

STATE OF MICHIGAN
COURT OF CLAIMS

EMERY ELECTRONICS INC v MICHIGAN DEP'T OF TREASURY

Case No. **16-000133-MT**

Hon. Michael J. Talbot

ORDER

At a session of said Court held,
Detroit, Wayne, Michigan, on
January 17, 2018.

Defendant having filed a motion for summary disposition pursuant to MCR 2.116(C) (10);

IT IS HEREBY ORDERED that Defendant's motion for summary disposition is GRANTED under MCR 2.116(C)(10).

IT IS FURTHER ORDERED that Plaintiff's January 9, 2018 motion for a status conference is DENIED as moot.

This is a final order that resolves the last pending claim and closes the case.



Michael J. Talbot, Judge



A true copy entered and certified by Jerome W. Zimmer Jr., Clerk, on

JAN 17 2018

Date



Clerk

STATE OF MICHIGAN
COURT OF CLAIMS

EMERY ELECTRONICS INC.,

Plaintiff,

v

Case No. 16-000133-MT

MICHIGAN DEPARTMENT OF TREASURY,

Hon. Michael J. Talbot

Defendant.

OPINION

This matter is before the Court on Defendant, Michigan Department of Treasury's ("Department"), motion for summary disposition pursuant to MCR 2.116(C)(10). In this suit, Plaintiff, Emery Electronics Inc. ("Emery"), challenges the Department's assessment of use tax under the Michigan Use Tax Act ("UTA"), MCL 205.91 *et seq.*, for the tax period November 1, 2012 through October 31, 2013 ("the tax year"). For the reasons stated below, the Department's motion is GRANTED.

I. FACTUAL BACKGROUND

The essential facts in this case are not in dispute. Emery¹ is a Michigan retailer of cellular telephone equipment and wireless service plans. During the tax year, Emery served as an authorized agent for service provider Verizon Wireless (Verizon) and received a fixed

¹ During the tax year at issue, Emery did business under the name of "Cellular Store and More."

commission for every new or extended wireless service plan agreement that Emery's customers entered into with Verizon.

Relevant here are cell phones and accessories that were purchased by Emery and given away at no charge when the customer also agreed to purchase one of Verizon's wireless service plans.² These cell phones and accessories were initially purchased by Emery tax-free using a "purchased for resale" certificate. Thus, no sales or use tax was collected or remitted on the initial purchase of the subject cell phones and accessories. The issue in this case is whether Emery subsequently made its own taxable "use" of the cell phones and accessories following its purchase of the items for resale.

A. EXCLUSIVE AUTHORIZED AGENCY AGREEMENT AND AMENDMENT

The transactions in this case occurred under an Exclusive Agent Agreement between Emery and Verizon (the "Agreement"), together with a subsequent amendment titled "Amendment No. 2 to the Authorized Agency Agreement" (the "Amendment"). At all times during the tax year, Emery acted as an agent for Verizon with respect to the sale of wireless service plans.

1. TERMS OF COMPENSATION

Under the Agreement and Amendment, Verizon compensated Emery in one of several ways, each involving a fixed commission. First, Emery was paid a set commission based on new wireless service activations. The amount of the activation commission depended upon the Verizon equipment category of the cell phones, as well as the length of the service plan. Second,

² Customers contracted for the cell phones services directly with Verizon.

a fixed “upgrade commission” was paid when an existing Verizon customer agreed to enter into new two-year service plan with Verizon. Emery provided the upgraded cell phone to the customer. The commission for the sale of the service plan was not in any way dependent upon the price charged (if any) by Emery for the phone provided to the customer. Third, in addition to receiving an upgrade commission, Emery was eligible to receive a “New Every Two” commission whereby Emery agreed to explain to the customer that it would receive a service plan credit on the customer’s next Verizon statement representing the amount the customer paid for the new phone.³ Fourth, Emery was entitled to a monthly volume bonus, based on the number of service plan activations that were made. Finally, under the Amendment, Emery agreed to promote activations and upgrades of service plans in connection with Apple iPhones and iPads. As under the provisions of the Agreement, Verizon agreed to pay a fixed commission based on new activations or extended service plans sold in association with Apple products provided by Emery. Where an existing Verizon customer merely made a cell phone purchase or upgrade that did not involve a new activation or extended service plan, Emery was not entitled to receive a commission from Verizon.

