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

M&M Pavement Marking, Inc,
Petitioner,
v MTT Docket No. 331637

Michigan Department of Treasury, Tribunal Judge Presiding
Respondent. Cynthia J Knoll

ORDER GRANTING MOTION TO WITHDRAW AS COUNSEL

FINAL OPINION AND JUDGMENT

On December 15, 2010, the Tribunal entered an Order granting Petitioner's Motion for Additional Time to Respond to the Tribunal's November 5, 2010 Order Partially Granting Respondent's Motion for Additional Information. The Tribunal also entered an Order placing Petitioner's representative's Motion to Withdraw as Counsel in abeyance pending proof of service of such motion to withdraw upon Petitioner.

On December 20, 2010, Petitioner's counsel, the law firm of Winegarden, Haley, Lindholm & Robertson, P.L.C. submitted a letter stating:

1. The requested Proof of Service is being forwarded under separate cover.

2. The undersigned counsel believes that Petitioner's current mailing address for correspondence is: M & M Pavement Marking, Inc., Attn: David Lawler, PO Box 530, Grand Blanc, MI 48439. Undersigned counsel also believes that Petitioner's current facsimile number is 810.695.4684. The address of 3259 Iron Street, Burton, MI 48519 is believed to be Petitioner's equipment storage yard, which may not accept mail deliveries.

The Tribunal received Counsel's Proofs of Service on December 22, 2010.

On December 29, 2010, Petitioner's counsel submitted documentation in response to the Tribunal's November 5, 2010, Order partially granting Respondent's Motion for Additional Information. The documentation included relevant copies of Petitioner's accounting records for purchase transactions listed by vendor for 2002 and 2006.

On January 21, 2011, Respondent submitted a letter stating the following:

> In compliance with the Tribunal's Order of November 5, 2010, Respondent submitted a letter to the Tribunal on December 3, 2010 containing the recalculations of tax owed by Petitioner. Subsequent to filing this letter, the Tribunal granted additional time to the Petitioner to submit additional

information. The Petitioner submitted the information requested by the Tribunal. Based upon the information submitted by the Petitioner, the Respondent has determined that the recalculated tax figures contained in the December 3, 2010 letter to the Tribunal is the correct amount currently owed under the assessment in question. Therefore, the tax due is $185,517.72.

The Tribunal, having given due consideration to the case file, finds:

1. Petitioner's accounting records show that it made no purchases from Ennis Paint during in the periods: July 1, 2002 through December 31, 2002 and January 1, 2006 through April 30, 2006. Therefore no additional tax is due for those periods.

2. The invoice from Potters Industries dated August 29, 2003, indicates 6% sales tax was collected. There are no other invoices from Potters Industries after such date in 2003. Petitioner was unable to produce invoices from this vendor for 2004; however, it did provide a schedule of purchases made between April 12, 2004 and November 11, 2004, with invoice numbers and amounts paid. Petitioner did submit invoices from Potters Industries for 2005, and sales tax was collected on all such invoices.

3. The first nine purchases from Potters Industries in 2004 were each in the amount of $10,239.60. Based on the data provided on invoices in the prior and subsequent years, it is reasonable to conclude that the purchases were made for exactly 42,000 pounds of material at $0.2300 per pound plus 6% sales tax. Invoices dated after June 25, 2004, are of differing amounts most likely due to the imposition of a variable freight surcharge as indicated on invoices in 2005.

4. Given the above, Respondent improperly recalculated tax on purchases from Potters Industries for 2004. The original assessment for use tax was $38,666.00. Respondent's recalculated assessment was $185,517.72. The corrected tax due for the period July 1, 2002, through April 30, 2006, is $168,365.00.

5. Further, the audit conducted by Respondent was incomplete, if not erroneous. As such, Petitioner should not be penalized by being subject to interest on the additional tax determined as a result of these proceedings. Respondent shall calculate interest on the original assessment of $38,666.00, only and beginning in 2004. No interest will be assessed on the remaining $129,699. Therefore,

IT IS ORDERED that Petitioner's Counsel's Motion to Withdraw as Counsel is GRANTED.

IT IS FURTHER ORDERED that the officer charged with collecting the affected taxes shall collect taxes and any applicable interest required by this Final Opinion and Judgment within 28 days of the entry of this Final Opinion and Judgment.

