STATE OF MICHIGAN
DEPARTMENT OF LICENSING & REGULATORY AFFAIRS
MICHIGAN ADMINISTRATIVE HEARING SYSTEM
MICHIGAN TAX TRIBUNAL

David L. and Vicki L. Anderson,
Petitioners,

v. MTT Docket No. 359228

Michigan Department of Treasury,
Respondent.
_____/

Tribunal Judge Presiding
Paul V. McCord

FINAL OPINION AND JUDGMENT

David L. Anderson, *pro se*.
Julius O. Curling (P58248), for Respondent.

I. INTRODUCTION

Petitioners petitioned the Tribunal to redetermine Respondent's determination of deficiencies of $1,241.16, $4,320.34, $5,632.42, $6,071.72, $2,206.30, and $277.36 in Michigan sales tax for the taxable periods 2001, 2002, 2003, 2004, 2005, and 2006, respectively, and MCL 205.23(3) accuracy-related penalties of $124.13, $432.03, $563.24, $607.17, $220.63, and $27.74. We decide whether Petitioners substantiated their nontaxable sales. We hold they did not. We also decide whether Petitioners are liable for accuracy-related penalties determined by Respondent under MCL 205.23(3). We hold they are.

II. FINDINGS OF FACT

During the taxable periods at issue, Petitioners were husband and wife, and filed joint 2001, 2002, 2003, 2004, 2005, and 2006 Federal and Michigan income tax returns. During the

relevant taxable periods, they resided in Wallace, Michigan, located in the Upper Peninsula about 13 miles from the Wisconsin boarder.

Petitioners operated a sole proprietorship called Anderson's Western Leather ("Anderson's"). Anderson's is a western tack shop that sold western leather goods, such as saddles, bridles, tack, chaps, leather coats, harness, western apparel, and miscellaneous western style items such as steer skulls and horns. During the periods at issue, Anderson's had essentially four lines of business; (1) a retail tack shop, (2) so-called "gypsy" sales (flea market and carnival sales); (3) vehicle and horse trailer sales; and (4) horse sales. Anderson's applied for a Sales Tax license beginning January 1, 2005. Petitioners reported their profit or loss from Anderson's on Schedule C of their Federal income tax return. For the tax years 2001 through 2005, Petitioners reported gross receipts and cost of goods sold from Anderson's as follows:

Year	Gross Receipts	Cost of Goods Sold
2001	$ 98,041	$ 65,763
2002	222,746	198,981
2003	213,742	163,136
2004	208,749	133,801
2005	461,952	389,294

1. Gypsy Sales

Throughout the tax periods at issue, Petitioners engaged in so-called gypsy selling of items at flea markets, fairs, carnivals, and horse auctions. Petitioners regularly traveled outside of Michigan and throughout the mid-west to these various events. Petitioners would set up a booth and sell their various items. At times, Petitioners would purchase items at these events to be sold at the next event. Petitioners went to several events a year at such locations as Nolan's Auction in Wisconsin, Waverly, IA, Topeka, IN, Peoria, IL, the Illinois State Fair in Springfield, IL, St. Paul, MN, and events in Oshkosh, Porterfield, Wausaukee, Wausau, and Marshfield, WI.

Petitioners also sold many of their items over the internet, via sites such as eBay and Craigslist. This method of doing business was Petitioners' principal business model during the early periods at issue. Beginning sometime in 2002, Petitioners opened a retail store in Wallace, Michigan. Petitioners continued to sell saddles, tack, and associated western leather goods and apparel from their store, as well as traveling to various events and engaging in gypsy sales.

2. Motor Vehicle and Trailer Sales

In 2002, while attending a horse auction, Petitioner, Mr. Anderson, purchased a horse trailer and later sold it. Shortly thereafter, Petitioners began to sell new horse trailers that they purchased from another dealer in Wisconsin. Petitioners were told by the local Secretary of State's office that either they could collect and remit state sales tax from the buyer or they could give the buyer a bill of sale and the buyer could pay state sales tax directly at the Secretary of State's office when they purchased the plates for the trailers.