2. PURCHASE AND RESALE TERMS OF CELL PHONES AND ACCESSORIES

Under both the Agreement and Amendment, Emery was required to purchase cell phones and accessories for resale from Verizon or its affiliates. Of relevance here are the following contractual provisions from the Agreement:

³ It is unclear whether the cell phone received by the customer under this plan was sold at retail price by Emery. However, the record reflects that sales tax was always collected and remitted by Emery when it sold, rather than gave away, cell phones or accessories.

4.4 All [Verizon] Equipment sales and/or leases shall be made by or on behalf of [Emery] for its own account and not as agent for, or for the account of, [Verizon].

4.5 [EMERY] SHALL UNILATERALLY ESTABLISH ITS RETAIL SALES PRICES, ADVERTISED PRICES OR OTHER FEES FOR [VERIZON] EQUIPMENT IN ITS SOLE DISCRETION, AND [VERIZON] SHALL HAVE NO CONTROL OVER SUCH PRICES, CHARGES OR FEES.

Thus, Emery was solely responsible for its resale of phones and other equipment (including the setting of sales prices, subject to the maximum price allowed for Apple products), and dealt directly with customers on equipment pricing, leases, warranty services, and equipment maintenance. And though Emery was solely responsible for pricing, as a practical matter, cell phones and accessories were almost always given away for free when accompanied by a purchase of a Verizon service plan and were never given away for free if the customer did not agree to enter into or extend a service contract with Verizon.

The Agreement also included provisions relating to credit extended by Verizon to Emery for purchases of cell phones and accessories, and subsequent offsets for amounts Emery owed to Verizon for the purchases:

4.3 In the event [Emery] purchases [Verizon] Equipment from [Verizon] . . . [b]ased on [Emery]'s credit history, [Verizon] may require a standby letter of credit to secure [Emery]'s payment obligations. . . .

4.3.1 Security Interest. To secure the prompt payment and performance of all obligations of every kind or nature whatsoever of [Emery] to [Verizon] incurred as all or part of the price of the [Verizon] Equipment or for credit or value given to enable [Emery] to acquire rights in or use the [Verizon] Equipment, whether such obligations are now existing or hereafter incurred, . . . [Emery] hereby grants to [Verizon] a continuing first priority security interest in and lien upon the following property of [Emery]. . . : (a) all [Verizon] Equipment purchased from [Verizon]. . . , (b) all accounts (as defined in the UCC) arising from the sale of [Verizon] Purchased Equipment

* * *

9. OUTSTANDING DEBTS AND OFFSET, SET OFF, CHARGEBACK, RECOUPMENT OR DEDUCTION. At any time, . . . [Verizon] and its Affiliates may offset, set off, recoup against and/or deduct (collectively, the “Deductions”) from Compensation any amounts which [Emery] or its Affiliates is responsible, as well as any amount owed to [Verizon] by [Emery] arising out of or related to this Agreement or any of the obligations or rights contemplated by this Agreement or any other agreement between the parties, for any cause whatsoever, incurred under this Agreement, whether or not due and payable, including without limitation, amounts owed for [Verizon] Equipment purchases from [Verizon]

Cell phones and accessories were ordered by Emery directly from Verizon or its affiliates,⁴ and Verizon would issue an invoice representing a discounted or wholesale price. According to its president, Emery received the items on credit and did not pay for the items directly. Later, when the commissions for the service plans were paid, Verizon offset the total amount of the commissions by the amount Emery owed for its prior cell phone and accessory purchases.