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

MICHIGAN TAX TRIBUNAL

Entered: February 7, 2011 By: Cynthia J Knoll

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

M&M Pavement Marking, Inc,
Petitioner,

v

Michigan Department of Treasury,
Respondent.

MTT Docket No. 331637

Tribunal Judge Presiding
Cynthia J Knoll

ORDER OF PARTIAL JUDGMENT

ORDER REQUIRING ADDITIONAL INFORMATION

I. INTRODUCTION

Petitioner, M & M Pavement Marking, Inc., appeals Respondent, Department of Treasury's, assessment of use tax as determined in Respondent's Audit Determination Letter dated March 9, 2006. The assessment resulted from Respondent's conclusion that materials purchased from an out-of-state vendor, upon which sales tax was not collected, were used and consumed by Petitioner in the fulfillment of real property contracts, and thus subject to use tax. Petitioner contends that the materials were purchased for resale to exempt government agencies and that Petitioner's services in relation to the cost of materials were incidental to the retail sale of the materials. The Tribunal finds that Petitioner was not engaged in the business of retail sales, but rather, was a contractor subject to use tax on its use, storage or consumption of materials used in fulfilling its contracts.

II. BACKGROUND

Petitioner enters into contracts with governmental units for the purpose of "facilitating the transfer" of paint and reflective bead material for use on roadways to mark traffic lanes. Respondent conducted a sales and use tax audit of Petitioner for the period July 1, 2002, through April 30, 2006, and found that Petitioner had purchased paint supplies from an out-of-state vendor in the amount of $644,428.00, on which neither sales nor use taxes were paid. Petitioner claimed it purchased the materials for resale, the ultimate sales of which were exempt sales to governmental entities. Respondent's auditor determined that Petitioner provided a service and

was not in the business of retail sales, therefore its use or consumption of the paint materials was taxable under the Use Tax Act. An Audit Determination Letter was sent to Petitioner showing a net tax due of $38,666.00, plus interest accrued through May 31, 2006, of $4,068.00. Petitioner's Vice-President, David Lawler, signed the Audit Determination Letter on June 1, 2006, indicating his agreement with the determination. On August 9, 2006, Respondent issued Final Bill for Taxes Due, Assessment Number O105824. Petitioner requested, and Respondent granted, an informal conference with Respondent's Hearings Division to appeal the assessment. The Hearing Referee concluded that the assessment of tax was proper. On March 19, 2007, Respondent issued its Decision and Order of Determination, accepting the recommendation of the Hearing Referee and determined that the Intent to Assess No. O105824 should be assessed as originally determined, with interest to be computed in accordance with 1941 PA 122. A Bill for Taxes Due (Final Assessment) was issued on April 2, 2007, in the amount of $38,666.00 plus interest of $6,532.60. Petitioner filed this appeal with the Tribunal on April 23, 2007, and a hearing was conducted on April 20, 2010.

III. PETITIONER'S CONTENTIONS

Petitioner contends that the assessment was issued in error and that no sales or use tax is due on the paint materials. Petitioner argues that it purchased the materials for resale and sold them at retail to exempt governmental entities. Petitioner contends that it was not required to pay sales tax at the time of the material purchases because it purchased the materials from an out-of-state vendor and because it is a reseller of the tangible personal property. Petitioner alleges that it was not required to collect sales tax on its retail sales because its customers were exempt governmental agencies. Petitioner further argues that it "did not itself 'use, store or consume' the tangible personal property"[1], when it delivered the paint to the roadways. Rather, Petitioner asserts that as a retailer, the application of paint to roadways was merely an incidental service to the sale of tangible personal property.

Petitioner alleges that it is in the business of "facilitating the transfer" of paint and reflective bead material from various manufacturers and suppliers to governmental entities for use on their roadways. Petitioner claims that the product is "drop shipped" from the manufacturer to Petitioner's customers' service yards, and that at no time does Petitioner assume actual control of the materials. Petitioner contends that it "arranges for the supplier to ship the materials directly to [the] customer's storage yard. The unloading of the materials is almost always performed by the customer's employees and is always overseen by a representative of the customer." (PP p. 14) Petitioner contends that it "does not exercise a right or power over the materials," even when "the materials are being delivered to the roadway, [because] a representative of the customer again oversees the process to make sure that their paint and beads are being applied correctly, and in the correct amounts." (PP p. 14)

