**S T A T E  O F  M I C H I G A N**

**C O U R T  O F  A P P E A L S**

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| CATALINA MARKETING SALES CORPORATION,<br><br>Petitioner-Appellant,<br><br>v<br><br>DEPARTMENT OF TREASURY,<br><br>Respondent-Appellee. | UNPUBLISHED<br>March 5, 2002<br><br><br><br>No. 221811<br>Tax Tribunal<br>LC No. 00-231397 |
| CATALINA MARKETING CORPORATION,<br><br>Petitioner-Appellant,<br><br>v<br><br>DEPARTMENT OF TREASURY,<br><br>Respondent-Appellee. | No. 221890<br>Tax Tribunal<br>LC No. 00-231398 |

Before: Fitzgerald, P.J., and Hoekstra and Markey, JJ.

PER CURIAM.

In these consolidated appeals, petitioners Catalina Marketing Sales Corporation (CMSC) and Catalina Marketing Corporation (CMC) appeal as of right from the final order of the Michigan Tax Tribunal (the Tax Tribunal) denying petitioners' motion for summary disposition and granting respondent Department of Treasury's (the department) motion for summary disposition.[1] Petitioners challenge the tribunal's conclusion that respondent properly characterized petitioners' business activities as subject to sales tax. We affirm.

I. Facts

[1] Petitioners' actions were also consolidated before the tribunal.

The parties presented this matter to the Tax Tribunal on stipulated facts, with multiple exhibits, and petitioners also presented the affidavits of two individuals. The stipulated facts reveal the following. CMSC is a wholly owned subsidiary of CMC, and both are Delaware corporations. During the period at issue,[2] these corporations performed business activities in Michigan and in twenty-eight to forty-one other states. At that time, CMC and CMSC (collectively, petitioners) contracted with product manufacturers interested in promoting particular products. Petitioners entered into standard integrated performance agreements with manufacturers to allow them to participate in petitioners' Checkout Coupon™ program. Those agreements[3]

> identified and categorized the product for which coupons would be prepared; the markets in which the coupon would be issued; the periods during which the program would be in effect; the base fee for participation in the program; and the payment rate for each coupon issued. Typically, differential rates were charged for issued coupons, depending upon the nature of the coupon. As an example, a rate of $.06 may have been charged for each coupon issued upon the purchase by a consumer or a competitor's similar product; a rate of $.05 per coupon for a coupon issued to promote a different product manufactured by the manufacturer of a product purchased by a consumer (e.g., a coupon for Company X's refried beans may issue upon the purchase of Company X's salsa); and a rate of $.035 per coupon to promote the same product purchased by a consumer.

During the same period, CMC also entered into "Checkout Coupon™ Distribution Agreements" with retailers who wished to use the Checkout Coupon™ system in their retail outlets to distribute coupons designated for distribution by CMC and the manufacturer and other coupons and promotional materials for other products for its own benefit "provided such coupons do not conflict with category exclusivity of programs established by Catalina with its manufacturer clients." According to these agreements,[4]

> CMC typically remunerated the retailer for its distribution of the coupons by paying it a flat fee (such as $0.005) for each coupon or manufacturer incentive printed, as well as an additional sum (e.g., $0.0025) for each coupon printed in excess of 50% of the retailer's customer counts. CMC also had the ability to charge (although it may not actually have charged) the retailer a fee of $0.035 per coupon for those coupons or promotions printed by the retailer for its private label or in other noncompetitive situations.

Computer hubs in Florida and California furnished each PC at the customer's individual sites with current programming that instructed the printer in each supermarket checkout lane to print a paper tape of either a money-off coupon or a message to the consumer. When someone scanned products at the checkout lanes, the computer hubs provided information to the computer in the store, causing the checkout lane printer to print on the paper tape specified information for

[2] The combined period from January 1, 1991 through June 30, 1993.

[3] Two exemplars of the standard agreements were attached to the stipulated facts as exhibits.

[4] A standard distribution agreement was attached to the stipulated facts as an exhibit.

the supermarket's customers. For each supermarket participating in this program, CMSC remitted to CMC a flat fee per calendar quarter and $0.015 for each coupon or message printed during the quarter.