Later on, Petitioners began selling used pickup trucks in addition to their sale of horse trailers. Petitioner, Mr. Anderson, could not recall the precise volume of used vehicle sales throughout the relevant time period. At first they didn't sell many vehicles per year; however, he estimated it to be around 100 vehicles per year. Typically, Petitioners would sell these vehicles for $1,500 to $2,900. As was their procedure with their trailer sales, Petitioners did not collect and remit sales tax on these transactions. Instead, they provided their customer with a bill of sale and left the tax, title, and registration for their customer to settle with the Secretary of State's office. Some of these vehicle sales were to out-of-state customers. Customers would either take delivery of the vehicles at Petitioners' location or, Petitioner, Mr. Anderson, would deliver the

vehicle if he was planning on being in the particular customer's location. Mr. Anderson could not recall the number of vehicle sales where he delivered the vehicle to the out-of-state customer.

In or about 2005, Petitioners were contacted by a branch office of the Secretary of State questioning Petitioners about lack of a Form RD-108, *Application for Michigan Title - Statement of Vehicle Sale,* involving one of their vehicle transactions. Form RD-108 is used by licensed Michigan vehicle dealers to apply for title and registration for their customers, as required by MCL 257.206. Form RD-108 records vehicle and purchaser information, sales tax information, and other important details of the transaction. This, according to Petitioners, was the first that they had heard of this requirement. Petitioners then obtained a Class B (Used Vehicle Dealer) license.[1] Mr. Anderson testifies that he also needed a dealer's license to participate in vehicle auctions. After obtaining their dealer license, Petitioners prepared Forms RD-108 with all of their vehicle sales. Again, Petitioners were apparently advised by their local Secretary of State's office that they could process the transaction by furnishing their customers with a completed Form RD-108 and send the customer to pay the tax, title and registration fees when they went to title the vehicle.

3. Horse Sales

Petitioners attended a number of horse auctions throughout the year where they would buy and sell horses. Petitioner, Mr. Anderson, estimated that they may have sold as many as 50 horses per year, although he indicated that sales volume has declined. Petitioners held a livestock dealers license. Petitioners believed that Michigan sales tax did not apply to their sales

[1] A motor vehicle dealer's license is required of persons in the business of buying, selling, brokering, leasing, negotiating a lease, or dealing in 5 or more vehicles in a 12-month period. A Class B (Used Vehicle Dealer) is required of persons who buy and sell used vehicles. See MCL 257.248(5).

of horses. Petitioners sold many of their horses to out-of-state customers. Customers would either take delivery of horses at Petitioner's place of business in Wallace, Michigan or would hire transporters to pick up the animals and deliver them to their customers' location. While in Wisconsin in 2004, Petitioners learned that Wisconsin imposed sales tax on the sale of horses. Petitioners made inquiries of local livestock dealers who indicated that they did not charge Michigan sales tax on their sales of livestock. In 2005 when Petitioner's renewed their livestock dealer's license, a State Veterinarian told Petitioners that they did not have to charge sales tax on their sale of horses.

4. Respondent's Examination

In early 2006, Respondent selected Petitioners for a sales tax examination after an apparent sales tax issue arose from a trailer Petitioners had sold. Respondent's auditor made initial contact with Petitioner's in February 2006. The auditor returned in the spring of 2006 and requested copies of Petitioner's income tax returns and book and records regarding Petitioners' sales. Petitioner, Ms. Anderson, informed the auditor that there had been a house fire in 2004 and, as a result, some of Petitioners' business records were lost or destroyed. The auditor was also informed by Petitioners that most of their sales occurred either outside of Michigan or were to out-of-state customers. Petitioner, Ms. Anderson, also told the auditor that they did not charge sale tax on their sale of horses as a State Veterinarian told her that sales of horses were not taxable. Petitioner, Ms. Anderson, also mentioned that she had been given incorrect information from the Secretary of State's office regarding the tax compliance on their trailer sales.

In March 2007, the auditor met with Petitioners and their long-time CPA, Kenneth J. Jones. Mr. Jones had a power of attorney from Petitioners. Petitioners' CPA presented copies of

Petitioners' 2001 through 2005 Schedules C and other information as to the breakdown of gross receipts and sales for each year. Working with Petitioners and their CPA at this meeting, Respondent's auditor made adjustments to total receipts for non-taxable sales receipts (such as Petitioners' pony rides) and substantiated out-of-state sales. Respondent's auditor determined taxable Michigan sales as follows:

2001	2002	2003	2004	2005	2006	Total
$20,687.74	$72,005.67	$93,873.60	$101,195.29	$36,771.70	$4,622.64	$329,156.64

The auditor also determined that Petitioners were liable for the accuracy-related penalty for negligence, but did not impose the addition to tax for failure to file. After an Informal Conference, Respondent issued Final Assessment O953100.

