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

K & S Industrial Services, Inc.,
Petitioner,

MTT Docket No. 311923

v

Tribunal Judge Presiding
Michigan Department of Treasury
Respondent.

Kimbal R. Smith III

ORDER GRANTING PETITIONER'S MOTION FOR SUMMARY DISPOSITION

ORDER DENYING RESPONDENT'S MOTION FOR SUMMARY DISPOSITION

ORDER MODIFYING PETITIONER'S BILL OF COSTS AND ATTORNEY FEES

FINAL OPINION AND JUDGMENT

I. INTRODUCTION

Petitioner, K & S Industrial Services, Inc., is appealing Final Assessment number K439106. The Final Assessment assesses use tax liability of $136,027.65 and interest of $30,374.32, for the period of June 1995 through December 1999.

On February 9, 2007, Petitioner, K & S Industrial Services, Inc., filed a Motion for Summary Disposition under MCR 2.116(C)(10) contending that repairing and maintaining processing equipment under an ongoing contract with auto manufacturers qualifies as industrial processing activity because it is a part of

the making of the product. On February 9, 2007, Respondent filed a Cross-Motion for Summary Disposition contending that the subject activity is not eligible for tax-exempt status for the period prior to March 31, 1999, because it is akin to Petitioner providing a service. Respondent also acknowledged in its Cross-Motion that Petitioner's Motion for Summary Disposition should be granted for the period beginning March 31, 1999. On March 2, 2007, Petitioner filed a Reply Brief to Respondent's Brief in Support of Motion for Summary Disposition. In response to a May 31, 2011, Order by the Tribunal awarding costs under Petitioner's Motion to Impose Other Sanctions for Violation of Scheduling Order, on June 14, 2011, Petitioner submitted a Bill of Costs and Attorneys Fees. On June 28, 2011, Respondent submitted an Objection to Petitioner's Bill of Costs. The issue is whether Petitioner's subject activity qualifies as "industrial processing" for the audited period between June 1, 1995, and March 31, 1999.

For the reasons set forth herein, the Tribunal finds that granting Petitioner's Motion for Summary Disposition under MCR 2.116(C)(10) is appropriate. The Tribunal denies Respondent's Motion for Summary Disposition. The Tribunal also modifies Petitioner's Bill of Costs and Attorney Fees as stated herein.

II. MOTIONS FOR SUMMARY DISPOSITION

a. PETITIONER'S CONTENTIONS

Petitioner contends that its activities qualify as industrial processing and that, prior to March 31, 1999, it is exempt as provided by MCL 205.94(g) or 205.94r. Petitioner contends that it is exempt after March 31, 1999, as provided by MCL 205.94o.

Petitioner contends that:

> the activity of repairing and maintaining processing equipment is well recognized as industrial processing activity which is a part of the making of the product made by the processing equipment repaired or maintained. If the activity of maintaining processing equipment is characterized as providing a service by Respondent, that really does not matter because those who provide that service have been recognized as acting as industrial processors when that service is provided.

Petitioner further contends, in the alternative, that "Petitioner purchases the defective boards from its customers, reconditions/remanufactures them and then resells the circuit boards. In this alternative argument, the circuit board is the product." (Emphasis omitted.) Petitioner contends that if the boards are sold to it, altered, and then resold, this constitutes a sale, and the industrial processing exemption applies because the test beds are "used to alter the products owned and resold by Petitioner."

Petitioner contends that the plain language of the statutes control in this case. Petitioner cites the definition of "industrial processing" under several statutes and contends that "'industrial processing' includes more than production." (Emphasis omitted.) "If industrial processing is the act of altering the form, composition, or character of property to be sold, the fact that the Rule and statutory examples of industrial processing include maintenance of industrial processing equipment as industrial processing, means that such maintenance must be viewed as altering the products made by the machines being maintained." (Emphasis omitted.) In support of this contention, Petitioner asserts that "the appellate courts have held 'industrial processing' activity to include all activities that are 'an essential part of the process of manufacture.'" Petitioner contends that it uses the test beds to make automotive products because they "are used for exactly the same use that has been repeatedly used as an example of industrial processing – maintenance of processing equipment."

Petitioner further contends that "the Hearing Officer . . . invented a 'directness' test, which is contrary to the statute and the rule which includes activities indirectly related to production as examples of industrial processing." (Emphasis omitted.) Petitioner additionally contends that the Hearing Officer "also imposed a 'production must cease' test to determine directness and that is wrong both factually and legally." Petitioner instead contends that the Hearing

Officer should have considered the "marketability test," looking at "whether the alteration is a change that 'customers' or the 'market' demand and thus makes the property more marketable." Citing *Mc Culley v Dept of Treasury*, MTT 229758, and *Michigan Allied Dairy v Dept of Treasury*, 302 Mich 643, 648; 5 NW2d 516 (1942), Petitioner contends that if the changes that occur are significant to the customers, then those changes are deemed to be industrial processing activity. Petitioner contends that "changes to both the circuit boards and to automobiles and automotive parts made using the circuit boards in the present case, obviously meet the marketability test." (Emphasis omitted.)

Petitioner contends that other companies have been treated as exempt for maintaining industrial processing equipment. The "maintenance of processing equipment meets marketability test and changes the character of the product, if the machine maintained does so. There is no difference in the alterations made or the importance of the alterations to the automobiles when the maintenance of processing equipment is performed by an auto company and when it is done by Petitioner." (Emphasis omitted).