As remuneration for their activities, CMC and CMSC required the manufacturer, pursuant to certain performance agreements, to remit the greater of the base program fee identified in the agreement or a sum determined by reference to the coupon rate not to exceed ten percent of the base amount chargeable in the cycle absent the written approval of the manufacturer, or to remit a program fee equal to the higher of the base program fee or per coupon rate identified in the agreement. During the audit period, either CMC or CMSC entered into each performance agreement, but the activity of entering into contracts with manufacturers shifted from CMC to CMSC during early 1992.

The parties further agreed that if the Tax Tribunal were to determine that petitioners are liable for sales tax, only CMC or CMSC, not both, is obligated to pay the tax attributable to any given portion of the audit period. The department recognized that it may not lawfully collect the same tax from both petitioners with respect to the same transaction for the same period.

For the period from January 1, 1991 through June 30, 1993, the department conducted a sales and use tax audit of CMC. Consistent with its position that its activities in Michigan during that period exclusively consisted of the provision of nontaxable services, CMC remitted a check for $38,002 (plus interest) to the department in full payment of its Michigan use tax liability for the period of January 1, 1991 through March 31, 1992. The department admitted that CMC paid the entirety of the use tax, penalty, and interest for that period and the department negotiated the check.

Petitioners requested an informal conference before a department hearing referee, and after the conference, the hearing referee recommended that Bills for Taxes Due (Intents to Assess) G902765, issued to CMSC, and G902721, issued to CMC, be canceled because the activities under consideration in this case constitute the provision of services, not the provision of tangible personal property. However, the department's revenue commissioner disagreed with the recommendation and issued a "Statement of Rebuttal."

In issuing the December 1, 1995 Bill for Taxes Due (Final Assessment) G902765, the department asserted that CMSC is liable for payment of additional Michigan sales tax for the period from January 1, 1992 through June 30, 1993, in the amount of $263,079.00,[5] plus interest computed to December 1, 1995, in the amount of $61,622.83, totaling alleged sales tax liability of $324,701.83. In issuing the December 1, 1995 Bill for Taxes Due (Final Assessment) G902721, the department asserted that CMC is liable for payment of additional Michigan sales tax for the period from January 1, 1991 through March 31, 1992, in the amount of $44,092.00,

[5] Although the stipulation of facts stated a slightly different number here, this correct number is listed on the final bill for taxes due, and adding this amount to the interest amount results in the total alleged sales tax liability.

plus interest computed to December 1, 1995, in the amount of $15,072.23, totaling alleged sales tax liability of $59,164.23.[6]

On January 5, 1996, petitioners filed similar, individual petitions contesting their use and sales tax assessment. The Tax Tribunal consolidated the cases. Both petitioners and respondent moved for summary disposition pursuant to MCR 2.116(C)(10).[7] On August 9, 1999, in a thirty-six page decision, the Tax Tribunal denied petitioners' motion and granted the department's motion. Petitioners appeal this decision.

## II. Standard of Review

Although generally we review a trial court's grant of summary disposition de novo, *Spiek v Dep't of Transportation*, 456 Mich 331, 337; 572 NW2d 201 (1998), review of Tax Tribunal decisions is limited:

> This Court's authority to review a decision of the Tax Tribunal is very limited. In the absence of an allegation of fraud, this Court's review of a Tax Tribunal decision is limited to determining whether the tribunal committed an error of law or adopted a wrong legal principle. The tribunal's factual findings will not be disturbed as long as they are supported by competent, material, and substantial evidence on the whole record. [*Michigan Milk Producers Ass'n v Dep't of Treasury*, 242 Mich App 486, 490-491; 618 NW2d 917 (2000) (citations omitted); see also Const 1963, art 6, § 28; *Michigan Bell Telephone Co v Dep't of Treasury*, 445 Mich 470, 476; 518 NW2d 808 (1994).]

Further, "[f]ailure to base a decision on competent, material, and substantial evidence constitutes an error of law requiring reversal." *Meijer, Inc v City of Midland*, 240 Mich App 1, 5; 610 NW2d 242 (2000). Moreover, "[t]his Court will generally defer to the Tax Tribunal's interpretation of a statute that it is charged with administering and enforcing." *Michigan Milk Producers Ass'n*, *supra* at 491.