The tax, interest, and penalty as reflected in Respondent's Final assessment are as follows:

Assessment No.	Tax	Interest	Penalty (Sec 23(3))
O953100	$19,749.30	per 1941 PA 122	$1,974.94

III. CONCLUSIONS OF LAW

1. *Burden of Proof*

The burden of proof is on Petitioners to show that Respondent's determinations set forth in its Final Assessment are incorrect. MCL 205.67 (now codified at MCL 205.68(4) by 2008 PA 438); *Vomvolakis v Dep't of Treasury*, 145 Mich App 238, 242-243; 377 NW2d 309 (1985). Where the taxpayer introduces credible evidence with respect to any factual issue relevant to

ascertaining the taxpayer's proper tax liability, then the burden of going forward with its evidence shifts to Respondent to support its claim. See, *Holy Spirit Assoc for the Unification of World Christianity v Dep't of Treasury*, 131 Mich App 743, 752; 347 NW2d 707 (1984).

The sales tax is a tax upon sellers for the privilege of engaging in the business of making retail sales of tangible personal property. MCL 205.51, *et seq*.; *University of Michigan Board of Regents v Department of Treasury*, 217 Mich App 665, 669; 553 NW2d 349 (1996). "Business" is defined in the sales tax act as "an activity engaged in by a person or caused to be engaged in by that person with the object of gain, benefit, or advantage, either direct or indirect." MCL 205.51(1)(e). For the tax periods 2001 through August 31, 2004, a "sale at retail" meant "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." MCL 205.51(1)(b) before amendment by 2004 PA 173. For the taxable periods beginning on or after September 1, 2004, the definition of a "sale at retail" or "retail sale" was expanded to include "a sale . . . *for any purpose* other than for resale . . . ." MCL 205.51(1)(b) (emphasis added). During the taxable periods at issue, Petitioners were engaged in the business of making retail sales of western leather goods, apparel, tack, used vehicles, trailers, and horses.

2. Substantiation

Here, there is no question that Petitioners made taxable sales over the period covered by the audit. That fact is undisputed by Petitioner, Mr. Anderson, whose honesty is not questioned. The only question is as to the portion of total sales that were taxable. Petitioners did not

maintain complete and accurate records as required by MCL 205.67(1) (prior to amendment by 2008 PA 438, now codified at MCL 205.68( )). To this end, we find that Petitioners failed to comply with substantiation requirements of the General Sales Tax Act. Although we note that this fact, of itself, is not a basis for liability (see *Arbor Sales Inc v Dep't of Treasury*, 104 Mich App 181; 304 NW2d 522 (1981) (noting that a person or organization may not be found liable for a tax merely because it fails to keep accurate and complete records)), generally, taxpayers may meet their burden of proof by producing their books and records that comply with the statute's substantiation and recordkeeping requirements. Petitioners have made their case much more difficult.

Petitioners assert that they had the requisite substantiation to support their claim as to their taxable and nontaxable sales for the earlier periods, but their tax records were destroyed by fire in 2004. Petitioners presented no documentation or direct evidence as to their taxable and nontaxable sales for the periods following the fire. Under *Wolverine Re-Steel Fabricators v Dep't of Treasury*, 6 MTT 170 (1990), if a taxpayer can establish that his or her failure to produce adequate records is due to the loss of such records through circumstances beyond the taxpayer's control, such as destruction by fire or other casualty, the taxpayer may satisfy its burden of proof and overcome the presumption in favor of Respondent's assessment where the taxpayer presents sufficient circumstantial evidence to establish their tax liability. In *Wolverine*, the Tribunal reasoned circumstantial evidence is as competent as direct evidence and that cases may be established by such evidence. *Id*. at 176. The Tribunal instructed that all evidence must be weighed according to the proof which was in the power of one side to present and the other side to refute, that the Tribunal in considering and weighing testimony, should consider its reasonableness. *Id*. The *Wolverine* taxpayer denied that it made a retail sale of steel that was the

basis for a sales tax assessment. It was determined that the taxpayer took possession of a large quantity of steel that belonged to its customer, fabricated the steel, and then delivered it to its customer. The department's auditor claimed a sale took place based on a contract between the taxpayer and its customer. The taxpayer claimed that the "contract" was only a proposal that had never been executed. The contract had been lost and neither party could produce a copy at hearing. Respondent argued that the taxpayer was obligated to produce a copy of the contract to prove that it did not engage in sales at retail. The Tribunal, in *Wolverine,* held that the taxpayer did not have the burden to produce the contract to prove that there was no sale and the bare assertion by the department's auditor that the sale had occurred was not sufficient.

