STATE OF MICHIGAN

COURT OF APPEALS

HI-TECH HOUSING, INC,

Petitioner-Appellant,

v

DEPARTMENT OF TREASURY,

Respondent-Appellee.

UNPUBLISHED
September 14, 2001

No. 220543
Michigan Tax Tribunal
LC No. 00-241717

Before: Neff, P.J., and Sawyer and Fitzgerald, JJ.

PER CURIAM.

Petitioner, Hi-Tech Housing, Inc., (Hi-Tech) appealed a final assessment of use tax by respondent, Department of Treasury (Revenue Division), to the Michigan Tax Tribunal. Following a hearing, the Tax Tribunal issued an opinion and judgment affirming the use tax assessment. Petitioner appeals the judgment of the Tax Tribunal as of right. We affirm.

The basic facts are undisputed, and Hi-Tech has indicated in its brief on appeal that it accepts the statement of facts set forth in the Tax Tribunal's findings of fact. These facts are as follows:

A

> Petitioner is an Indiana based manufacturer of mobile and modular homes; its corporate offices and only manufacturing plant are located in Bristol, Indiana near the Michigan/Indiana border. A mobile home is manufactured on a steel frame with axles and wheels, has a certificate of title, and is built to a HUD code. A modular home consists of modules (sections) of a custom home built to the BOCA or local building code to be erected (setup) by a builder on a site. The setup requires the usual skilled trades (i.e., carpenter, plumber, electrician, roofer, and dry waller) necessary to construct a stick-built home. Petitioner sells modular housing units only to licensed builders; the modules represent some 40% - 50% of a completed house with the foundation, garage, and other components built on site.
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> In 1993, approximately 80% - 85% of petitioner's production consisted of mobile homes being supplied to a HUD retirement project (Saddlebrook Farms) in Illinois being developed by the owner of petitioner. The balance of petitioner's

1993 production consisted of modular homes. By 1996, 65% - 70% of petitioner's production consisted of mobile homes, the balance consisting of modular homes. A very high percentage of its modular home production is sold to Michigan builders. In the audit period, petitioner sold 64 modular homes to some 34 Michigan builders; gross receipts from such sales totaled $3,202,398.00. The builders, petitioner's customers, are independent dealers free to purchase and erect other manufacturer's homes.

Petitioner markets modular homes to Michigan builders through trade shows in Indiana, advertising and feature articles in trade magazines and word of mouth. Michigan builders are provided a package of materials including illustrations of its modular home designs, floor plans and available options and colors. Modular units are built and sold pursuant to individual sales orders (contracts) signed by the purchasing builder. The sale order specifies the modular home model and details, including floor plan, sidewalls, shell, roof, plumbing, electrical, interior and exterior finish, kitchen and baths, floor covering and appliances. Upon placing the order, the builder pays a deposit, usually 10% of the purchase price, with the balance payable upon delivery. Modular housing units are shipped FOB factory to Michigan on carriers (frames with axles and wheels) owned by petitioner and hauled by a transporter engaged by petitioner or by the purchasing builder. The transporter upon delivery of the unit in Michigan collects the balance due on a sales order. If the unit is picked up by the builder at the factory, the builder pays the balance due at the time of pick-up.

A builder is charged a $300 deposit for each carrier used to transport a modular home to the building site. Typically, the builder's crew uses two to four carriers to transport a modular home to a construction site in Michigan for setup. A carrier remains in Michigan until the unit is removed from the carrier and setup; it is then returned to petitioner's Indiana factory and the deposit returned. The typical turnaround time for a carrier is two or three weeks; however, in one instance a $3,500 deposit was charged for carriers used by a Michigan builder to display a modular home beginning May 1995 and returned after the end of the audit period.

B

Kim Knapp, petitioner's witness, was employed in May 1995 by petitioner as a sales representative, having formerly worked for Miller Residential, an Indiana based modular home manufacturer that discontinued business in May 1995. He testified that, as petitioner's sale representative, he conducted business in Michigan in the audit period, but denied making sales calls or soliciting business from Michigan builders. Judy L. Peck, a Michigan builder and former customer of petitioner, testified that in the audit period, Knapp made two business visits in which he promoted the purchase of petitioner's products and that he "wanted me to stock a home." On his visits, Knapp worked directly with Peck's sales personnel and provided product literature for their use.