[1] Petitioner's Post-Hearing Brief (PP), p. 2

Petitioner argues that the entire process (i.e., its sale) is a single transaction, involving the provision of a service and the transfer of tangible property. (PP p. 3) Petitioner further argues that the provision of the service (i.e., the delivery of the paint to the municipalities' roadways) is merely incidental to that of the sale of tangible property. It asserts that the "painting or restriping" is "more akin to the delivery of paint to various roadways and not the provision of a painting service." [Emphasis in original] (PP p. 3) Petitioner argues that because it sold tangible personal property in retail sales to municipalities, it did not "use" the property and is therefore not subject to sales or use tax.

Petitioner relies on *Liquid Dustlayer, Inc v Dept of Treasury*, an unpublished opinion per curiam of the Court of Appeals, decided September 15, 2000, (Docket No. 217912). Petitioner argues that the facts of this case are strikingly similar to *Liquid Dustlayer*, and cites the Court's conclusion that the sales at issue were "not taxable under the Use Tax Act because petitioner did not 'use, store, or consume tangible personal property' when it applied the liquid calcium chloride [to roads] according to governmental entities' direction." (PP p. 17) Petitioner cites the Court's determination that:

> We have found no authority to support the Tribunal's implicit determination that in order for the government entities to take receipt of the liquid calcium chloride so as to constitute a sale at retail, the liquid calcium chloride had to be physically placed into a contained area such as a storage tank, rather than be spread on the roads. PP p. 18

Petitioner argues that based on the decision in *Liquid Dustlayer*, "the mere delivery of tangible property to the roadways of a customer does not constitute a 'use, storage, or consumption' of the material, nor does it constitute the provision of a particular 'service.'" (PP p. 18)

Petitioner also contends that the transactions at issue were single, mixed transactions that involved a service component along with the transfer of tangible personal property. Petitioner applies the "incidental to service test" (discussed below), developed in *Catalina Marketing Sales Corp v Dep't of Treasury*, 470 Mich 13; 678 NW2d 619 (2004), arguing that the service component of its contracts was incidental to the true purpose of the transaction; i.e., the provision of tangible personal property. Petitioner asserts the following in its application of the "incidental to service" test:

1. The buyer (Customer) sought as the object of the transaction, "a tangible product – paint and reflective bead materials, to be delivered to their roadways." (PP p. 11)

2. The seller (Petitioner) is ". . . a contractor, [and] . . . in the business of 'facilitating the transfer of [paint and reflective beads].'" It is "in business to 'furnish and apply' pavement markings by delivering reflective paint to roadways." (PP pp.13 & 14)

3. "[T]he goods were provided with a profit making motive. . . . [I]t is also clear that this was a retail enterprise, in which [Petitioner's] customers could purchase paint or reflective beads by themselves if they so chose." (PP p. 15)

4. Petitioner "did make tangible goods available, on occasion, for sale without a service component." (PP p. 15)

5. "[T]he majority of the price of the contracts at issue are attributable to the paint and bead material that is delivered to the roadway. The intangible services at issue do not contribute a substantial amount to the value of the paint and bead material." (PP p. 16) "Without the paint material on the road, the road would still be capable of its essential function – allowing the movement of vehicles. The delivered paint merely added a safety component." (PP p.12)

In further support of its argument that the service component of its contracts was incidental to the sale of tangible personal property, Petitioner brought forth evidence in the form of purchase and sales invoices. Petitioner contends that the invoices prove that the cost of the paint and bead material was so significant in relation to the entire contract price that they could not be considered incidental to the service, but rather, the service was incidental to the property transferred. (PP pp. 8 & 9) One example, as outlined in Petitioner's post-hearing brief, indicates the material cost for one contract was 85.37% of the contract price, whereas the labor, overhead and profit was only 14.63%. (PP p. 7) Another example presented by Petitioner shows a material cost of 63% and labor, overhead and profit at 37% of the contract. (PP p. 8) Petitioner asserts that because the material cost was a greater proportion of the overall contract price, it was not incidental to the transaction, therefore the service must be incidental.

