not "performed in this state" within the meaning of MCL 208.53(a).

In our case, even though Petitioner entered into a formal contract for services with the insurance companies, Petitioner did not earn fee for performance of the entire contract, but received override commissions which constituted a single item of income "on a transactional basis." *Honigman* supports the approach of examining each individual "override commission" received

by Petitioner as consideration for a separate business activity. The inquiry then focuses upon whether the taxpayer's business activity was "in this state" or "both in and outside this state."

The Tribunal holds that the override commissions were consideration for Petitioner's business activity of recruitment, supervision, training and otherwise assisting the sales agents. Petitioner's services were performed completely within Michigan. It strains the language and purpose of the statute to relate Petitioner's override commission to the business activity of the sales agents. The sales representatives were compensated by an 8% commission that is not at issue in this case. The independent sales representatives' activity was not Petitioner's business activity. Therefore, Petitioner's "business activity" was performed "in this state" under MCL 208.53(a).

If Petitioner's "business activity" is viewed as the totality of services performed under a contract with an insurance company, the result is the same because Petitioner performed all of its business activity under each contract physically within Michigan.

In *Honigman*, the services performed by Honigman's attorneys were in fact and in law the "business activity" of Honigman, and the sales at issue (amounts billed for out of state services) were Honigman's sales. The attorneys who performed the services were either partners or employees of the firm, Honigman, Miller, Schwartz and Cohn LLP. The independent sales agents in this case are not analogous to the attorneys in the *Honigman* case.

Assuming *arguendo* that Petitioner could be said to have solicited applications "through the sales agents" in other states (and hence participated in the business activity of solicitation in those states) it does not follow that the override commissions should be sourced to the other state. In such case, Petitioner's business activity would have occurred both in and outside Michigan by virtue of the "imputed" sales activities of the agents outside Michigan and by its own supervisory activity in Michigan. In such case, a cost of performance analysis would be required under MCL 208.53(b), which neither party advocates. Under such an analysis, it would not be appropriate to limit the inquiry to the location of the solicitation activity when it is clear that Petitioner also performed substantial business activity in Michigan in relation to the supervision of the solicitation activity. There is no conceivable factual development under which the Tribunal could conclude that Petitioner incurred a greater proportion of the costs of performance outside Michigan, where Petitioner performed its services while physically located in Michigan. Petitioner has offered no such analysis to that effect, and Petitioner does not contend that costs of performance applies to this case.

Both parties cite *Detroit Lions v Treasury*, 157 Mich App 207; 403 NW2d 812 (1986). Respondent has properly analyzed that case in its brief. The holding of *Detroit Lions* supports Respondent's position that the "business activity" of the taxpayer (Detroit Lions Football Club) took place in Michigan, notwithstanding that certain "post season revenues" arose from playoff games played outside Michigan by other teams. The sales at issue in that case were sourced to Michigan where the Lions performed business activity as a member of the National Football League and not where the other teams played the games that produced the revenue.

Petitioner has not cited a single appellate case from Michigan or any other state holding that an "insurance wholesaler" (or, Independent Marketing Organization) such as Petitioner has the right to apportion its tax base under similar facts, where all of Petitioner's payroll and property is located in Michigan and Petitioner's own employees or officers do not work outside Michigan.

Conclusion

The Tribunal concludes that Petitioner did not establish nexus with another taxing jurisdiction outside Michigan by virtue of the sales activities of the agents that solicited applications for products for insurance companies outside Michigan. Therefore, Petitioner's tax base is not subject to the formulary apportionment provisions of the SBTA, but is allocated to Michigan. MCL 208.41. Even if Petitioner could establish that it had nexus outside Michigan, the override commissions at issue are properly sourced to Michigan under MCL 208.53(a). Petitioner's refund claim was properly denied.

IT IS ORDERED that Petitioner's Motion for Summary Disposition is DENIED.

IT IS FURTHER ORDERED that Respondent's Motion for Summary Disposition is GRANTED.

IT IS FURTHER ORDERED that Respondent's Motion for Teleconference or Briefing to Clarify Contractual Provision Discussed at Hearing is DENIED.

This Proposed Order resolves all claims and this case shall be dismissed, subject to the provisions of MCL 24.281(1) and MCL 205.726.

Date Signed: November 4, 2009 By: Thomas A. Halick

Date Entered by Tribunal: November 4, 2009

This Proposed Opinion and Judgment ("Proposed Opinion") was prepared by the State Office of Administrative Hearings and Rules. The parties have 20 days from date of entry of this Proposed Opinion to notify the Tribunal in writing if they do not agree with the Proposed Opinion and why they do not agree (i.e., exceptions). After the expiration of the 20-day time period, the Tribunal will review the Proposed Opinion and consider the exceptions, if any, and:

a. Adopt the Proposed Opinion as a Final Decision.
b. Modify the Proposed Opinion and adopt it as a Final Decision.
c. Order a rehearing or take such other action as is necessary and appropriate.

The exceptions are limited to the evidence submitted prior to or at the hearing and any matter addressed in the Proposed Opinion. There is no fee for the filing of exceptions. A copy of a party's written exceptions must be sent to the opposing party.