

**STATE OF MICHIGAN**  
**COURT OF CLAIMS**

**JIM'S BODY SHOP INC v MICHIGAN DEP'T OF TREASURY**

Case No.      **16-000135-MT**

Hon. Michael J. Talbot

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**ORDER**

At a session of said Court held,  
Detroit, Wayne County, Michigan, on  
April 3, 2018.

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

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

IT IS HEREBY ORDERED that plaintiff's motion is DENIED and defendant's motion is GRANTED.

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



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Michael J. Talbot, Judge



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

April 3, 2018

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Date

  
Clerk

**STATE OF MICHIGAN**  
**COURT OF CLAIMS**

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JIM’S BODY SHOP, INC.,

Plaintiff,

v

Case No. 16-000135-MT

MICHIGAN DEPARTMENT OF TREASURY,

Hon. Michael J. Talbot

Defendant.

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**OPINION**

Currently before the Court are the parties’ cross-motions for summary disposition under MCR 2.116(C)(10). The underlying dispute in this case concerns an assessment under the Use Tax Act (UTA), MCL 205.91, *et seq.* For the reasons stated herein, defendant’s motion is GRANTED and plaintiff’s motion is DENIED.

**I. FACTUAL BACKGROUND**

Plaintiff, Jim’s Body Shop, Inc. (JBS), is a Michigan automotive body shop that is primarily engaged in the business of making collision repairs to insured vehicles. The work performed by JBS involves both body work and mechanical repairs, including part repairs and replacement, as well as exterior painting and refinishing. Though most of its activities relate to collision repairs, JBS also provides routine services such as tire installation and oil changes.<sup>1</sup>

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<sup>1</sup> Approximately 90% of JBS’s business involves collision repairs made pursuant to insurance claims, and 10% involves non-insurance activities such as tire installation and oil changes. In addition, JBS occasionally makes sales of used automobiles

The assessment in this case arose from a sales and use tax audit conducted by Defendant, Michigan Department of Treasury (the Department), for the tax period from August 1, 2011 to December 31, 2014 (“tax years”). During the audit, it was discovered that JBS had remitted no use tax for the tax years at issue. Though JBS had remitted some sales tax for each tax year, it provided no sales or use information on its Annual Returns for Sales, Use and Withholding Taxes (“Form 165”).<sup>2</sup> Relevant information needed to calculate the correct sales and use tax included the total gross sales (line 1B) and allowable deductions for resale (line 5a). This information was required to derive total taxable purchases (line 14a) and, ultimately, the total use tax due (line 14b).

Because JBS was unable to produce necessary documentation, the Department applied an “indirect audit procedure.”<sup>3</sup> Using this method, the Department estimated the total gross sales by looking at the total sales tax that JBS remitted and dividing by the tax rate of 6%. To estimate the total taxable purchases upon which use tax was to be assessed (line 14a), the Department reviewed trial balances for accounts of purchases of all tangible personal property that JBS made during the tax years related to the performance of collision repairs. It then estimated how much of the total represented exempt purchases for resale that could be deducted to arrive at total taxable purchases (line 14a). Taking the estimated total gross sales from line 1B, and using the single customer invoice provided by JBS during the audit, the Department determined JBS marked up the its items sold at retail by 43% on average. Thus, 43% of the total gross sales (line 1B) represented cost of goods sold that could be deducted from the total of all purchases made to

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<sup>2</sup> Form 165 was filed for each of the tax years, but was completed for withholding tax purposes only (lines 16 through 19).

<sup>3</sup> See MCL 205.104a(4).

arrive at total taxable purchases (line 14a) and total use tax due (line 14B). The Department repeated this process for the 2011 through 2013 tax years to derive the total use tax owed.

JBS produced additional documentation during litigation, including 63 invoices from JBS's tire account, 36 invoices from JBS's "parts-body shop" account, and two invoices from JBS's "parts-mechanical" account. Those invoices reflected an average markup of 10.82% for tire sales, an average markup of 27.81% for body shop parts, and an average markup of 66.45% for mechanical parts. The Department averaged these figures to reach a revised estimated markup of 35%, which was reapplied to the Department's calculations to reach a new total estimated taxable purchases figure and total tax due.

## II. STANDARD OF REVIEW

"Summary disposition is appropriate under MCR 2.116(C)(10) if there is no genuine issue regarding any material fact and the moving party is entitled to judgment as a matter of law."<sup>4</sup> A court ruling on a motion under MCR 2.116(C)(10) must consider the "pleadings, affidavits, depositions, admissions, and other admissible evidence submitted by the parties in the light most favorable to the nonmoving party."<sup>5</sup> When the nonmoving party has the ultimate burden of proof at trial, the moving party can satisfy its burden of production under MCR 2.116(C)(10) by "submit[ting] affirmative evidence that negates an essential element of the nonmoving party's claim, *or* by demonstrat[ing] to the court that the nonmoving party's evidence

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<sup>4</sup> *Dancey v Travelers Prop Cas Co of America*, 288 Mich App 1, 7; 792 NW2d 372 (2010) (quotation marks and citation omitted).