Petitioner further contends that it is an industrial processor, stating that "whether one looks to the automobiles or the circuit boards, Petitioner is changing a product to be sold." Petitioner contends that "it alters the form, composition, or character of the automobiles which are ultimately resold." (Emphasis omitted.)

Petitioner states that, since its activities are industrial processing activities, it must therefore qualify as an industrial processor. Petitioner contends that "the definition of an 'industrial processor' requires that property be altered 'for ultimate sale at retail,' but the statutory language does not require that the industrial processor, itself, sell any property." (Emphasis omitted.) By the absence of language explicitly requiring ultimate sale at retail by the industrial processor, Petitioner contends that the Legislature did not intend such a result. Petitioner further contends that, contrary to the finding of the Hearing Officer, "processors who provide a service may still be an industrial processor when performing the service. When a person who performs a service, acts as an industrial processor, in doing so, it still qualifies for the exemption." (Emphasis omitted.) As a result, Petitioner contends that the true test should be whether Petitioner "altered the form, composition, or character of some item of property (e.g. automobiles) for eventual resale (by anyone) and those tests are clearly met."

Petitioner states that, separate from the activity of making automobiles, Petitioner also makes and sells reconditioned or refurbished circuit boards. Petitioner contends that the Hearing Officer found in error that Petitioner's customers retained ownership of the circuit boards sent to Petitioner for repair. Instead, "the property was physically transferred to Petitioner for consideration and Petitioner does not ever have to return it." (Emphasis omitted.) Petitioner

contends it is then at its own discretion whether to alter the property by renovating or reconditioning it, or to throw the property away. Petitioner also contends that pricing is relevant here, stating:

> Whether many changes and many parts are changed on a particular board or whether fewer changes are made, there is only one price charged for the reconditioned board of a particular type which is shipped to the customer. This is not at all like a typical repair contract for consumer goods in which there is a bailment. . . . The present facts are consistent with a sale to petitioner of unfettered title to the board, followed by a resale to the customer of a reconditioned board, not a repair made while customer maintains ownership of the board.

Petitioner further contends that, for the period after March 31, 1999, the test beds are exempt if the Petitioner's activity was performed on behalf of or for an industrial processor, or if Petitioner was engaged in manufacturing.

Petitioner further contends that, even if it is not an industrial processor or engaged in industrial processing, the subject equipment is exempt because the test beds are a part of Computer-Assisted Manufacturing ("CAM") system and the test beds are used to maintain the CAM system are parts of a CAM system. Petitioner lists four reasons to treat the subject property as part of a CAM system: that such a definition is the most consistent with the word 'system'; that maintenance and repair of CAM components is a part of the CAM system because they have long been treated as components in industrial processing; that maintenance and testing equipment is generally included in the sale of CAM systems; and that the

Legislature clearly intended to include all CAM-related equipment by listing separate types of equipment in the statute.

As a result of the aforementioned, Petitioner contends that the penalty imposed upon it by Respondent should be canceled and asks the Tribunal to grant summary disposition in its favor.

Petitioner filed a Reply Brief to Respondent's Brief in Support of Motion for Summary Judgment on March 2, 2007. In its Reply Brief, Petitioner contends that Respondent has not submitted an affidavit and that its counter-statement of facts is inaccurate by omission. Petitioner contends that Respondent attempts to summarize its description of facts in "one short paragraph," which Petitioner contends is misleading "by simply omitting many important facts." (Emphasis omitted.) Petitioner's specific contentions of Respondent's key omissions include Respondent's exemption for test beds purchased by manufacturers to test, maintain, repair, or recondition their own equipment on the basis that the activity alters or modifies the form, composition, or character of property; Petitioner's receipt of malfunctioning circuit boards from its customers for consideration with no requirement that the board ever be returned, which Petitioner then contends will lead to the eventual reconditioning of property which Petitioner already owns; Petitioner's obligation to its customers only to provide a functioning circuit board, not to "have any specific repair made to any specific portion of the boards"; and

Petitioner's fixed charge to its customers for the repair or replacement of a particular circuit board, which Petitioner contends is distinguishable from a repair shop because "the same charge will be made regardless of the cost or activity involved in renovating that particular board."

Petitioner further contends that Respondent mischaracterized the figure of $136,027.65 as a tax amount when Petitioner contends that figure actually represents the tax amount, penalty, and interest.

Petitioner further contends that Respondent's interpretations of the statutes governing this case are incorrect and inconsistent with positions taken toward other taxpayers.

Petitioner further contends that Respondent's admission of Petitioner's exemption for the last three quarters of 1999 "would reduce the assessment tax and penalty amount to $86,104 … to which statutory interest would apply." (Emphasis omitted.)

Petitioner further contends that it should prevail if it proves either of two alternative arguments: that either the automobiles sold by Petitioner's customers or the circuit boards themselves are transformed, altered, or modified by Petitioner in terms of the boards' form, composition, or character.