Respondent's witness, James R. Pixley, owner of Lakeside Custom Homes

and a Michigan builder of modular homes, testified that petitioner became his supplier in June 1995 after his former supplier, Miller Residential, discontinued business operations. Some 80% - 85% of his business is with petitioner from whom he purchased five modular homes from June 1995 through March 1996. He testified that Knapp and he are social friends and that Knapp made one or two visits per year which he combined with a social visit. On visits, Knapp would drop off product literature and, occasionally, a faucet, sink, or other parts that were omitted from a modular home he purchased from petitioner. They discussed business and went over floor plans for modular homes. Pixley testified that Jack Byrd, petitioner's field service representative, made visits to assess warranty problems regarding roofs on cape cod and ranch models that he was erecting and that Byrd occasionally made repairs.

Petitioner extends a one-year express warranty to the homeowner (the builder's customer) which provides:

Hi-Tech Housing, Inc. warrants your home for one year from the date of purchase from all structural defects or failures due to faulty materials or workmanship.

Appliances, furnaces, water heaters or other items of this type purchased with your home will be warranted by their respective manufacturer.

Unauthorized alterations, repairs, improper installation, and/or transportation damage are not covered by this warranty. Warranty services are administered through your builder.

Petitioner's obligations under this warranty are performed by the builder whenever feasible or other independent contractors engaged directly by petitioner or the builder where the builder cannot remedy a structural defect or failure due to petitioner's faulty materials or workmanship. The cost of warranty repairs is charged to and paid by petitioner. Defects and failures ordinarily become apparent during setup and are remedied by the builder's setup crew in consultation to petitioner's service department where required. When the builder's setup crew is unable to perform the warranty repair, petitioner or the builder engages another contractor to make the repairs.

Petitioner's service department personnel visit Michigan to make inspections and assess warranty claims to determine responsibility and the repair required. Petitioner's employee field representative, Jack Byrd, testified that during the audit period he traveled to Michigan three or four times a year to assess problems with modular homes, taking pictures, determining the problem, and reporting back to petitioner's service manager at the factory. Byrd occasionally delivered modular home repair or replacement parts to Michigan builders and made minor repairs.

Steve Schultz was petitioner's customer service manager during 1993 until appointed sales manager at the beginning of 1994. He testified that he made business trips to Michigan to assess warranty claims, including a 1993 visit with

> Jack Byrd to evaluate a roof problem on a cape cod model being constructed by Edward Koshar, a Michigan builder. Schultz described Byrd's role in warranty administration:
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> Jack's use at that time would have been to be basically my eyes and ears. To go out and take a look at this problem and report back to me, assess the damage, if you will. He was damage control. Assess the damage, come back let me know.
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> Edward Koshar (Koshar Realty), located in Marcellus, Michigan, began purchasing modular homes from petitioner in 1991 and discontinued purchases in May or June 1996. During the period 1993 through February 1995, Koshar purchased eight modular homes from petitioner. Called as respondent's witness, he testified that during the period he did business with petitioner, Byrd made approximately twelve visits to his building sites in Michigan. Some visits lasted two or three days and Byrd made repairs to modular homes Koshar was constructing.

Hi-Tech contends that the Tax Tribunal incorrectly determined that Hi-Tech has a sufficient nexus with Michigan to warrant the imposition of Michigan use tax. In reviewing the Tax Tribunal's determination, in this context, "the effect of admitted facts is a question of law." *Nelson v Montgomery Ward & Co*, 312 US 373, 376; 61 S Ct 593, 595; 85 L Ed 897 (1941).

The use tax, MCL 205.91 *et seq*., is an excise tax imposed for the "privilege of using, storing, or consuming tangible personal property in the state." MCL 205.93(1). The legal incidence of the use tax falls upon the consumer or purchaser who buys personal property outside this state for use in Michigan, but the out-of-state seller is responsible for the collection of the tax. *Scholastic Book Clubs, Inc v Dep't of Treasury*, 223 Mich App 576, 579; 567 NW2d 692 (1997).