Applying this principle to the present case, Petitioners' testimony at hearing was insufficient to substantiate their claim as to their non-taxable sales. Petitioner, Mr. Anderson, was unable to recall any of the pertinent transactional details to either substantiate Petitioners' claims or from which we could make our own reconstruction.

Petitioners were apparently of the belief their sales of horses were not taxable and, thus, did not charge and collect sales tax on these transactions. Petitioners were required to do so. See 1995 AC, R 205.93(3). Mr. Anderson estimated that Petitioners may have sold up to 50 horses per year, but could not recall the number of sales made to out-of-state customers where the transactions were consummated outside of Michigan. See, e.g., *World Book, Inc v Dep't of Treasury,* 459 Mich 403, 409-412; 590 NW2d 293 (1999).

Petitioner, Mr. Anderson, estimated that at their peak, they may have sold up to 100 vehicles per year and surmised that, being 13 miles from the Wisconsin border, a majority of their sales were to Wisconsin residents. But, as was the case with their sales of horses, Mr. Anderson did not know the number of instances where the transaction occurred out-of-state.

Petitioners further assume that, as to their in-state vehicle sales, Michigan use tax must have been paid by the buyer otherwise the buyer would not have been able to register and title the vehicle or trailer. Whether or not their buyers in fact remitted Michigan use tax on their vehicle/trailer purchase is an unsubstantiated inference that we refuse to make. Nor were Petitioners able to supply us with any useful data from which we could even venture an estimate. We note, as a dealer, Petitioners were required to charge and collect sales tax on all of their used car and trailer sales and could have protected themselves for this possibility by properly preparing, submitting, and retaining Form RD-108. They did not.

On the evidence presented in this case, we find that Respondent acted reasonably in its audit methodology basing its assessment upon the information that was available and obtainable from Petitioners and after meeting with Petitioners and their CPA. *Vomvolakis, supra* at 244 (stating that the Legislature intended to give the Department of Treasury power to base assessments on the best information that it could obtain). Respondent's auditor credited Petitioners for non-taxable and out-of-state transactions. Thus, we are not convinced by a fair preponderance of the evidence that the assessment as issue includes nontaxable or out-of-state sales.

Petitioners, citing their reliance on the advice of unsophisticated third parties, ask this Tribunal for "fairness." Insomuch as their prayer for relief seeks a reduction in the assessed tax liability, the referenced statutes, rules and case law do not, however, reward with exemption from taxation, honest, albeit *negligent*, parties who do not maintain records, or who maintain disorganized or incomplete sets of records. Holding Petitioners liable for the asserted sales tax deficiency determined by Respondent is "fair" as the law does not confer Petitioners a benefit not afforded those who properly ascertain their tax obligations and who are able to support their

reported liabilities with complete backup documentation. Accordingly, we sustain Respondent's determination that Petitioners are liable for the sales tax deficiencies in its assessment O953100.

3. Negligence Penalty

Respondent assessed Petitioners for the accuracy-related penalty under MCL 205.23(3). Section 23(3) imposes an accuracy-related penalty equal to 10 percent of the portion of an underpayment that is attributable to, among other things, negligence. Petitioners will avoid this accuracy-related penalty if the record shows that they were not negligent; *i.e.*, they made a reasonable attempt to comply with the provisions of the tax laws, and they were not careless, reckless, or in intentional disregard of the law or rules. Negligence connotes a lack of due care or failure to do what a reasonable and prudent person would do under the circumstances. See 1979, AC, R 205.1012(2). An accuracy-related penalty is not applicable to any portion of an underpayment to the extent that an individual has reasonable cause for that portion. MCL 205.23(3), see also Rule 205.1012(4).

Respondent bears the burden of production with respect to the accuracy-related penalties. Rule 205.1012(2). In order to meet this burden of production, Respondent must produce sufficient evidence that it is appropriate to impose the accuracy-related penalties. Once Respondent has done so, the burden of proof is upon Petitioners. *Id*. Petitioners may carry their burden by establishing facts that negate a finding of negligence, proving that with respect to their underpayment there was reasonable cause. MCL 205.23(3); Rule 205.1201(2).