In support of its argument that the automobiles ultimately sold are altered by Petitioner, Petitioner contends that Rule 40(2) explicitly defines industrial

processing as the alteration of tangible personal property for ultimate sale and that Rule 40(5) lists maintenance of processing equipment as an exempt industrial processing activity. Petitioner contends that Respondent is attacking its own rule that otherwise has been "consistently applied and never rescinded." Petitioner further contends that Respondent's citation of *Guardian v Dep't of Treasury*, 243 Mich App 244, 254; 621 NW2d 450 (2000), is in this case inappropriate because that case deals with a rule that contradicts the plain language of a statute, which Petitioner contends is not applicable in the present case. Petitioner further contends that "Rule 40 has been relied upon since 1972 for the proposition that maintenance of machinery does alter the product. The Department now wants to argue that these and many other activities essential to industrial processing do not cause an alteration or modification of the form, composition, or character of a product and that Rule 40 was void all along." Petitioner contends that Respondent "is bound to its promulgated rules until they are revised or rescinded." (Emphasis omitted.) Petitioner further contends that the Supreme Court has repeatedly determined that the application of Rule 40 is consistent with the statute through its decisions in cases such as *Minnaert v Dep't of Treasury*, 366 Mich 117; 113 NW2d 868 (1962); and *Elias Bros Restaurants v Dep't of Treasury*, 452 Mich 144, 152, fn 16, 156; 549 NW2d 837 (1996); and by lower courts in cases such as *International Research & Dev Co v Dep't of Treasury*, 25 Mich App 8; 81 NW2d 53 (1970); and

White Consolidated, Inc v Dep't of Treasury, Unpublished Opinion Per Curiam of the Court of Appeals, issued [April 15, 2003] (Docket No. 238096). Petitioner contends that for the Tribunal to reject Rule 40 as suggested by Respondent would be "inconsistent with the Supreme Court's decisions both before and since it was decided."

Petitioner further contends that the plain statutory language does not require Petitioner itself to sell the automobiles it alters.

In support of its argument that the circuit boards are altered and sold by Petitioner, Petitioner contends that the boards are owned by Petitioner, "reconditioned and then resold to the customer." Petitioner further contends that "the property altered is sold by Petitioner, itself." Further, Petitioner contends that "the test beds are used 'throughout the reconditioning process.'" Petitioner's contention is that Respondent "argues that the changes made to the circuit boards do not transform, alter, or modify the form, composition, or character of the circuit boards." (Emphasis omitted.) Petitioner contends Respondent's argument is incorrect due to the changes made to the reconditioned circuit boards while in Petitioner's possession, stating that lack of change to the products means "no one would pay for reconditioned products" and that "the Department would not have instructed that reconditioning qualifies for the exemption."

Petitioner further contends that Respondent relies upon two cases – *Beckman Production Services v Department of Treasury*, 202 Mich App 342; 508 NW2d 178 (1993); and *Michigan Automotive Resource Corp (MARCO) v Department of Treasury*, MTT Docket No. 109067, 1985 Mich Tax Lexis 35; 22 Mich App 227; 564 NW2d 503 (1997) – "to support its position that the exemption at issue in this case does not apply." Petitioner contends that both cases rely upon statutory language, 1970 PA 15, which "was completely removed from the statute by 1987 PA 141 suggesting that the removal of that language was intended by the Legislature to remove that limitation." Petitioner further contends that the present case is factually distinguishable from *Beckman* due to alterations made by Petitioner which reconditioned the boards, rather than removing foreign matter from the circuit boards as was the issue in *Beckman*. Petitioner further contends that the present case is factually distinguishable from *MARCO* due to the lack of ownership of the subject property by the party in that case. Petitioner therefore contends that "neither the *Beckman* nor *MARCO* decisions concerning the 1970 Amendment are binding in this case and activity essential to making automobiles is to be viewed as altering the automobiles in applying the 1987 Amendment."

Petitioner further contends that, in the alternative, it is entitled to an industrial processing exemption pursuant to MCL 205.94(g)(ii). Petitioner contends that Respondent does not attempt to analyze the meaning of the statute

and that Respondent offers only "a conclusory statement claiming that the test beds are not computers, computer equipment or components of a CAM or CAD system." Petitioner further contends that Respondent is incorrect in contending that production does not cease when a board fails. Petitioner further contends that "test beds and related equipment are considered in the industry to be part of the CAM system." (Emphasis omitted.)

b. RESPONDENT'S CONTENTIONS

Respondent filed a Cross-Motion for Summary Disposition on February 9, 2011. Respondent contends that any exemption from taxation for a taxpayer should be narrowly construed in favor of Respondent.

Respondent contends that Petitioner is not entitled to the exemption to the period prior to March 31, 1999, under MCL 205.94r. Respondent states that, in order for the exemption to apply, Petitioner would need to meet the two elements of an industrial processor under MCL 205.94r(1). Respondent contends that Petitioner fails the first prong of this test because Petitioner performs a service and does not act as an industrial processor while performing the service.

Respondent contends that *Beckham Production Services v Department of Treasury*, 202 Mich App 342; 508 NW2d 178 (1993), is mandatory authority. Respondent contends that *Beckham* supports its position by expressly rejecting exemption for a party whose services are not absolutely essential to the industrial

process of a manufacturer or producer. The court in that case held that the petitioner "provided a service that cleaned and removed sediment from tubing that improved oil and gas flow but that activity did not 'transform, alter, or modify the property so as to place it in a different form, composition, or character.'"

Respondent also contends that *Michigan Automotive Research Corp v Department of Treasury*, MTT Docket No. 109067; 1995 Mich Tax LEXIS 35, is mandatory authority in support of its position. The appellate court in *MARC* held that the test is "whether the petitioner performs services that transform, alter, or modify the property so as to place it in a different form, composition, or character."