Subsection 4(b) of the Use Tax Act exempts from taxation "[p]roperty, the storage, use, or other consumption of which, this state is prohibited from taxing under the constitution or laws of the United States or under the constitution of this state." MCL 205.94(b). To determine whether petitioner is exempt from collecting use tax under subsection 4(b), it must be determined whether imposition of the tax violates the Commerce Clause, US Const, art I, § 8, cl 3, which forbids the burdening of interstate commerce or its essential instrumentalities through taxation. *Kellogg Co v Dep't of Treasury*, 204 Mich App 489, 493-494; 516 NW2d 108 (1994). The United States Supreme Court analyzed the Commerce Clause question at issue here in *Quill Corp v North Dakota*, 504 US 298; 112 S Ct 1904; 119 L Ed 2d (1992). Quill was a national merchandiser of office equipment and supplies. It solicited business in North Dakota and elsewhere through catalogues and flyers, advertisements in national periodicals, and telephone calls. *Id.* at 302. It delivered all of its merchandise to its North Dakota customers by mail or common carrier from out-of-state locations. None of Quill's employees worked or resided in North Dakota, and the only tangible property Quill owned in North Dakota was a software program that it licensed to a few customers. On these facts, the Court ruled that Quill did not have the substantial nexus under the Commerce Clause to allow the state to require Quill to collect and pay use tax on its sales to North Dakota customers.

In reaching this conclusion, the Court reaffirmed its decision in *Nat'l Bellas Hess, Inc v Dep't of Revenue of Illinois*, 386 US 753; 87 S Ct 1389; 18 L Ed 2d 505 (1967), and adopted a bright-line, physical presence standard for determining the substantial nexus required by the Commerce Clause. The Court stated:

> *Bellas Hess* . . . created a safe harbor for vendors "whose only connection with customers in the [taxing] state is by common carrier or the United States mail." Under *Bellas Hess*, such vendors are free from state-imposed duties to collect sales and use taxes.
>
> Like other bright-line tests, the *Bellas Hess* rule appears artificial at its edges: Whether or not a state may compel a vendor to collect a sales or use tax may turn on the presence in the taxing state of a small sales force, plant, or office. Cf. *National Geographic Society v California Bd of Equalization*, 430 US 551 (1977); *Scripto, Inc v Carson*, 362 US 207 (1960). [*Quill, supra* at 504 US 315.]

The Court specifically rejected a "slightest presence" standard for determining substantial nexus, concluding that the licensing and presence of floppy discs in North Dakota did not meet the substantial nexus requirement of the Commerce Clause. The Supreme Court reiterated its holding in *Complete Auto Transit, Inc v Brady*, 430 US 274, 279; 97 S Ct 1076, 1079; 51 L Ed 2d 326 (1997). Thus, the Supreme Court left it to the courts to fill in the gaps and give meaning to the term "substantial nexus"[1] in each individual case.

In *Magnetek Controls, Inc v Dep't of Treasury*, 221 Mich App 400; 562 NW2d 219 (1997), the Court considered the impact of *Quill* in the context of the application of the single business tax to sales by a Michigan taxpayer to customers in other states. The Court stated:

> Of the many precedents cited by both parties from other jurisdictions applying *Quill*, we find *In re Orvis Co, Inc v Tax Appeals Tribunal of the State of New York*, 86 NY2d 165; 654 NE2d 954 (1995), most instructive. After a complete review of *Quill* in the context of *Bellas Hess* and other Supreme Court precedents, the court in *Orvis* rejected the taxpayer's claim that *Quill* increased the in-state physical presence requirement of the substantial nexus analysis to require "'*substantial amounts* of in-state people or property.'" *Id.* at 176. The court in *Orvis* noted that neither *Bellas Hess*, *Quill*, or surrounding Supreme Court cases expressed "any insistence that the physical presence of the interstate vendor be substantial . . ." *Id.* Further, requiring that physical presence be substantial would "destroy the bright-line rule the Supreme Court in *Quill* thought it was preserving"; it would require a "weighing of factors such as number of local visits, size of local sales offices, intensity of direct solicitations, etc." to determine whether there was "substantial" physical presence in the target state. *Id.*at 177. Finally, the court in *Orvis*, *supra* at 178, noted that in a recent case, *Oklahoma Tax Comm v Jefferson Lines, Inc*, 514 US 175; 115 S Ct 1331; 131 L