<sup>5</sup> *Robins v Garg (On Remand)*, 276 Mich App 351, 361; 741 NW2d 49 (2007).

is insufficient to establish an essential element of the nonmoving party's claim."<sup>6</sup> If the nonmoving party fails to produce evidence sufficient to demonstrate an essential element of its claim, the moving party is entitled to summary disposition.<sup>7</sup>

### III. ANALYSIS

The issues in this case concern JBS's liability for use tax assessed on tangible personal property it purchased during the tax years at issue.<sup>8</sup> Resolution of these issues requires application of the UTA. The primary goal of statutory interpretation is to ascertain and give effect to legislative intent.<sup>9</sup> "If the language of the statute is unambiguous, the Legislature is presumed to have intended the meaning expressed."<sup>10</sup> As the Court of Appeals has previously explained,

The use tax complements the sales tax and was designed to govern those transactions not covered by the General Sales Tax Act, [MCL 205.51 *et seq.*] The UTA . . . applies to every person in this state "for the privilege of using, storing, or consuming tangible personal property in this state . . ." Tax exemptions are disfavored, and the burden of proving an entitlement to an exemption is on the party claiming the right to the exemption. Tax exemptions are strictly construed against the taxpayer because they represent the "antithesis of tax equality . . ." <sup>[11]</sup>

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<sup>6</sup> *Lowrey v LMPS & LMPJ, Inc*, 500 Mich 1, 7; 890 NW2d 344 (2016) (quotation marks and citation omitted; alterations in original).

<sup>7</sup> *Id.* at 9.

<sup>8</sup> Under MCL 205.94(1)(a), where sales tax under the General Sales Tax Act (GSTA), MCL 205.51, *et seq.* is "due and paid" on property sold in the state, use tax does not apply. The items in controversy in this case are those purchased in the state for which JBS has not met its burden of showing that sales tax has been paid.

<sup>9</sup> *Casco Twp v Secretary of State*, 472 Mich 566, 571; 701 NW2d 102 (2005).

<sup>10</sup> *G C Timmis & Co v Guardian Alarm Co*, 468 Mich 416, 420; 662 NW2d 710 (2003).

<sup>11</sup> *Guardian Indus Corp v Dep't of Treasury*, 243 Mich App 244, 249; 621 NW2d 450 (2000) (citations omitted).

## A. AUDIT METHODOLOGY

JBS first argues that the Department calculated JBS's use tax through an improper sampling procedure. JBS relies on the Department's Audit Sampling Manual (ASM), which provides that "[a] sample that is not representative of the population does not produce results that can be used to make conclusions about the population and will be difficult to defend." According to JBS, the Department's calculations are unreasonable because: (1) it applied a general markup rate to 11 different accounts,<sup>12</sup> based upon a markup rate derived from only three accounts; and (2) it failed to weight the markups reflected on JBS's invoices based upon the percentage of JBS's business attributable to those accounts. JBS maintains that Treasury should have viewed JBS's invoices as samples from *all* purchases at issue to derive a single average markup, rather than dividing the invoices into categories and averaging the resulting markups. JBS contends that such a methodology would result in an average markup of 13%.

The UTA imposes certain record-keeping requirements on taxpayers.<sup>13</sup> This includes an obligation to keep "sufficient records," which the act defines as "records that meet the department's need to determine the tax due under this act."<sup>14</sup> A taxpayer's failure to maintain "sufficient records" enables the Department to employ alternative methods to determine the amount of tax due. Pursuant to MCL 205.104a(4),

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<sup>12</sup> The Department reviewed accounts for "Refund[s]," "Paintless Dents," "Parts-Mechanical," "[Cost of Goods] Inventory Vehicles," "Cost of Goods Sold," "Paint Supplies," "Parts-Body Shop," "Alignment & Balancing Supplies," "Tires," "Sandblaster Sand & Supplies," and "Shop Supplies."

<sup>13</sup> See MCL 205.104a.

<sup>14</sup> MCL 205.104a(7)(b).

If a taxpayer fails to file a return or to maintain or preserve sufficient records as prescribed in this section, or the department has reason to believe that any records maintained or returns filed are inaccurate or incomplete and that additional taxes are due, the department may assess the amount of the tax due from the taxpayer based on an indirect audit procedure or any other information that is available or that may become available to the department. That assessment is considered prima facie correct for the purpose of this act and the burden of proof of refuting the assessment is upon the taxpayer. An indirect audit of a taxpayer under this subsection shall be conducted in accordance with 1941 PA 122, MCL 205.1 to 205.31, and the standards published by the department under section 21 of 1941 PA 122, MCL 205.21, and shall include all of the following elements:

(a) A review of the taxpayer's books and records. The department may use an indirect method to test the accuracy of the taxpayer's books and records.