IV. RESPONDENT'S CONTENTIONS

Respondent contends that Petitioner is a contractor and therefore is the consumer of tangible personal property used to provide its services. It argues that the governmental entities were specifically contracting for pavement marking services and not for paint alone.[2] Respondent argues that as the consumer, Petitioner is required to pay use tax on the materials it consumes. (RP p. 4)

Respondent contends that Petitioner's claim of "drop-shipment" is erroneous. Respondent cites as an example Petitioner's contract with the City of Flint, under which "the City will not provide buildings or space to store the contractor's materials and/or equipment."[3] Respondent alleges that the materials in question are the paint supplies necessary for Petitioner to provide the city with the service of pavement marking. In cases where contracts do allow Petitioner to store

[2] Respondent's Post-hearing Brief (RP), p. 4
[3] Respondent's Brief in Support of Its Motion for Summary Disposition, (RB) p. 9

materials at the customer's facility, Respondent contends that Petitioner is responsible for unloading and marking materials upon delivery to the customer's facility and the disposal of materials after application. (RB p.9) Respondent contends that Petitioner takes possession of the materials from the manufacturer when they are delivered and maintains possession through the provision of the service.

Respondent disagrees with Petitioner's reliance on *Liquid Dustlayer, supra*, and points to distinguishable factors. For example, Respondent noted that in *Liquid Dustlayer* "[t]he bids were prepared at a per gallon price, [and] it computed amounts charged for spreading or application of the liquid calcium chloride separately from the product sale,. . . ." (RB p.8) In this case, Respondent contends that Petitioner did not sell paint by the gallon, but rather the sale of paint was included in the price of application, which was determined based on length in feet or miles. (RB p.8) Another distinguishing fact noted by Respondent was that the petitioner in *Liquid Dustlayer* "was to release [the chemical] according to the specifications and instructions of the governmental entities, and that it had no responsibility for the actual application of the product to the road service [sic]." (RB p.8) Respondent contends that Petitioner in this case "was responsible for more that [sic] just applying the paint. Petitioner was responsible for preparing the surface to paint by making sure it was clean and dry prior to application of paint." (RB p.8)

Respondent also considers the "incidental to services" test developed in *Catalina Marketing, supra*. Respondent argues the following in concluding the paint was incidental to the service provided to its customers, and therefore Petitioner is the consumer of the paint in question:

1. The buyer (Customer) sought as the object of the transaction, the service of providing pavement markings on Michigan roads, based on contracts which stated "the work shall consist of furnishing and applying pavement markings." (RB p. 11)

2. The seller (Petitioner) is engaged in the business of "enter[ing] into contracts with governmental entities . . . to paint lines . . . on Michigan roads . . . ." (RB p. 12)

3. Petitioner's "profit making motive" is in the paint application business and not the business of selling paint. Petitioner billed its customers for paint application not for the sale of paint. (RB p. 12)

4. Although Petitioner has sold paint to its customers without a service component, it was rare and not its core business. (RB p. 13)

5. The pavement marking service necessarily contributes a great deal to the value of the paint. Without the application of the paint, the paint would be virtually worthless to the governmental entities. (RB p. 13)

Respondent relies on Revenue Administrative Bulletin ("RAB") 1999-2 which "explains that a contractor is required to pay sales or use tax if he or she acquires tangible personal property even

if he or she does not purchase or own the tangible personal property if sales or use tax has not already been paid on the tangible personal property." (RP p. 2) Respondent cites *Van Dyken Heating and Jenison Public Schools v Department of Treasury,* Michigan Board of Tax Appeals Docket No. 864 (1978) and *Sollitt Construction Company v Michigan Department of Treasury,* Michigan Tax Tribunal Docket 103662, (1990), in support of its contention that "[t]he legal consequence of the tax falls statutorily upon the contractor, Petitioner, as 'consumer.'" (RP p. 3)

V. FINDINGS OF FACTS

The parties have filed a Joint Stipulation of Uncontroverted Facts and the Tribunal accepts as true, the following:

1. M&M is a Michigan corporation that was incorporated on March 5, 1992.
2. Respondent conducted an audit of Petitioner for tax periods July 1, 2002 through April 30, 2006.
3. Respondent found that Petitioner was required to pay tax on the paint supplies purchased during the audit.
4. Respondent issued Final Assessment O105824 on April 2, 2007, in the amount of $38,666.00 tax, $0 penalty, and $6,532.60 interest, which continues to accrue per statute.
5. This Petition was commenced on April 23, 2007, and contests the accuracy of Final Assessment O105824.
6. The paint and bead material are used for the various lane markings seen on roadways and are highly reflective so that they can be seen at night or in adverse weather conditions.
7. The paint and bead material that were delivered to the roadways did not have a long life span – the markings and symbols were required to be repainted at regular intervals.