[1] In *Quill*, the Court suggested that that a substantial nexus may be created by the presence of a small sales force, plant, or office within the state.

Ed 2d 261 (1995), the Supreme Court "did *not* apply a substantial physical presence test, but instead strictly utilized the substantial nexus prong of the *Complete Auto* test without even passing reference to the substantiality of the physical presence of the vendor . . . in the taxing state."

On the basis of this survey of relevant precedents, the court in *Orvis*, *supra* at 178, determined that *Quill* required the following test:

While a physical presence . . . is required, it need not be substantial. Rather it must be demonstrably more than a "slightest presence." . . . And it may be manifested by the presence in the taxing State of . . . property or the conduct of economic activities in the taxing State performed by the vendor's personnel on its behalf.

Applying this standard to the cases before it, the court in *Orvis* determined that a Vermont wholesaler whose salespeople came into New York to visit nineteen customers an average of four times a year had sufficient physical presence in New York to be susceptible to the imposition of tax obligations by the state of New York. *Id.* at 180, 630 NYS2d 680, 654 NE2d 954. The same was true for a second taxpayer before the court, a mail-order computer equipment supplier that had sent trouble-shooting consultants into New York on forty-one occasions during the three-year audit period at issue. *Id.* at 180-181, 630 NYS2d 680, 654 NE2d 954. [*Magnetek, supra,* at 410-411.]

Thus, the Court in *Magnetek* concluded:

Accordingly, just as *Orvis* rejected the taxpayers' argument that substantial nexus requires "substantial amounts in in-State people or property," *id.* at 176, 630 NYS2d 680, 654 NE2d 954, we reject defendant's argument that an in-state sales force continuously soliciting customers is needed. Instead, tax obligations may be imposed, consistent with the Commerce Clause, on taxpayers with "demonstrably more than a 'slightest presence'" in a state, and this requirement can be satisfied by "the conduct of economic activities in the taxing State performed by the vendor's personnel or on its behalf."

Consistent with the holding in *Orvis*, we further conclude that this test is satisfied in the present case, the facts at issue here being similar to those in *Orvis*. Plaintiff demonstrated to the trial court that it had more than a "slightest presence" in the states for which tax relief was granted. As the trial court concluded, economic activities were performed there by plaintiff's personnel (the general sales manager's and product line sales managers' visits), as well as by persons not employed by plaintiff but acting on its behalf in those states (the independent sales representatives). [*Magnetek, supra* at 412.]

In *Scholastic Book Clubs, supra,* an out-of-state book company brought an action seeking a declaratory judgment that this state's imposition of use tax on books sold by the company to state purchasers violated the Commerce Clause. The plaintiff was a Missouri-based company that sold books and other materials to schoolchildren throughout the United States. The plaintiff

mailed catalogs to teachers to obtain orders from students. If a teacher or any of the teacher's students wanted to order something, the teacher entered the order for the student and submitted the order to the plaintiff with payment. The plaintiff neither owned nor leased any real property in this state, and it had no employees or independent contractors in the state. The issue presented was whether the state's teachers provided the requisite substantial nexus or physical presence to allow the imposition of a use tax collection obligation on the out-of-state plaintiff. The Court, after noting *Quill's* pronouncement that an out-of-state vendor must have some "physical presence" in the taxing state to establish a substantial nexus with it and it's comment that a substantial nexus may be created by the presence of a small sales force, plant, or office within the state, stated:

> In contrast, it is also well-established that the presence of salespersons who are employed by an out-of-state vendor to solicit business in the taxing state, regardless of whether they are residents of the taxing state, constitutes a sufficient nexus with that state. *Guardian Industries [Corp v Dep't of Treasury*, 198 Mich App 363; 499 NW2d 349 (1993)], *supra*, p 377, 499 NW2d 349. In *Scripto, Inc v Carson*, 362 US 207, 212; 80 S Ct 619, 622; 4 L Ed 2d 660 (1960), the Supreme Court extended this concept to include a situation where the out-of-state vendor retained part-time, nonexclusive wholesalers, or "jobbers," to market their products in the taxing state. The plaintiff vendor in *Scripto* hired independent contractors in the taxing state to take orders from customers within the state. These salespersons, who were not exclusively employed by the plaintiff, then received a commission on each sale. The Court found the fact that the workers were not formal full-time employees to be a "fine distinction . . . without constitutional significance." *Id.* at p 211, 80 S Ct at pp 621-622. Rather, the Court stated, "The test is simply the nature and extent of the activities of the [out-of-state vendor]." *Id. Scripto* has been recognized as the furthest extension to date of a state's power to impose use taxes against the limitation of the Commerce Clause. (Citations omitted.) [*Scholastic Book Clubs, supra,* at 580-581.]

The relevant inquiry, therefore, is whether the asserted contacts establish a "substantial nexus" to Michigan; i.e., whether there is more than a "slightest presence" in Michigan. These contacts, as found by the Tax Tribunal, are as follows: (1) Hi-Tech's carriers were used in Michigan on sixty-four occasions during the audit period and were stored in Michigan from two to three weeks on each occasion; (2) Hi-Tech solicited sales in Michigan by personally calling on Michigan customers; (3) Hi-Tech's business practice included sending a field representative to Michigan to assess damages to modular homes several times a year; (4) Hi-Tech employees delivered parts to Michigan locations on occasion; (5) Hi-Tech's express warranty instructed Michigan consumers to turn to Hi-Tech's Michigan builders who performed warranty services on Hi-Tech's behalf; (6) Hi-Tech retained third party contractors to perform warranty repairs on its behalf in Michigan; and (7) Hi-Tech personnel performed repairs on these products in Michigan.

After a review of the record, we conclude that Hi-Tech had a substantial nexus with Michigan that would permit Michigan to impose the obligation on respondent to collect use tax on its sales to Michigan customers. Evidence was submitted from which the tribunal could reasonably infer that respondent's written warranty obligated it to make structural repairs at the

customer's site in Michigan if defects were discovered within the first year of purchase. Hi-Tech would reimburse its customers for any warranty repairs made by the customer, or would hire independent contractors to make the warranty repairs if the customer was unable to make the repair. If necessary, Hi-Tech would send a representative to Michigan to assess the situation. On occasion, Hi-Tech's representative made the repair, or contacted a local contractor to make the repair if the repair was deemed to be a warranty repair. Testimony was presented that Hi-Tech's employees traveled to Michigan on at least twelve occasions to resolve warranty disputes during the three-year audit period, and it is undisputed that warranty repairs were routinely made by customers or independent contractors on behalf of petitioner. See, e.g., *Orvis*, *supra* wherein the court stated with regard to an out-of-state vendor of mail-order computer accessories:

> . . . there was ample support in the record for the State Tax Appeals Tribunal's finding that VIP's trouble-shooting visits to New York vendees and its assurances to prospective customers that it would make such visits enhanced sales and significantly contributed to VIP's ability to establish and maintain a market for the computer hardware and software it sold in New York. VIP's activities in New York were, thus, definite and of greater significance than merely a slightest presence. [*Orvis*, 86 NY2d 165, 180; 654 N.E.2d 954.]

Applying *Quill*, *Magnatek*, and *Orvis* to the present case, we find that Hi-Tech had "more than a slightest presence" in Michigan during the audit period. Hi-Tech's substantial nexus with Michigan was sufficient to permit Michigan, consistent with the commerce clause, to enforce a use tax against Hi-Tech.

Affirmed.

/s/ Janet T. Neff
/s/ David H. Sawyer
/s/ E. Thomas Fitzgerald