II. PROCEDURAL HISTORY AND ARGUMENTS OF THE PARTIES

After an audit conducted by the Department, Emery was issued an assessment for use tax on the cell phones that it had purchased using a tax-exempt resale certificate, and subsequently gave away to customers for no consideration. According to the Department, Emery made taxable “use” of the cell phone and accessories when it gave them to customers gratuitously in order to promote the sale of Verizon service contracts.

⁴ A minor number of the cell phone accessories at issue were purchased from outside vendors. However, Emery’s president testified that all cell phones at issue were purchased by placing orders directly with Verizon or its affiliates.

Emery's first amended complaint alleged four counts against the Department.⁵ Under Counts I and III, Emery alleges that use tax does not apply because the cell phones and accessories were purchased for resale using a valid resale certificate. In addition, with respect to the cell phones and accessories purchased from Verizon or its affiliates, Emery's "purchase price" for the cell phones was zero because the cost was fully reimbursed by Verizon as part of Emery's commissions arising from the sale of Verizon service contracts. Therefore, the use tax base was zero, and no use tax is owed. In Count II, Emery alleges that its gratuitous distribution of cell phone accessories was incidental to the sale of the Verizon service contracts and, under Michigan case law, exempt from tax.

The Department's motion for summary disposition is based primarily on its assertion that although Emery purchased the property for resale on a tax-exempt basis, it subsequently made its own taxable use of the tangible personal property when it gave away the property as an incentive for customers to enter into service contracts with Verizon. The price Emery paid to Verizon or its suppliers is therefore subject to use tax. In addition, the Department argues that the cell phone accessories were not exempt as "incident to the sale of services" because customers purchased service plans from Verizon—not Emery. Additionally, even if the accessories had been purchased by customers along with wireless services provided by Emery, the "incidental to services" rule is inapplicable because cell phone services are themselves subject to use tax under MCL 205.93b.

⁵ Count IV, based on a statute of limitations claim, was summarily dismissed by this Court on April 17, 2017.

III. ANALYSIS

The issues in this case concerns Emery’s liability for use tax on cell phones and accessories it provided to customers for free, on the condition that they agreed to enter into wireless service contracts with Verizon. Resolution of these issues requires application of the UTA. The primary goal of statutory interpretation is to ascertain and give effect to legislative intent.⁶ “If the language of the statute is unambiguous, the Legislature is presumed to have intended the meaning expressed.”⁷ However, “[t]ax exemptions are disfavored, and the burden of proving an entitlement to an exemption is on the party claiming the right to the exemption.”⁸

Use tax is a complement to sales tax, and is designed to cover transactions where sales tax is not collected under the General Sales Tax Act, MCL 205.51, *et seq.*⁹ Michigan use tax is imposed “for the privilege of using, storing, or consuming tangible personal property in this state”¹⁰ A person¹¹ who uses, stores, or consumes tangible personal property in Michigan is required to remit 6% of the “price” of the tangible personal property.¹² The tax also applies to a person who “acquires tangible personal property . . . for any tax-exempt use who subsequently

⁶ *Casco Twp v Secretary of State*, 472 Mich 566, 571; 701 NW2d 102 (2005).

⁷ *G C Timmis & Co v Guardian Alarm Co*, 468 Mich 416, 420; 662 NW2d 710 (2003).

⁸ *Guardian Indus Corp v Dep’t of Treasury*, 243 Mich App 244, 249; 621 NW2d 450 (2001).

⁹ *Auto-Owners Ins Co v Dep’t of Treasury*, 313 Mich App 56, 69; 880 NW2d 337 (2015).

¹⁰ MCL 205.93(1).

¹¹ Under MCL 205.92(a), “person” includes a corporation like Emery.

¹² MCL 205.93(1).

converts the tangible personal property . . . to a taxable use, including an interim taxable use.”¹³
Tax-exempt use under the UTA includes “[p]roperty purchased for resale.”¹⁴

A. TAXABLE “USE” OF THE CELL PHONES AND ACCESSORIES

It is undisputed that Emery initially purchased the cell phones and accessories on a tax-exempt basis by presenting resale tax certificates, and Defendant has made no argument as to the validity of such certificates. Thus, the question that must be decided by the Court is whether Emery converted its initial exempt use of the cell phones under MCL 205.94(1)(c)(i) to a taxable “use” under MCL 205.93(1) when it gave the cell phones and accessories to its customers as an incentive to purchase Verizon service plans.