Respondent contends that Petitioner's process is similar to the petitioners from the aforementioned cases and as a result is ineligible for the exemption. Respondent contends that, as a result, the testing, analyzing, and repairing of malfunctioning chips and boards does not qualify for the industrial processing exemption under MCL 205.94r.

Respondent further contends that the equipment used by Petitioner is not subject to the CAM equipment exemption that Petitioner cites. Respondent states that, to qualify, the equipment would need to be a computer, computer equipment, equipment used in a computer, or subunits or components in a computer-assisted manufacturing or design system, and that Petitioner's equipment does not fit any of those categories. "K&S readily admits that its customers, auto manufacturers,

continue to run their production facilities irrespective of whether K&S uses its test stations to check the functionality of computer chips and circuit boards because those customers simply replace any malfunctioning chip or board. Thus there is no connection between K&S's test stations and its customers' computer assisted manufacturing and design systems."

Respondent further contends that, because of its contention that Petitioner's test beds do not qualify for the stated exemptions, that use of those test beds is also subject to tax for the audited period ending March 31, 1999.

Respondent finally concedes that Petitioner's Motion for Summary Disposition for the period beginning March 31, 1999, is proper. Respondent recommends that Petitioner's Motion in reference to that time period is granted.

As a result of the aforementioned, Respondent contends that there is no genuine issue of material fact and that it is entitled to summary disposition for the audited period of June 1, 1995, through March 31, 1999.

Respondent filed a Reply to Petitioner's Brief in Support of its Motion for Summary Disposition on March 2, 2007. In its Reply Brief, Respondent contends that Petitioner incorrectly contends that "there is no distinction between the very different versions of the industrial processing exemption statutes applicable to different time periods in this case" and that "K&S's use of test stations to test and repair broken circuit boards that are component parts of its customers' computer

assisted manufacturing systems means that K&S is itself manufacturing automobiles and therefore it is an industrial processor engaged in industrial processing."

Respondent further contends that Petitioner asserts an incorrect amount of use tax and penalty owed in controversy. Respondent contends that the amount of use tax in controversy is not $105,389 but rather is $136,027.65.

Respondent further contends that Petitioner incorrectly contends that "facts supported by affidavits or other documentary evidence in support of a motion for summary disposition, are deemed to be true unless Respondent submits a counter affidavit raising a genuine issue of material fact." Respondent contends that, pursuant to MCR 2.116(G)(4), "when a motion under subrule (C)(10) is made and supported as provided in this rule, an adverse party may not rest upon the mere allegations or denials of his pleading, but must, by affidavit or as otherwise provided in the rule, set forth specific facts showing that there is a genuine issue for trial." Respondent contends that, pursuant to the rule, it is not limited to "raising a genuine issue of material fact only by counter affidavit."

Respondent further contends that Petitioner mischaracterizes the proposition that Respondent's construction of a statute is entitled to no greater weight than a taxpayer's construction, as propagated in *S Abraham & Sons v Department of Treasury*, 260 Mich App 1; 677 NW2d 31 (2003).

Respondent further contends that Petitioner mischaracterizes the proposition that Respondent cannot contend new reasons for its final assessment, as propagated in *Montgomery Ward v Department of Treasury*, 191 Mich App 674; 478 NW2d 745 (1991). Respondent contends that such an assertion is not relevant here because it continues to assert that Petitioner's "activities are not within the statutory language of the industrial processing exemption."

Respondent further contends that there were two versions of the exemption statute in effect at different times in this case and that the versions contain very different language. While repeating its concession that Petitioner is entitled to the industrial processing exemption for the period after March 31, 1999, Respondent contends that the statutory language in MCL 205.94r, in effect for the period from March 30, 1995, to March 31, 1999, "was much more limited in scope and application." Respondent contends that the cases cited by Petitioner – *Minnaert*, Supra and *International Research*, Supra – are not applicable here because those cases applied a different statutory exemption. Respondent contends that the 1987 amendment defined the term "industrial processor" to the effect that services "that are 'absolutely essential' to the industrial process of a manufacturer or producer" be excluded.

Respondent further contends that Petitioner's use of the test stations to repair the circuit boards does not transform, alter, or modify the boards so as to change

the boards' form, composition, or character. Respondent contends that Petitioner's reliance upon a "marketability test" is a misreading of the Tribunal's decisions in *Thompson McCulley v Department of Treasury*, MTT 229758, 1997 Mich Tax LEXIS 6, and *Michigan Allied Dairy v Department of Treasury*, 302 Mich 643; 5 NW2d 516 (1942). Respondent contends these cases are further distinguishable from the present case due to Petitioner's testing and fixing of a finished product, rather than the processing of raw materials such as in the two cited cases. Respondent instead contends this case is more akin to *Beckman*, Supra and *MARCO*, which involves cleaning and testing of equipment for industrial processors. Respondent further contends that Petitioner's customers' use of CAM systems to produce automobiles "simply cannot be the equivalent of a General Motors, or Ford, or DiamlerChrysler [sic] building cars from raw materials."

Respondent further contends that Petitioner is also ineligible for the exemption under the exception for people using computers, CAM, or CAD equipment. While conceding that Petitioner's activity "is a necessary aspect of purchasing and operating a CAM system," Respondent contends that the language of MCL 205.94r(1)(b) does not include "all equipment necessary for repair and maintenance," such as the equipment used by Petitioner.