(b) Both the credibility of the evidence and the reasonableness of the conclusion shall be evaluated before any determination of tax liability is made.

(c) The department may use any method to reconstruct income, deductions, or expenses that is reasonable under the circumstances. The department may use third-party records in the reconstruction.

Here, JBS correctly points out that the Department's decision to apply a markup average derived from three accounts to all 11 accounts under review was seemingly at odds with the ASM's directives concerning sample quality (i.e., ensuring that the sample is representative of the relevant population). However, although the ASM provides guidance for audit sampling, it is not an administrative rule and lacks the force of law.<sup>15</sup> Moreover, JBS's argument ignores the simple reality that the Department's ability to review sampling from each account was hindered by JBS's failure to produce sufficient records for that purpose. That is, JBS only produced 101 invoices for transactions attributable to three accounts. Without other evidence to substantiate JBS's taxable purchases or the markups applied to the remainder of JBS's accounts, the

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<sup>15</sup> See *Danse Corp v Madison Heights*, 466 Mich 175, 181; 644 NW2d 721 (2002).

Department employed a reasonable indirect audit methodology relying on the best—and only—information available to it.<sup>16</sup>

JBS's argument regarding the weight attributed to each invoice is also unpersuasive because JBS did not produce a representative sampling for each account. As argued by the Department, if it was required to collectively average the markups reflected in limited documentation whenever a taxpayer failed to produce sufficient records, the taxpayer would be free to manipulate the markup calculation by withholding invoices reflecting a high or otherwise unfavorable markup. This problem is aptly demonstrated in the instant case: 63 of the 101 invoices produced by JBS were for tire sales, which had the lowest markup rate of the three categories of invoices provided, yet JBS's tire sales only constituted about 4% of its business in 2014. Accordingly, it would be unreasonable to give extra weight to those invoices merely because JBS produced a larger quantity of invoices reflecting tire sales. JBS has therefore failed to rebut the statutory presumption that the Department's assessment is *prima facie* correct.

#### B. INDUSTRIAL PROCESSING EXEMPTION

JBS next argues that it is entitled to an industrial processing exemption for certain items it uses to mix, convert, and condition chemicals and compounds for resale as paint supplies.

“Industrial processing” is defined, in relevant part, as “the activity of converting or conditioning tangible personal property by changing the form, composition, quality, combination, or character of the property for ultimate sale at retail or for use in the

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<sup>16</sup> See Mich Admin Code, R 205.2009 (“If an audited person does not have sufficient records or fails to provide records, the auditor shall determine the best information available and base the estimated tax liability on that information.”).

manufacturing of a product to be ultimately sold at retail . . . .”<sup>17</sup> An “industrial processor” is defined, in relevant part, as “a person who performs the activity of converting or conditioning tangible personal property for ultimate sale at retail or use in the manufacturing of a product to be ultimately sold at retail or affixed to and made a structural part of real estate located in another state.”<sup>18</sup>

Although JBS has provided the Court with an exhaustive explanation as to the process of painting and refinishing vehicles, the mere act of mixing chemicals and compounds according to predetermined formulas to create particular shades of paint is not an industrial processing activity, nor does that act bring JBS within the definition of an industrial processor. JBS does not convert or condition property “for ultimate sale at retail,” nor does it manufacture products for “use in the manufacturing of a product to be ultimately sold at retail.” Rather, JBS engages primarily in the repair of automobiles owned by others. The purchases in dispute were used or consumed in the performance of services related to collision repair, and JBS did not convert raw material into a finished product for retail sale. JBS merely repaired existing property belonging to another so as to restore that item to its original condition or usefulness.

Even if JBS’s creation of paint mixtures could be construed as converting or conditioning tangible personal property, the final paint mixture is not sold at retail or used in the manufacturing of a product to be sold at retail. Instead, the paint is used to restore the damaged

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<sup>17</sup> MCL 205.94o(7)(a).