Respondent has satisfied its burden of production in that the record establishes that Petitioners failed to substantiate their claim to non-taxable sales. During the taxable periods at issue, sales of horses were subject to Michigan Sales Tax. See Rule 205.93(3). Petitioners did

not charge or collect sales tax on these transactions believing they were not taxable. Petitioners' belief, while perhaps held in good faith, was erroneous.

In addition to the obligations imposed by the General Sales Tax Act, and Section 206 of the Michigan Vehicle Code (MCL 257.206), Petitioners were required to comply with the tax collection and reporting requirements for motor vehicle sales, title, and registration applications, and the record keeping requirements of MCL 257.251. They did not.

Finally, MCL 205.67 imposed on Petitioners a duty to maintain books and records sufficient to support items reported on their returns. Petitioners' various breaches of their statutory duties were contrary to what a prudent and responsible taxpayer would have done under the circumstances. Petitioners must now establish reasonable cause in order to escape liability for the accuracy-related penalties under MCL 205.23(3).

There is considerable overlap between Section 23's negligence and careless disregard concepts on the one hand and the reasonable cause concept on the other. This is because the definitions of negligence (no reasonable attempt to comply) and careless disregard (no reasonable diligence) generally require a determination of the reasonableness of a taxpayer's conduct. Similarly, the reasonable cause exception applies if the taxpayer "exercises ordinary care and prudence in preparing and filing a return and paying the applicable tax," but nonetheless fails to comply with the law's requirements. Rule 205.1012(1). That is, Rule 205.1012 asks (1) whether the taxpayer has an excuse for his or her conduct and (2) whether that excuse constitutes reasonable cause. The proper focus is on whether the taxpayer can demonstrate a reasonable excuse (*i.e.*, reasonable cause) for deviating from the standards normally expected of taxpayers. Petitioners assert they had the requisite substantiation to support their claims, but their tax records were lost in a 2004 fire that destroyed their home. Certainly the loss of one's business

and tax records due to circumstances beyond the taxpayer's control could serve as reasonable cause; however, other than Mr. Anderson's testimony, Petitioners have failed to submit credible evidence to establish either part of that assertion.

Here, Petitioners state that they justifiably relied on the representations made by a branch office employee of the Secretary of State's office and on the advice of a State Veterinarian regarding their tax obligations. Given that the tax laws are complex, this is probably the most common excuse for a taxpayer's noncompliant conduct – the taxpayer's reliance on the advice of a tax professional. Michigan case law has not fully developed the scope of this exception; however, a similar exception has been developed under federal law under IRC § 6664(c)(1).

Under IRC § 6664(c)(1), where a taxpayer relies on improper advice of an accountant or tax attorney as to a matter of tax law, such as whether the taxpayer has a tax liability, failing to file a return in reliance on this advice may be considered reasonable cause if certain conditions are met. *United States v Boyl*e, 469 US 241, 250-251 (1985). These conditions include: (1) the person relied on by the taxpayer is a tax professional with competency in the subject tax law, and (2) the tax professional's advice is based on the taxpayer's full disclosure of the relevant facts and documents. See *Mortensen v Commissioner*, 440 F3d 375, 387 (CA 6, 2006). We find the various federal case law analysis of "reasonable reliance" for purpose of the Federal reasonable cause exception instructive as to our application of MCL 205.23(3). As a result, Reliance on the tax advice of non-tax professionals is not reasonable cause. Further, Petitioner, Mr. Anderson, admits that they did not seek the advice of their long term CPA on any of these tax issues. Under these circumstances we conclude that Petitioners have not demonstrated "reasonable cause" for failing to collect and remit sales tax on their various sale transactions. As a result, we sustain

Respondent's Final Assessment O95310 imposing the accuracy-related penalties under MCL 205.23(3) for 2001, 2002, 2003, 2004, 2005 and 2006.

IV. JUDGMENT

IT IS ORDERED that assessment No. O953100 is AFFIRMED in amount of $19,749.30, with statutory interest calculated under 1941 PA 122.

IT IS FURTHER ORDERED that the penalty imposed under MCL 205.23(3) in Assessment No. O953100 is hereby AFFIRMED.

This Order resolves all pending claims in this matter and closes this case.

MICHIGAN TAX TRIBUNAL

Entered: March 28, 2012 By: Paul V. McCord