Respondent further contends that a 10% penalty may be assessed upon Petitioner if the deficiency is due to negligence. Respondent contends that its

auditor recommended assessing a 10% negligence penalty because Petitioner "never reported any use tax during the audit period even though the auditor had identified all of the errors that lead [sic] to the entire audit deficiency two years earlier." Respondent further contends that its final assessment does not impose any penalty. Respondent contends that Petitioner never raised penalty as an issue either through its informal conference challenging the Intent to Assess nor in its prehearing statement or prehearing summary to the Tribunal. As a result, Respondent contends that penalty is not an issue in this case.

III. BILL OF COSTS AND ATTORNEY'S FEES

a. PETITIONER'S BILL OF COSTS AND ATTORNEY'S FEES

On May 31, 2011, the Tribunal ordered an award of costs to Petitioner under Petitioner's Motion to Impose Other Sanctions for Violation of Scheduling Order. On June 14, 2011, Petitioner filed a Bill of Costs and Attorney Fees. In this Bill, *inter alia*, Petitioner states:

a. "Petitioner's Bill of Costs and Attorney Fees is timely submitted."

b. "MCR 2.114(E) provides that 'the court … shall impose upon the person who signed it, a represented party, or both, an appropriate sanction, which may include an order to pay to the other party or parties the amount of the reasonable expenses incurred because of the filing of the document, including reasonable attorney fees.'"

c. "Pursuant to the Order of the Tax Tribunal, entered May 31, 2011, Petitioner herewith submits a bill of costs in the amount of $4,968.75 for attorney fees, plus costs of $50, for a total of $5,018.75."

d. "Petitioner's bill of costs is … based on a number of factors, including experience, reputation, and ability of the lawyer or lawyers performing the services; the professional standing and experience of the attorney; the skill, time and labor involved; and the amount in question and the results achieved."

e. "The hourly fees charged by Miller Canfield are reasonable and are customarily charged in the State of Michigan for matters involving tax law. … In this case, Mr. Rhoades charged a reasonable rate of $375 per hour."

f. "The number of hours expended by Mr. Rhoades in preparing the proposed Stipulation of Facts and Motion to Impose Sanctions are supported by 'detailed billing records.'"

g. "After determining a reasonable hourly rate and reasonable number of hours billed, a court should then consider the eight factors set forth in Michigan Rule of Professional Conduct ('MRPC') Rule 1.5 and the six factors set forth in *Wood v Detroit Auto Inter-Insurance Exchange*, 413 Mich 573, 588; 321 NW2d 653 (1982), for determining whether an adjustment should be made to the attorney fee charged."

h. "Petitioner has been wrongfully assessed over $105,389 of use tax for tax periods 6/1995-12/1999, exclusive of interest. With over $100,000 at issue, not including interest that has been running for over 15 years, $5,018.75 expended for the preparation and filing of a proposed Stipulation of Facts that the Tax Tribunal ordered the Parties to prepare and file and for the preparation and filing of Petitioner's Motion to Impose Sanctions was reasonable."

i. "Petitioner is a valued and important client of Miller Canfield. The thought of improperly charging Petitioner is out of the question."

j. "Mr. Rhoades has been practicing law since 1977. At the time of the preparation of the Stipulation of Facts and Motion to Impose Sanctions (February 9, 2007), Mr. Rhoades has taught classes in state and local taxation at Wayne State University and at Walsh College and is a frequent national speaker on property taxation. Mr. Rhoades' current biographical information as a Member of Dickinson Wright PLLC and biographical

information from around the time Mr. Rhoades prepared the proposed Stipulation of Facts and Motion to Impose Sanctions as a Principal of Miller, Canfield, Paddock and Stone, P.L.C., are presented as Attachment 5. Based on his experience, the charges are entirely reasonable."

k. "Petitioner hereby submits that the hourly fees charged as well as the number of hours expended were reasonable and that Petitioner should be awarded the attorney fees and costs requested, $5,018.75, as supported by the detail attached as Attachment 3."

b. RESPONDENT'S OBJECTION

On June 28, 2011, Respondent filed an Objection to Petitioner's Bill of Costs. In its Objection, Respondent states:

a. "Respondent still objects to various items included in Petitioner's bill of costs as set forth in Tab 3 attached to its motion."

b. "Regarding the entry for 1/5/2007, Petitioner does not show a reduction for any time billed from Tab 2 to Tab 3. Respondent objects to the inclusion of time for drafting, revising Petitioner's affidavit attached to the motion for summary disposition, and a letter to its client. Neither of those items falls within the Tribunal's order for which it granted Petitioner costs for preparation of the proposed stipulation of facts and the motion to impose other sanctions."

c. "Regarding the entry for 1/11/2007, Respondent objects to the inclusion of time for reviewing the scheduling order and telephone call to Petitioner. Neither of those items falls within the Tribunal's order for which it granted Petitioner costs for preparation of the proposed stipulation of facts and the motion to impose other sanctions."

d. "Regarding the entry for 2/6/2007, Respondent objects to the entire amount of time claimed because none of the items and associated time relate to Petitioner's drafting of the proposed stipulation of facts or to the motion to impose other sanctions."