## III. Central Arguments

Petitioners first argue that the Tax Tribunal erred in determining that their activities in Michigan during the audited period constituted sales of tangible personal property at retail subject to Michigan sales tax. According to petitioners, the Tax Tribunal "misapplied legal principles governing the distinction between the taxable sale of tangible personal property and the provision of nontaxable service to the facts before it, and its findings were unsupported by competent, material and substantial evidence on the whole record." In essence, petitioners argue that their sale of coupons to manufacturers is merely incidental to their nontaxable marketing services and therefore their activities should be not be assessed sales tax. Petitioners begin their

[6] Although the stipulation of facts stated a slightly different number here, this correct number is listed on the final bill for taxes due and results from adding together the two previous numbers.

[7] Despite the department's cite to MCR 2.116(A) and (B), the tax tribunal concluded that, for all practical purposes, the department bases its motion for summary disposition on MCR 2.116(C)(10).

analysis by noting the formulations that the Tax Tribunal and courts have used prior to the adoption of the "real object test" and finish their analysis by concluding that the Tax Tribunal's failure to apply these principles was legal error requiring reversal. According to petitioners, the prior formulations stood for the principle "that an otherwise exempt service transaction that also happens to involve an incidental transfer of tangible personal property is not subject to sales tax" (emphasis omitted) and, applying this test, the creation of slips of paper in the form of coupons and/or product messages are simply incidental by-products. Petitioners claim that they use their marketing and product selection expertise to provide highly customized marketing services to their clients and that the slips of paper produced are merely incidental to these services. Petitioners explain that the manufactures pay for their sophisticated marketing services "to enable them to efficiently and effectively target potential customers and motivate them to acquire the manufacturers' products upon a future store visit" and that the slip of paper "is merely the medium through which the manufacturer obtains this desired outcome."

Not only do petitioners argue that the Tax Tribunal committed legal error here by failing to accord any consideration to the "pre 'real object'" principles, they further argue that the Tax Tribunal "misapplied the 'real object' analysis to the facts at issue and wrongfully ignored the substantial, competent and material evidence it had before it." Petitioners claim that an accurate application of the "real object" test demonstrates that petitioners provide services. According to petitioners, the manufacturers' intent when contracting with them is to obtain services, as discerned from the contractual language, the nature of what petitioners' activities are meant to accomplish for them, and the actual mechanics of petitioners' relationship with the manufacturers. At most, the coupon is an inconsequential medium with which to transmit information to specifically-targeted customer groups. Petitioners state that the intrinsic value of the arrangement lies in the services that petitioners and the manufacturers have strategically designed using the enhanced marketing skills that petitioners have developed over time. In sum, petitioners claim that they provide targeted marketing services, not retail sales.

Contrary to petitioners' assertions, the department contends that the Tax Tribunal's final decision is consistent with the "real object" test. According to the department, the contracts are for the creation and distribution of paper coupons for customers to use to buy the manufacturer's products at a discount and, without distribution of the coupons, the manufacturer's purpose of stimulating future purchases of its product by offering discounts is not accomplished. The department states that from the manufacturer's prospective, the real object of the transaction is to get the coupons into the hands of shoppers at checkout. The department claims that the alleged services could not be provided to consumers through some other medium, such as by verbal delivery, without breach of contract. With regard to petitioners' reliance on cases involving the "pre 'real object'" test formulations, the department responds that those cases are not on point and are clearly distinguishable, especially where the contracts here demonstrate that petitioners are engaged in the distribution of coupons. According to the department, "[t]he analysis, the reports, and service enhanced the value of coupons in the eyes of the manufacturers, not the other way around," and thus the service aspect of petitioners' activities is incorporated into, and incidental to, the distribution of coupons. The department concludes that the Tax Tribunal's decision was proper.

## IV. Analysis of Central Arguments

While some activities clearly constitute sales and others clearly constitute services, "mixed" transactions of both sales and services pose difficulty in determining how the activity is to be taxed. Struggling with that issue, the Tax Tribunal, in *Shelby Graphics, Inc v Michigan Dep't of Treasury*, 5 MTTR 63 (Docket No. 83611, October 7, 1986), concluded that, "[i]n attempting to affix the character of a transaction as a sale or service, the standard best aligned to Michigan's statutory sales tax framework appears to be the 'real object' test …." *Shelby*, *supra* at 70. Years later, the department issued Revenue Administrative Bulletin (RAB) 95-1, establishing the "real object test" guidelines that the Department of Treasury adopted to differentiate between the sale of a service and the sale of tangible personal property.