The Tribunal further finds the following facts:

Petitioner is in the business of, and holds itself out as, a contractor. Petitioner was not registered for sales tax with Respondent during the audit period. Petitioner did not collect sales tax exemption certificates from its customers nor did it provide resale certificates to its vendors. Petitioner submitted evidence showing that its invoices did not separately state a price for paint and other charges such as labor or overhead. Rather, the invoices typically show quantity in terms of lineal feet or miles, specific types of line (e.g., color, single/double, skip, etc), rate per quantity, and total charge. The quantity of paint (in gallons) and bead materials (in weight) per unit of length is considered an industry standard. A set formula was used to compute number of gallons and pounds based on the specifications of a particular contract. Petitioner did not charge a mark-up on materials; profits were based on the labor provided.

Petitioner was contractually obligated to order materials for its customers. Only two paint manufacturers were approved suppliers by MDOT (Michigan Department of Transportation) and Petitioner was required to use only approved suppliers. Petitioner placed the material orders according to the amount needed for a specific contract. It arranged for the materials to be shipped to the customer's service yard, and then provided the service of applying the paint to the roadways in accordance with the customer's directives.

Petitioner's work crews filled its vehicles with materials located at the customer's service yard. Paint and bead materials were combined in specific measurements at the time they were sprayed on the pavement. Petitioner did not design the layout for road markings, rather the customer directed Petitioner where to place certain markings. A customer representative oversaw Petitioner's performance of the painting services. Petitioner was responsible for ensuring the roadways were clear from debris and on occasion was required to move dead animals or other items from the area to be painted. Petitioner was required to provide traffic control for safety and to ensure the paint dried prior to vehicles driving over the lines. From time to time, Petitioner was engaged for an additional fee to remove old road markings, which was done using a grinder.

Respondent's audit work papers show a single line item of use tax exceptions for "various" invoices from a single vendor located in Texas, during 2004, in the total amount of $644,428. Petitioner submitted evidence of other purchases made in 2003 and 2005, of similar materials upon which tax was not paid, and which Respondent's auditor did not capture in its audit. Petitioner also provided evidence that tax was paid on material purchases in some instances.

VI. CONCLUSIONS OF LAW

The General Sales Tax Act, MCL 205.51 *et seq*. provides that "[e]xcept as provided . . ., there is levied upon and there shall be collected from all persons engaged in the business of making sales at retail, by which ownership of tangible personal property is transferred for consideration, an annual tax for the privilege of engaging in that business equal to 6% of the gross proceeds of the business . . ." MCL 205.51(b) provides in part:

> "Sale at retail" or "retail sale" means a sale, lease, or rental of tangible personal property for any purpose other than for resale, sublease, or subrent.

The Use Tax Act, MCL 205.91 *et seq*., is intended to cover transactions not covered by the General Sales Tax Act. MCL 205.93(1) provides in pertinent part:

> There is levied upon and there shall be collected from every person in this state a specific tax for the privilege of using, storing, or consuming tangible personal property in this state at a rate equal to 6% of the price of the property . . . .

"Use" means the exercise of a right or power over tangible personal property incident to the ownership of the property including transfer of the property in a transaction where possession is given." MCL 205.92(b)

The two taxes are complimentary and the imposition of one precludes the imposition of the other.

Governmental agencies are not subject to tax. MCL 205.54h.

Administrative Rule 205.71 provides that a contractor is deemed the consumer of materials it uses. (1979 Administrative Code: 1979 AC, R 205.71) It provides in part:

> (1) "Contractor" includes only prime, general, and subcontractors directly engaged in the business of constructing, altering, repairing, or improving real estate for others.
>
> (2) Contractors are consumers of the materials used by them. All sales to or purchases by contractors of tangible personal property are taxable, except when affixed and made a structural part of real estate for a qualified exempt nonprofit hospital or a nonprofit housing entity qualified as exempt under the sales and use tax acts.
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> ***
>
> (5) Where a contractor is not engaged exclusively in the contracting business but makes sales of tangible personal property at retail to other contractors and **consumers**, he shall secure a sales tax license and file returns to report sales on such transactions. [Emphasis added] *Id.*

It is well settled that tax exemptions are to be strictly construed against the taxpayer,[4] and that the burden of proving an entitlement to an exemption is on the party claiming the right to the exemption.[5] Accordingly, Petitioner has the burden to prove that the transactions where Petitioner applied paint to the road surfaces were not taxable.