e. "For purposes of its bill for costs, Petitioner has grouped several tasks for each entry date and billed time for the total time spent as a group of tasks. This method makes it difficult to object with specificity as to the amount of time for a specific task on a specific date that Respondent asserts is not properly included in the bill of costs."

f. "Based on the method in which Petitioner has submitted the costs per group of tasks under Tab 3, and the fact that many tasks are not related to the preparation of the proposed stipulation of facts and the motion to impose other sanctions, Respondent asserts that the amount of time billed should be reduced by 25% to 50%."

g. "In addition, Respondent objects to Petitioner's use of the 2010 Economics of Law Practice Attorney Income and Billing Rate Summary Report to support applying a 2010 year, $375.00 hourly rate charge to billing time that occurred in 2007. (Petitioner's Bill of Costs p3)"

h. "The proper Report is the 2007 Economics of Law Practice Summary Report. (Attachment 1)"

i. "For 2007, listed within the top 10 median hourly transactional billing rates by practice, taxation set a media billing rate of $275.00 per hour. (Attachment 1, p21). That same category for litigation by field of practice listed the median hourly rate for litigation at $200.00. (Attachment 1, p2.)"

j. "When broken down by region, the top 10 regional median hourly transactional billing rate for the Lansing area was $197.50. (Attachment 1, p23). While there was not a corresponding top 10 regional median hourly litigation billing rate for the Lansing area, in 2007, even in large markets like Grand Rapids and Downtown Detroit the rates were $237.50 and $210.00, respectively."

k. "Consequently, under the proper benchmark, the proposed 2010 year $375.00 hourly rate Petitioner relies on in its bill of costs is excessive in the range of $100.00 to $150.00 per hour over the customary and usual rate of 2007."

l. "Finally, Petitioner includes two motion fees in its bill. There should be only one motion fee attributable to the motion to impose other sanctions for violating the scheduling order."

IV. FINDINGS OF FACTS

Petitioner, K & S Industrial Services, Inc., is appealing Final Assessment number K439106 issued on September 7, 2004. The Final Assessment assesses use tax liability of $136,027.65 and interest of $30,374.32, for the period of June 1995 through December 1999.

Petitioner K & S Industrial Services, Inc., is a Michigan corporation that receives circuit boards from its manufacturing customers, in exchange for consideration, for the purposes of testing and reconditioning. Respondent is the state department responsible for administering the state's use tax. Respondent audited Petitioner for the period from June 1995 to December 1999. Due to a change in state law on March 31, 1999, Respondent and Petitioner agree that Petitioner is eligible for the exemption from April through December 1999. However, the period from June 1995 through March 1999 remains contested.

For the period of June 1995 through March 1999, Petitioner's subject activity is exempt from the use tax if it is used by an industrial processor for industrial processing, as set forth by MCL 205.94(g)(i), or if it meets one of the

exceptions applied to computers and computer-related equipment, as set forth by MCL 205.94(g)(ii).

As defined by MCL 205.94r, an industrial processor is an entity which "transforms, alters, or modifies tangible personal property by changing the form, composition, or character of the property for … sale to another industrial processor to be further processed for ultimate sale at retail."

Petitioner receives malfunctioned circuit boards from its customers, and such receipt excludes the customers' right to receive back the same board or any portion of that board. Petitioner used the subject equipment, known as a test bed or test station, to analyze the circuit board for diagnostic failure or defects. Based upon the result, Petitioner then determines whether to replace the board, which includes ordering the replacement board, testing it, and shipping it to the customer, or to recondition the board, which includes replacing any non-operating portion of that equipment.

V. APPLICABLE LAW

Petitioner and Respondent both move for summary disposition pursuant to MCR 2.116(C)(10), which provides that: "Except as to the amount of damages, there is no genuine issue as to any material fact, and the moving party is entitled to judgment or partial judgment as a matter of law." There is no specific tribunal rule governing motions for summary disposition. As such, the Tribunal is bound to

follow the Michigan Rules of Court in rendering a decision on such a motion. TTR 1111(4).

The Michigan Supreme Court, in *Quinto v Cross and Peters Co*, 451 Mich 358; 547 NW2d 314 (1996), provided the following explanation of MCR 2.116(C)(10).

> MCR 2.116 is modeled in part on Rule 56(e) of the Federal Rules of Civil Procedure…[T]he initial burden of production is on the moving party, and the moving party may satisfy the burden in one of two ways.
>
> First, the moving party may submit affirmative evidence that negates an essential element of the nonmoving party's claim. Second, the moving party may demonstrate to the court that the nonmoving party's evidence is insufficient to establish an essential element of the nonmoving party's claim. If the nonmoving party cannot muster sufficient evidence to make out its claim, a trial would be useless and the moving party is entitled to summary judgment as a matter of law.
>
> In reviewing a motion for summary disposition brought under MCR 2.116(C)(10), a trial court considers affidavits, pleadings, depositions, admissions, and documentary evidence filed in the action or submitted by the parties, MCR 2.116(G)(5), in the light most favorable to the party opposing the motion. A trial court may grant a motion for summary disposition under MCR 2.116(C)(10) if the affidavits or other documentary evidence show that there is no genuine issue in respect to any material fact, and the moving party is entitled to judgment as a matter of law. MCR 2.116(C)(10), (G)(4).
>
> In presenting a motion for summary disposition, the moving party has the initial burden of supporting its position by affidavits, depositions, admissions, or other documentary evidence. The burden then shifts to the opposing party to establish that a genuine issue of disputed fact exists. Where the burden of proof at trial on a dispositive issue rests

> on a nonmoving party, the nonmoving party may not rely on mere allegations or denials in pleadings, but must go beyond the pleadings to set forth specific facts showing that a genuine issue of material fact exists. If the opposing party fails to present documentary evidence establishing the existence of a material factual dispute, the motion is properly granted. *Id*. at 361-363. (Citations omitted.)