In the present case, petitioners do not challenge the department's ability to issue a RAB[8] or to adopt the "real object test" guidelines. Nor do they argue that the test is inconsistent with the General Sales Tax Act (STA), MCL 205.51 *et seq*.[9] Rather, they suggest that the Tax Tribunal failed to take into consideration all of the formulations other than the real object test. We see no need to focus on the "pre 'real object'" test, as petitioners desire, because the real object test is clearly more aligned with the circumstances in this case. Under the real object test, the trier of fact must "discern whether, from the perspective of the purchaser, the purpose of the transaction lies in the transfer of an end product or in the acquisition of services." *Shelby*, *supra* at 69; see also *Speaker-Hines & Thomas, Inc v Michigan Dep't of Treasury*, 9 MTTR 129, 141 (Docket No. 88326, October 9, 1991), affirmed 207 Mich App 84; 523 NW2d 826 (1994). The statement of the test in RAB 95-1 provides, "From the perspective of an impartial third party, what is the purchaser seeking? A tangible end product produced by a service, or merely the service itself?" Here, the Tax Tribunal indicated that "**the linchpin issue** requiring review and resolution is whether, *from the perspective of the manufacturer-clients*, the 'real object' sought by them from the business activities of CMC and CMSC during the audit period involved the purchase, for distribution to retail consumer, of tangible coupons pursuant to contracts between [p]etitioners and the manufacturers, or whether the real object sought by the manufacturers consisted of the receipt of nontaxable computer and informational services from [p]etitioners." [Emphasis in original.] We find no error of law in the Tax Tribunal's use of the real object test or in its conclusion derived from its use of that test.

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[8] The administrative head of the revenue division of the state department of treasury, that being the state commissioner of revenue, MCL 205.2, shall have "the power and authority incidental to the performance of the following acts, duties, and services":

> (f) The department may periodically issue bulletins that index and explain current department interpretations of current state tax laws. [MCL 205.3(f).]

[9] The STA levies a tax on "all persons engaged in the business of making sales at retail . . . ." MCL 205.52(1). The STA defines a "sale at retail" as

> a transaction by which *the ownership of tangible personal property* is transferred for consideration, if the transfer is made in the ordinary course of the transferor's business and is made to the transferee for consumption or use, or for any purpose other than for resale, or for lease . . . . [MCL 205.51(b) (emphasis supplied).]

The circumstances in the present case are similar to those in *Shelby, supra*. There, the petitioner was engaged in the business of advertising, including designing and furnishing for its clients advertising products such as signs, banners, point of purchase displays, and trade show items as well as planning and creating advertising and artistic services. *Id.* at 65-67. The petitioner challenged the department's final assessment of sales tax. *Id.* at 65. As the *Shelby* decision indicates, "[t]he paramount question proposed by this case focuses upon the penumbral dichotomy between sales and services: in providing [a supermarket] with signs, banners, displays and other advertising related materials, did Shelby predominantly engage in the provision of creative services in relation to which transfers of tangible personal property were inconsequential, or did Shelby make taxable sales at retail which necessarily incorporated certain services?" *Id.* at 67. After surveying the standard established in other jurisdictions in similar cases, *Shelby* adopted the real object test, noting that that test, "in requiring that consideration be given to the intent of the purchaser in acquiring an item (the salient question being whether the purchaser is seeking to obtain the services of the seller or is contracting for a tangible end product), appropriately focuses upon the point at which an ultimate consumer comes into play." *Id.* at 70. In applying the real object test, *Shelby* determined that the supermarket's real object in contracting with Shelby was to obtain a tangible end product for its use. *Id.* at 70-71.