There are four potential transactions that could trigger the application of sales or use tax in this case. First, Petitioner argues that the vendor did not collect tax on its purchase of the paint materials because the vendor was located outside of Michigan and had no obligation to collect sales tax. This explanation is plausible and Respondent did not rebut the argument.

The second is Petitioner's contention that it purchased the materials under the exemption of sales for resale. This argument is less persuasive because Petitioner was not registered for sales tax nor was there evidence that Petitioner provided resale certificates to its vendors. Petitioner

[4] *Guardian Industries Corp v Dep't of Treasury*, 243 Mich App 244, 249; 621 NW2d 450 (2000)
[5] *Elias Bros Restaurants Inc v Dep't of Treasury*, 452 Mich 144, 150; 549 NW2d 837 (1996)

argues this despite the fact that two other non-Michigan vendors began collecting tax at some point during the audit period and Petitioner did not claim a resale exemption on those purchases[6] even though the materials were used in identical transactions as the subject materials.

Third, Petitioner claims it "facilitated the transfer" of the materials in retail sales to tax exempt entities; however, Petitioner's witness, Mr. David Lawler, testified that it did not collect exemption certificates from its customers. (HT p.72) Petitioner argues that its customers were seeking tangible personal property in the form of reflective lines made from paint and bead materials. It contends that the service of delivering those lines to the roadways was inconsequential to the sale of tangible personal property. Yet by its own admission, Petitioner's customers would have no reason to purchase the materials if they did not also engage Petitioner to apply the paint to the roads. This indicates that the service of painting the roads was important, if not vital, and certainly not incidental.

And finally, the fourth transaction potentially giving rise to tax was Petitioner's use of tangible personal property in the provision of a service. The Tribunal finds this to be the correct application of the tax.

Petitioner relies on *Liquid Dustlayer, Inc v Dept of Treasury*, unpublished opinion per curiam of the Court of Appeals, issued September 15, 2000 (Docket No. 217912), lv den 464 Mich 857; 630 NW2d 332 (2001). In that case, the petitioner appealed the Tribunal's opinion and judgment affirming an assessment under the Use Tax Act on transactions involving petitioner's provision and application of liquid calcium chloride to public roads for various governmental entities. The liquid calcium chloride was typically delivered directly to the storage tanks of the customers but in some cases, the petitioner would deliver the material directly to the roadways according to the instructions of the governmental entity. The Court of Appeals disagreed with Treasury and the Tribunal, finding that the sales at issue were not "taxable under the Use Tax Act because petitioner did not 'use, store or consume tangible personal property when it applied the liquid calcium chloride [to roadways] according to the governmental entities' direction." *Id*. Petitioner argues that this case supports its position that the "mere delivery of tangible property to the roadways of a customer does not constitute a 'use, storage, or consumption'" of the material.[7]

The facts in this case are distinguishable from *Liquid Dustlayer*. In that case, "[u]sually, the liquid calcium chloride is delivered to the storage tanks of the applicable governmental entity, however sometimes the governmental entity requests that the [materials] be delivered by spreading it on roadways according to instructions of the governmental entity."[8] The petitioner's sole responsibility was "to release [the material] according to the bid specifications . . . and that petitioner has no responsibility for the actual application of the product to the road surface after the moment the product was released." *Id.* Further, "Liquid Dustlayer when preparing a bid

[6] Transcript of Hearing (HT) p. 81
[7] Petitioner's Brief in Opposition to Respondent' Motion for Summary Disposition. p. 7
[8] *Liquid Dustlayer, Inc v Dep't of Treasury*, Docket No. 217912, lv den 464 Mich 857; 630 NW2d 332 (2001)

compute[d] the charge for spreading separate from the [per gallon] charge for the liquid calcium chloride itself." *Id.*