In the event, however, it is determined that an asserted claim can be supported by evidence at trial, a motion under subsection (C)(10) will be denied. *Arbelius v Poletti*, 188 Mich App 14; 469 NW2d 436 (1991).

For the period prior to March 31, 1999, MCL 205.94(g) and MCL 205.94(r) provide taxation exemptions to parties engaged in industrial processing. MCL 205.94(g)(i) and MCL 205.94r(1)(a) exempt industrial processors for use or consumption in industrial processing. "Industrial processor" in this instance means "a person who transforms, alters, or modifies tangible personal property by changing the form, composition, or character of the property for ultimate sale at retail or sale to another industrial processor to be further processed for ultimate sale at retail." MCL 205.94(g)(ii) and MCL 205.94r(1)(b), where relevant, exempt a person, whether or not they are an industrial processor, "when the property is a computer used in operating industrial processing equipment; equipment used in a computer assisted manufacturing system; equipment used in a computer assisted design or engineering system integral to an industrial process; or a subunit or

electronic assembly comprising a component in a computer integrated industrial processing system."

For the period after March 31, 1999, MCL 205.94o provides taxation exemptions to parties engaged in industrial processing or, in relevant part, as stated in MCL 205.94o(1)(c), to "a person, whether or not the person is an industrial processor, if the tangible personal property is used by that person to perform an industrial processing activity for or on behalf of an industrial processor."

VI. CONCLUSIONS OF LAW

As discussed above, the first issue to be resolved by the Tribunal in this matter is whether remanufacturing and reselling processing equipment under an ongoing contract with auto manufacturers qualifies as industrial processing activity. The Tribunal has carefully considered Petitioner's and Respondent's Motions under MCR 2.116(C)(10) and finds that granting Petitioner's Motion under MCR 2.116(C)(10) is warranted. The Tribunal concludes that the pleadings, affidavits, and documentary evidence prove there is no issue as to whether such an activity is a type of industrial processing.

For the period prior to March 31, 1999, the controlling unambiguous statutory language is MCL 205.94(g)(i). The statute states in relevant part that "'industrial processor' means a person who transforms, alters, or modifies tangible personal property by changing the form, composition, or character of the property

for ultimate sale at retail or sale to another industrial processor to be further processed for ultimate sale at retail."

First, the Tribunal must determine whether Petitioner is a ". . . person who transforms, alters, or modifies tangible personal property by changing the form, composition, or character of the property. . . ." *Id.* Specifically, the first issue to be addressed is whether reconditioning computer boards changes the form, composition, or character of the boards.

Words and phrases in a statute are to be given their plain and ordinary meaning. *Kinder Morgan Mich., LLC v. City of Jackson*, 277 Mich App 159, 163; 744 NW2d 184, 188 (2007). Dictionary definitions may be helpful in construing statutory language according to its common and approved usage. *People v Bobek*, 217 Mich App 524, 529; 553 NW2d 18, 21 (1996). "Character" is defined as "[t]he combination of qualities or features that distinguishes one person, group, or thing from another." *The American Heritage College Dictionary* (4th Ed., 2002). "Composition" is defined as "[t]he combining of distinct parts or elements to form a whole," and is also defined as "[t]he manner in which such parts are combined or related." *Id.*

It is clear from the facts at hand that the reconditioning of the circuit boards changes the character *and* composition of the board. Specifically, when Petitioner receives the circuit board it is not in working condition and Petitioner makes the

following various alterations: "replaces or repairs all nonfunctioning components . . . parts are added and connections repaired, short circuits are repaired, etc." Affidavit of Peter Okonkowski, ¶ 10. The composition of the circuit boards are changed which results in a functioning circuit board. Additionally, the character of the circuit boards is changed as the nonfunctioning circuit board is altered to become a circuit board in full working condition.

Petitioner cites *Thompson McCulley v Department of Treasury*, MTT Docket No. 229758. Here, the Tribunal held that "[t]he reduction of moisture content to a marketable level, even though small, is a substantial altering and modification to the composition and character of the product." *Id.* at 13. Thus, the test is not a test of marketability; rather, the test is whether there is substantial modification. The Tribunal finds that the reconditioning of the circuit boards to alter a nonworking circuit board to a working circuit board is substantial modification of the character and composition of the circuit boards.