Here, like in *Shelby*, both services and tangible personal property are components of petitioners' business. We admit that the situation here is complex and subject to different interpretations. Although petitioners persuasively argue their position that the coupon/advertisement issued is merely an inconsequential medium with which to transmit information to specifically-targeted customer groups and that it is incidental to the services that they provide to their manufacturer clients, competent, material and substantial evidence supports the Tax Tribunal's determination that

> in this "mixed" service/sales transaction, the objective evidence shows the "customized" Checkout Coupons and advertising messages, which are printed at supermarket checkout lanes for distribution to *targeted* retail consumers, to be the "real object" of the manufacturers' contracts with [p]etitioners. It is the end product, the tangible personal property, which promotes a manufacturer's product(s) and which attempts, through discount offers and advertising messages, to convince consumers to purchase its product(s) in the future. Without question, highly skilled, detailed and creative services undoubtedly went, and continue to go, into the final product—the targeted coupons and advertising messages distributed to retail consumers. However, it is the tangible end product of those efforts which manufacturers ultimately seek. [MTT Docket Nos. 231398 and 231397, August 9, 1999 decision, p 30-31 (emphasis in original).]

The contractual language, the focus on coupons, and the fact that the manufacturer only obtains an increased redemption rate if the coupons are issued and used is competent, material and substantial evidence sufficient to support the Tax Tribunal's determination that the manufacturer's intent in contracting with petitioners is to use petitioners information and expertise to target certain customers and provide them with a coupon or advertisement for the manufacturer's product(s), and thus the manufacturer's intent is to obtain a tangible end product. Although this Court may have reached a different conclusion, we cannot say that the Tax

Tribunal committed legal error in concluding that petitioners' activities were subject to sales tax or that the decision is not supported by competent, material and substantial evidence.

## V. Secondary Arguments & Analysis

Petitioners also argue that the Tax Tribunal erred in failing to find that the department exceeded its administrative authority under the Revenue Act, MCL 205.1 *et seq.*, in issuing multiple, inconsistent alternate sales and use tax assessments to petitioners. We find this argument without merit.[10] As the department argued to the Tax Tribunal and to this Court on appeal, and with which we agree, "there has been no persuasive showing, statutory or otherwise, of authority precluding the [d]epartment from *auditing* the taxpayer for both taxes" when the taxpayer and the department have differing views on which theory applies. [Emphasis supplied.] MCL 205.20 provides that "[u]nless otherwise provided by specific authority in a taxing statute administered by the department, all taxes shall be subject to the procedures of administration, audit, assessment, interest, penalty, and appeal…." When it is questionable whether taxation under the STA, MCL 205.51 *et seq.* or the Use Tax Act, MCL 205.91 *et seq.*, is appropriate, we see no legislative limitation of, nor the legislative intent to limit, the department's ability to audit under only one theory of taxation. We note that there was no dispute that tax was owed under only one of the two theories, and thus petitioners would not be exposed to double taxation.

Petitioners next argue that because they paid the use tax in full and the department accepted the payment, their tax liability is satisfied. In other words, petitioners suggest that the department's acceptance of their use tax payment was an admission that the use tax amount represented their sole tax liability. In effect, petitioners claim that a taxpayer may pay the smaller amount due under two separate theories of tax liability to shield itself from further tax liability. We disagree. The fact that sales tax and use tax are complementary in nature, *Elias Brothers Restaurants, Inc v Treasury Dep't*, 452 Mich 144, 153; 549 NW2d 837 (1996), in no way precludes the department, in these circumstances where the record reveals that petitioners knew that the department's position was that petitioners' activities were subject to sales tax, from seeking to collect sales tax on activities that the taxpayers, petitioners, deem subject only to use tax.[11]

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[10] We found no use tax *assessment* in the record before us, and apparently the tax tribunal was aware of no final assessment for use tax.

[11] See MCL 205.22(1) ("A taxpayer aggrieved by an assessment, decision, or order of the department may appeal the contested portion of the assessment, decision, or order to the tax tribunal within 35 days, or to the court of claims within 90 days after the assessment, decision, or order. The uncontested portion of an assessment, order, or decision shall be paid as a prerequisite to appeal.") We note that the department credited the amount that petitioners paid toward their sales tax liability. We further note that the tax tribunal ordered that "an industrial processing exemption, which the [d]epartment has agreed is proper to be allowed to [p]etitioner(s), shall forthwith be calculated" and that the department shall issue a revised Bill of Taxes Due. [Emphasis omitted.]

Affirmed.

/s/ E. Thomas Fitzgerald
/s/ Joel P. Hoekstra
/s/ Jane E. Markey