In the instant case, paint materials were always delivered to the customer's service yard and not directly to the roadways. Petitioner's responsibilities clearly included not only the application of the materials to the roadway, but in the proper combination (raw material of paint combined with beads resulting in reflective paint), the proper design (e.g., single vs. double line, center versus edge, yellow versus white, etc.), proper application (on dry roadways clear of debris and dead animals) and the proper drying time. Also, despite Petitioner's contention that lineal measurement is essentially equivalent to volume or weight measurement, Petitioner included in its contract prices an amount for labor, overhead, and profit. For these reasons, the Tribunal finds that the determination in *Liquid Dustlayer* does not apply in this case.

Both Petitioner and Respondent apply the "incidental to service test" found in *Catalina Marketing, supra*, to evaluate the true nature of the transactions. In that case, the Supreme Court validated the "incidental to service test" for "categorizing a business relationship that involves both the provision of services and the transfer of tangible personal property as either a service or a tangible property transaction." *Id.* at 24. The Court determined that it should examine:

> …what the buyer sought as the objective of the transaction, what the seller or service provider is in the business of doing, whether the goods were provided as a retail enterprise with a profit-making motive, whether tangible goods were available for sale without the service, the extent to which intangible services have contributed to the value of the physical item that is transferred, and any other factors relevant to the particular transaction. *Id*. at 26.

Based on Petitioner's contracts with governmental entities and Mr. Lawler's testimony, the buyers sought reflective paint delivered on the roadways in specific patterns, shapes and markings. Mr. Lawler testified that Petitioner's services would almost always be utilized in conjunction with a purchase. He stated "there would be no reason for [the governmental agency] to buy the paint unless they would need our service. There's no reason for them to buy a truckload of paint unless it was always in conjunction with [] applying it to their roads . . . ." (HT p. 84) He went on to say that "their purpose was to get their roads painted. They wanted the paint to come in there, and then we applied it. There would be no other reason for them to purchase it." (HT p. 84) The Tribunal finds that the buyer sought a service and not tangible personal property.

Petitioner claims to be in the business of "facilitating the transfer of paint and bead materials" from various suppliers in other states to the roadways of various governmental entities. It argues that this is a retail activity. Yet, when asked whether Petitioner holds itself out as a retail seller of paint or a contractor, Mr. Lawler stated "I guess we'd be a contractor." (HT p. 72) He testified:

> We're not really in the retail business of doing the paint. We're just facilitating the transfer. I think it became easier [for] road commissions, just for us to do more and more of their work for them. We facilitate the transfer of materials. It comes right from the manufacturer out of state and drops it in their yard. . . . They want to maintain their roads, so they need the materials in there, so we facilitate the transfer. And then they also want us to come – once they receive the materials, they also want us to perform that labor part of the [contract.] (HT p. 77)

Petitioner argues that because the layout work necessary for determining the location and placement of the pavement markings was performed by an engineer or some other person, Petitioner's activities of actually spraying the paint are inconsequential. Petitioner also attempts to minimize the value of its contractual obligations of preparing the surface of the pavement by making sure it is clean, dry and free of foreign materials, as well as maintaining traffic control and protecting the paint while it cures. While the occasional removal of a dead animal might be inconsequential to the service of painting the roadways, Petitioner's primary responsibility is to ensure that the paint is properly laid down according to its customer's specifications. Petitioner did not submit evidence that it was compensated over and above the contract price for any inconsequential activities such as debris or animal removal, but it is clearly compensated for the actual painting of the roadways. It is this compensation which gives rise to Petitioner's profit, not the sale of paint.

Rule 205.71 provides that a contractor is directly engaged in the business of constructing, altering, repairing, or improving real estate for others. Despite its stipulation that roadways are real property owned by others, Petitioner attempts to argue that it is not a contractor because it does not "affix" the paint materials to real property. Petitioner's assertion that the paint is not affixed but rather "sits on top of the roadways" (HT p. 96), is laughable and is clearly a meritless claim. If these lines were merely sitting on top of the roadway, removal would not require line removal grinders. (HT p.60) Further, the removal of the paint would destroy its character no different than removal of tar paper from a roof (which is sitting on top of the roofing plywood, but is no more or less "affixed" to a building) would destroy its character and use.