“Use” is defined under the UTA as “the exercise of a right or power over tangible personal property incident to the ownership of that property including transfer of the property in a transaction where possession is given.”¹⁵ Under the general law of property, rights incident to ownership are “usually understood to include ‘[t]he exclusive right of possessing, enjoying, and disposing of a thing.’ ”¹⁶ In addition, a key feature in determining whether a party exercised a

¹³ *Id.*

¹⁴ MCL 205.94(1)(c)(i).

¹⁵ MCL 205.92(b). The statutory definition further provides: “Converting tangible personal property acquired for a use exempt from the tax levied under this act to a use not exempt from tax levied under this act is a taxable use.” *Id.*

¹⁶ *Adams v Cleveland-Cliffs Iron Co*, 237 Mich App 51, 57; 602 NW2d 215 (1999) (alteration in original), quoting Black’s Law Dictionary (6th ed), p 1216.

right or power over tangible personal property is whether the party had some level of control over that property.¹⁷

Here, the record is replete with evidence that Emery had control over, and exercised a right or power incident to ownership, of the cell phones and accessories. Looking first to the language of the parties' Agreement, the Court should note that "[w]hen the terms of a contract are unambiguous, their construction is for this Court to determine as a matter of law."¹⁸ When interpreting a contract, the examining court must ascertain the intent of the parties by evaluating the language of the contract in accordance with its plain and ordinary meaning.¹⁹ If the language of the contract is clear and unambiguous, it must be enforced as written.²⁰

Under the unambiguous terms of the Agreement, Emery had sole discretion as to whether, and for how much, it would sell the cell phones and accessories for consideration, as opposed to giving them away free of charge. After Emery purchased the products at wholesale from Verizon or one of its affiliates, Emery could have, but did not, charge its customers for the subject cell phones and accessories. Rather, it exercised its right, incident to its ownership of the cell phones, to dispose of the property gratuitously. Emery's president readily admitted that had the phones not been given away for free, no Verizon service plans would have been sold. Without "using" the cell phones by giving them away, Emery would have received no

¹⁷ See *WPGPI, Inc v Dep't of Treasury*, 240 Mich App 414, 417-419; 612 NW2d 432 (2000) (noting that the plaintiff did not "use" the airplanes under the meaning of the term in the UTA because the plaintiff did not have control over them).

¹⁸ *Hubbell, Roth & Clark, Inc v Jay Dee Contractors, Inc*, 249 Mich App 288, 291; 642 NW2d 700 (2002).

¹⁹ *In re Smith Trust*, 480 Mich 19, 24; 745 NW2d 754 (2008).

²⁰ *Id.*

commissions from Verizon. That the cell phones and accessories were “used” to sell service plans is bolstered by the fact that at no time was a cell phone ever given away for free without the customer executing the a service plan. Clearly the cell phones served a promotional purpose of convincing customers to buy service plans for which Emery received commission. Such a promotional use of inventory, despite its initial purchase for resale, is subject to use tax.²¹

B. “PURCHASE PRICE” AND REIMBURSEMENT OF COSTS OF CELL PHONES

Having found that Emery made taxable use of the cell phones and accessories in question, the Court must now consider the appropriate tax base for those items. Emery argues that because Verizon reimbursed it for the cell phones and accessories,²² the “purchase price,” and thus the use tax base, is zero.