The remaining issue is whether the tangible personal property is changed for ultimate sale at retail or sale to another industrial processor to be processed for ultimate sale at retail. Petitioner contends that the property is transferred to Petitioner for consideration and Petitioner does not ever have to return the circuit board. Rather, Petitioner maintains that it has unfettered control over the circuit board and the original owner of the board does not retain any right to regain

possession or control over that circuit board. According to Petitioner, when it receives possession of the circuit board the consideration for the transfer of possession is its promise to recondition or replace the board. Affidavit of Peter Okonkowski, ¶ 11. Once Petitioner has possession of the board it may ". . . replace it by ordering a new board or recondition the existing board." *Id.* The boards are transferred to Petitioner with the understanding that the customer will be given a working board and the customer pays Petitioner to send back a working board. *Id.* Petitioner then transfers the reconditioned circuit board back to the customer for consideration. Affidavit of Peter Okonkowski, ¶ 10. The amount charged is based on the reconditioned board price for a particular model of board, ". . . regardless of Petitioner's costs to recondition any particular board." *Id.*

The statutory definition of "purchase," in the Use Tax Act is ". . . to acquire for a consideration, whether the acquisition is effected by a transfer of title, of possession, or of both, or a license to use or consume; whether the transfer is absolute or conditional, and by whatever means the transfer is effected; and whether consideration is a price or rental in money, or by way of exchange or barter." MCL 205.92(e). The statutory definition of "price," in the Use Tax Act is ". . . the total amount of consideration paid by the consumer to the seller, including cash, credit, property, and services, for which tangible personal property or services are sold, leased, or rented, valued in money, whether received in money or

otherwise, and applies to the measure subject to use tax." In applying these definitions to the transactions that occurred between Petitioner and its customers, the Tribunal finds that when Petitioner acquired possession of the malfunctioning circuit boards and promised its customers it would recondition the circuit board, this transaction is considered a purchase. Further, after Petitioner retained possession over the circuit boards, it fulfilled its promise by reconditioning the circuit boards (or replacing the circuit board) and selling it to the customer. Thus, Petitioner has met its burden in establishing that the tangible personal property is changed for ultimate sale at retail.

Petitioner's subject activity qualifies as industrial processing under MCL 204.94(g)(i); thus, Petitioner is an industrial processor entitled to an exemption for the use of gas and electricity consumed while reconditioning computer boards and granting of the exemption for Petitioner for the period prior to March 31, 1999, is appropriate.

Pursuant to MCL 205.94o, use tax does not apply to property sold to the following after March 30, 1999: (a) an industrial processor for use or consumption in industrial processing and (2) a person, whether or not the person is an industrial processor, if the tangible personal property is intended for ultimate use in and is used in industrial processing by an industrial processor. MCL 205.94o. The Tribunal has determined that Petitioner is an industrial processor and therefore,

Petitioner is exempt from use tax under MCL 205.94o(a). Nevertheless, Respondent concedes that Petitioner is exempt under MCL 205.94o(b), regardless of the Tribunal's determination, for the period after March 31, 1999.

As a result of the findings above, it is not necessary to determine whether Petitioner qualifies for the exemption under MCL 205.94(g)(ii) relating in relevant part to "a person, whether or not the person is an industrial processor, when the property is … equipment used in a computer assisted manufacturing system."

For the reasons stated herein, the Tribunal grants Summary Disposition in favor of Petitioner under MCR 2.116(C)(10).

The remaining issue to be resolved in this matter is whether Petitioner's Bill of Costs and Attorney Fees is appropriate. The Tribunal's Order of May 31, 2011, stated ". . . that Petitioner's request for costs is justified." The Order provided Petitioner with 14 days to file and serve a bill of costs in compliance with TTR 145(3). Petitioner filed a Bill of Costs and Attorney Fees on June 14, 2011. The bill included $4,968.75 for attorney fees and $50.00 for costs. Respondent objected to Petitioner's Bill of Costs on June 28, 2011.

The Tribunal's Order did not grant an award of attorney fees to Petitioner. Attorney fees are generally not recoverable as costs in the absence of a statute or court rule authorizing an award of attorney fees. MCL 600.2405(6). *See also* 7 Mich Civ Jur Damages § 8 (citing *Matras v Amoco Oil Co*, 424 Mich 675; 385

NW2d 586 (1986); *Attorney General v Piller*, 204 Mich App 228; 514 NW2d 210 (1994); *Bonner v Chicago Title Ins Co*, 194 Mich App 462; 487 NW2d 807 (1992); *DeWald v Isola*, 188 Mich App 697; 470 NW2d 505 (1991)). Two exceptions to the general rule can be found in MCR 2.114 and MCL 600.2591. In order to ensure that documents filed with a court do not contain unwarranted allegations or denials, MCR 2.114 requires that every document submitted to a court be signed by at least one attorney of record. MCR 2.114(C)(1). Additionally, the Michigan Legislature has adopted MCL 600.2591 to further combat frivolous lawsuits. *See BJ's & Sons Const Co, Inc v Van Sickle*, 266 Mich App 400, 405; 700 NW2d 432 (2005).

In this instance, the Tribunal finds no evidence that would justify granting attorney fees. As a result, awarding Petitioner's requested $4,968.75 for attorneys fees is not appropriate. Petitioner's request for $50.00 in costs is supported and shall be awarded.

VII. JUDGMENT

IT IS ORDERED that Petitioner's Motion for Summary Disposition is GRANTED.

IT IS FURTHER ORDERED that Respondent's Motion for Summary Disposition is DENIED.

IT IS FURTHER ORDERED that Respondent shall remit $50.00 to Petitioner within 21 days of the entry of this Order.

IT IS FURTHER ORDERED that Respondent's Final Assessment No. K439106 is CANCELLED.

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

MICHIGAN TAX TRIBUNAL

Entered: July 15, 2011 By: Kimbal R. Smith III