Petitioner submitted two invoices showing 55 gallons of paint sold to a governmental entity, arguing that this is proof it sold paint directly without the service. However, Mr. Lawler's testimony that a customer would have no reason to buy a truckload of paint without the service was compelling. While Petitioner may occasionally sell small quantities of materials to its customers, it did not demonstrate this to be a significant part of its business and, in fact, appears "incidental" to the pavement marking business.

Petitioner does admit that the spraying of paint and bead materials "did contribute somewhat to the value; however, . . . all that happens on the truck is that the paint gets thinned out a little bit and it gets spread in a particular pattern." (HT p.99) Despite Petitioner's argument that the painting is a very simple process, Mr. Lawler testified that they correct mistakes "[b]ut it doesn't

happen very often. My . . . machines are quite automated and the guys are **quite skilled at it**." [Emphasis added] (HT p. 75) He also testified that in order to be awarded a contract, the contractor must have "the experience to do [the job] . . . and have the right equipment that can sustain" painting throughout the day. (HT p. 75) It seems a governmental entity places significant value on the quality and dependability of the service.

Another argument Petitioner makes is that "any incidental service provided by [Petitioner] did not change the character of the road. Without the paint material on the road, the road would still be capable of its essential function – allowing for the movement of vehicles. The delivered paint merely added a safety component to the roadway surface." (PP p. 12) The Tribunal disagrees with this argument because road lines are necessary for maintaining proper traffic flow and communicating to drivers certain indications and expectations. Petitioner also contends that the character of the paint does not change as a result of its service. Petitioner claims, "It was paint before [delivery to the roadway]. It's basically the same paint after. It's just in a little bit thinner consistency." (HT p. 12) The Tribunal finds this to be false given that Petitioner combines the paint with beads based on specific measurement formula, resulting in reflective paint.

The facts and evidence in this matter support a finding that a single transaction did occur – the provision of a contract service in which Petitioner, the contractor, was user of the tangible personal property. The service of painting the roadways is so commingled with the provision of paint and bead material that they cannot be separated. Based on these facts and the applicable statutory authority, the Tribunal finds that Petitioner is liable for use tax on materials used in its business of pavement marking.

Petitioner has put the entire assessment at issue in this appeal. By doing so, the Tribunal has considered all of the evidence brought forth and concludes that the preponderance of evidence indicates the assessment is incorrect and Respondent incorrectly calculated the tax due. Specifically, Petitioner's evidence shows, at a minimum, that there were $265,847 in taxable purchases during 2003, $224,634 during 2004, and $640,764 during 2005, for a total of $1,131,244 upon which tax was not paid. Respondent's audit report shows only $644,428 in untaxed purchases made in 2004.

Petitioner's counsel indicated that the invoices submitted as evidence at hearing were in support of his examples and were not all inclusive of purchases made during the audit period. The Tribunal therefore requires Petitioner to submit documentary evidence (i.e., invoices received from and paid to vendors Ennis Paint, Inc. and Potters Industries, Inc. during the period July 1, 2002 through April 30, 2006) that reflect purchases that were not taxed for the tax years at issue. Respondent shall then recalculate the tax due and owing within 30 days, and submit the recalculation to the Tribunal for final decision and order.

If Petitioner complies with the Tribunal's Order, the Tribunal will waive all penalties, and interest will begin to accrue on the increased adjusted amount on the date of the entry of the

Final Opinion and Judgment. If Petitioner fails to respond to the Tribunal's Order, the Tribunal will have no choice but to recalculate the tax with the evidence currently submitted and assess full penalties and interest.

VII. ORDER AND PARTIAL JUDGMENT

IT IS ORDERED that Petitioner is liable for use tax on purchases of paint and bead materials used in the provision of road marking services on behalf of its customers.

IT IS FURTHER ORDERED that Petitioner shall submit copies of all invoices received from and paid to vendors Ennis Paint, Inc. and Potters Industries, Inc. during the period July 1, 2002 through April 30, 2006 within 45 days of the entry of this Order.

IT IS FURTHER ORDERED that Respondent shall recalculate the tax, interest and penalties, if any, due and owing and submit such calculation to the Tribunal within75 days of the entry of this Order.

MICHIGAN TAX TRIBUNAL

Entered: July 22, 2010 By: Cynthia J Knoll