<sup>18</sup> MCL 205.94o(7)(b).

vehicles already owned by JBS's customers.<sup>19</sup> If the paint mixtures were sold separately at retail, rather than as part of JBS's repair services, they would have been separately itemized on invoices, and JBS would have been able to establish that sales tax had been properly collected from its customers. JBS failed to submit such evidence and therefore is not entitled to an industrial processing exemption.<sup>20</sup>

### C. NEGLIGENCE PENALTY

Lastly, JBS argues that the negligence penalty should not apply. The Department imposed a ten percent negligence penalty for JBS's failure to remit the use taxes for the tax years at issue. MCL 205.23(3) requires the imposition of a penalty in the event that a tax deficiency is due to the taxpayer's negligence. Negligence, for purposes of imposing such a penalty, "is the lack of due care in failing to do what a reasonable and ordinarily prudent person would have done under the particular circumstances."<sup>21</sup> Whether a taxpayer was negligent is determined on

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<sup>19</sup> See *Catalina Marketing Sale Corp v Dep't of Treasury*, 470 Mich 13, 25; 678 NW2d 619 (2004) ("If the consideration paid in a transaction is not paid for the transfer of the tangible property, but for the service provided, and the transfer of the tangible property is only incidental to the service provided, the transaction is not a sale at retail . . .").

<sup>20</sup> The expressed rationale behind enactment of the industrial processing exemption also supports this conclusion. In enacting the industrial processing exemption, the Legislature "sought to avoid multiple layers of taxation—referred to as pyramiding—by exempting property used or consumed in the production of goods that will ultimately be subject to a use or sales tax when purchased by consumers." *Granger v Dep't of Treasury*, 286 Mich App 601, 608; 780 NW2d 611 (2009). See also *Elias Bros Restaurants, Inc v Treasury Dep't*, 452 Mich 144, 152; 549 NW2d 837 (1996) ("The industrial processing exemption is, in part, the product of a targeted legislative effort to avoid double taxation of the end product offered for retail sale or, in other terms, to avoid 'pyramiding the use and sales tax.' "). Here, there is no danger of the double taxation that the industrial processing exemption attempts to rectify because there is no "end product" that is sold at retail. Like most service providers, JBS incurs the cost of and consumes tangible personal property necessary to perform its work, and such tangible personal property is generally subject to use tax.

<sup>21</sup> Mich Admin Code, R 205.1012.

a case-by-case basis, but the “standard for determining negligence is whether the taxpayer exercised ordinary care and prudence in preparing and filing a return and paying the applicable tax in accordance with the statute.”<sup>22</sup> As such, if the taxpayer “demonstrates to the satisfaction of the department that the deficiency . . . was due to reasonable cause, the department shall waive the penalty.”<sup>23</sup>

Here, JBS states that it “has [presented] good faith arguments to support its position that use tax does not apply.” The Court disagrees. James Paetsschow, JBS’s owner and president, readily admitted in his discovery deposition that he did not have knowledge as to whether anyone had filed the sales and use tax returns during the audit period and that he was not familiar with general reporting procedures for sales and use tax. JBS’s lack of knowledge as to the basic sales and use tax reporting requirements cannot be excused, and does not support a conclusion that the standard of “ordinary care and prudence in preparing and filing a return and paying the applicable tax” was met in this case.<sup>24</sup> In short, there is no basis for waiving the negligence penalty in this case.

#### D. CAPITAL ASSETS

The Department also argues in its dispositive motion that it correctly assessed use tax on JBS’s other capital assets, namely, tools (“asset #156”), a foam spray (“asset # 179), a 2008 Grand Prix (“asset #189), and a 2003 International 4300 (“asset #196”). In determining the tax owed for JBS’s capital assets, the Department reviewed JBS’s depreciation schedules and

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<sup>22</sup> *Id.*

<sup>23</sup> MCL 205.23(3).

<sup>24</sup> See Mich Admin Code, R 205.1012.

assessed use tax in each instance that JBS was unable to produce an invoice showing that sales tax had been paid. In response to the Department's position, JBS refers this Court to its discovery responses, wherein JBS avers that no use tax is owed for these assets because: the tools and foam spray are fixtures permanently affixed to realty; the 2008 Grand Prix was never purchased; and the 2003 International is on JBS's vehicle lot for resale. JBS also offers an affidavit from its owner asserting the same. However, "[a] litigant's mere pledge to establish an issue of fact at trial cannot survive summary disposition under MCR 2.116(C)(10),"<sup>25</sup> and JBS has not produced any evidence, apart from these unsubstantiated assertions, to support its description of what these assets consist of or why they are exempt. Thus, even viewing the evidence in the light most favorable to JBS, JBS has failed to satisfy its burden of demonstrating a question of fact as to its entitlement to the claimed exemptions.<sup>26</sup>

#### IV. CONCLUSION

For the foregoing reasons, the Department's motion for summary disposition is GRANTED, and JBS's motion for summary disposition is DENIED.

Dated: April 3, 2018



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Michael J. Talbot, Judge

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<sup>25</sup> *Maiden v Rozwood*, 461 Mich 109, 121; 597 NW2d 817 (1999).

<sup>26</sup> See *Guardian Indus Corp*, 243 Mich App at 249 (stating that the party claiming an exemption has the burden of proving entitlement).