“Purchase price” under the UTA is defined, in pertinent part, as “the total amount of consideration paid *by the consumer* to the seller, *including* cash, *credit*, property, and services, for which tangible personal property or services are sold, leased, or rented, valued in money,

²¹ See *Brunswick Bowling & Billiards Corp v Dep’t of Treasury*, 267 Mich App 682, 685; 706 NW2d 30 (2005) (“[U]se of inventory for promotional purposes in Michigan is subject to the use tax.”). This conclusion, in the context of this case, comports with the Department’s longstanding position that tangible property purchased for resale and later given away, are subject to use tax. In 1961, the Department promulgated Rule 62 of the Michigan Administrative Code, which states: “If goods purchased for resale are subsequently given away or used by the retailer, he must include in his use tax return the cost of such goods and pay the tax thereon.” Mich Admin Code R 205.112(2). The Court recognizes that such administrative rules are not binding upon it, *Guardian Indus Corp*, 243 Mich App at 254, and cites the above rule as persuasive authority only.

²² This argument presumably applies only to the cell phones and accessories purchased from and reimbursed by Verizon and its affiliates, and not to cell phone accessories purchased from other non-Verizon suppliers.

whether received in money or otherwise, and applies to the measure subject to use tax.”²³

“Consumer” is defined as “the person who has purchased tangible personal property or services for . . . use . . . in this state”²⁴

A plain reading of the Agreement between Emery and Verizon reveals that commissions paid to Emery were based solely on the sale of service contracts and did not represent reimbursement for the purchase of cell phones or accessories. Moreover, rather than Verizon reimbursing Emery for the costs of these products through “offsets” or credits when the commissions were paid, Emery ultimately reimbursed Verizon for amounts it contractually owed for the costs of the cell phones by allowing those amounts to be deducted from its commission revenue. Such credits clearly made up the “purchase price” as defined under MCL 205.92(f). As the consumer of the tangible personal property that purchased the cell phones and accessories, Emery is subject to use tax on the amount it paid, including amounts extended as credit.²⁵

In conclusion, under the clear and unambiguous provisions of the Agreement, Emery was compensated by a commission for the sale of Verizon service plans, and such commission did not represent reimbursement for cell phones and accessories purchased from Verizon or its affiliates. Emery’s “purchase price,” and therefore its use tax base, was the amount reflected in the invoices issued when the cell phones and accessories were initially ordered by Emery.

²³ MCL 205.92(f) (emphasis added).

²⁴ MCL 205.92(g).

²⁵ MCL 205.92(f); MCL 205.93(1).

C. PURCHASE OF CELL PHONE ACCESSORIES AS INCIDENTAL TO SALE OF SERVICES

Finally, the Court rejects Emery's nonsensical argument that under the test articulated by the Supreme Court in *Catalina Mktg Sales Corp v Dep't of Treasury*,²⁶ use tax does not apply to cell phones and accessories that were provided incidental to services. In *Catalina*, the Court adopted the "incidental to service" test for determining how to categorize a transaction involving both the provision of non-taxable services and the transfer of taxable tangible personal property.²⁷ Here, the wireless services are subject to use tax under the UTA²⁸ in any event, and there is no purchase price paid by the respective customers for the phones and accessories. In addition, as argued by the Department, Emery itself does not sell wireless services. In short, *Catalina* does not apply to the facts of this case.

IV. CONCLUSION

Emery did not pay sales tax when it acquired the cell phones and accessories because it presented a certificate for resale to Verizon and its affiliates. However, it did not ultimately resell the property in question, so no sales tax was collected or remitted. Use tax, serving as a complement to the sales tax that was not paid,²⁹ thus applies to the cell phones and accessories purchased by Emery and given away gratuitously to its customers. Within the meaning of the UTA, Emery "used" the property to incentivize customers to purchase service plans for which it

²⁶ *Catalina Mktg Sales Corp v Dep't of Treasury*, 470 Mich 13; 678 NW2d 619 (2004).

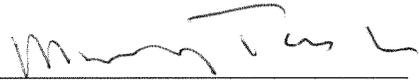
²⁷ *Id.* at 24.

²⁸ See MCL 205.93b.

²⁹ *Auto-Owners Ins Co*, 313 Mich App at 69.

received fixed commissions. Such use constitutes a taxable use for which use tax is owed. Accordingly, the Department is entitled to summary disposition in this case as a matter of law.

Dated: January 17, 2018



Michael J. Talbot, Judge