

STATE OF MICHIGAN
IN THE SUPREME COURT

DETROIT EDISON COMPANY,

Plaintiff-Appellee,

v

DEPARTMENT OF TREASURY,
~~STATE OF MICHIGAN,~~

Defendant-Appellant.

Supreme Court No.

Publ. Opn.

Court of Appeals No. 309732

1-9-14

Court of Claims No. 10-104-MT

P. Manderfeld

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MICHIGAN DEPARTMENT OF TREASURY'S
APPLICATION FOR LEAVE TO APPEAL

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STATEMENT OF QUESTIONS PRESENTED

1. The statute that creates a tax exemption for tangible personal property used in industrial processing specifically states that “[i]ndustrial processing does not include . . . distribution . . . [or] shipping.” Here, Detroit Edison uses one set of equipment to generate electricity, but then uses a different set of equipment to transmit and distribute the electricity to its customers. Did the Legislature intend to treat electricity generators differently from other industrial processors by exempting electricity transmission and distribution equipment from the use tax?

Appellant’s answer: No.

Appellee’s answer: Yes.

Trial court’s answer: Yes.

Court of Appeals’ answer: Yes.

2. The industrial processing exemption statute requires persons who use tangible personal property in the exempt activity of industrial processing but who also use the same property for non-exempt purposes to apportion such use to allow for exemption of only the exempt activity. The lower courts relied on invalid caselaw to grant Detroit Edison an exemption “*in full*” even though both courts found it indisputable that Detroit Edison used its tangible personal property at issue for both exempt and non-exempt purposes. Did the lower courts err?

Appellant’s answer: Yes.

Appellee’s answer: No.

Trial court’s answer: Did not address.

Court of Appeals’ answer: Did not address.

CONSTITUTIONAL PROVISIONS, STATUTES, RULES INVOLVED

MCL 205.94o Exemptions; limitation; industrial processing; definitions.

Sec. 4o.

(1) The tax levied under this act does not apply to property sold to the following after March 30, 1999, subject to subsection (2):

(a) An industrial processor for use or consumption in industrial processing.

(2) The property under subsection (1) is exempt only to the extent that the property is used for the exempt purpose stated in this section. The exemption is limited to the percentage of exempt use to total use determined by a reasonable formula or method approved by the department.

(3) Industrial processing includes the following activities:

(a) Production or assembly.

(d) Inspection, quality control, or testing to determine whether particular units of materials or products or processes conform to specified parameters at any time before materials or products first come to rest in finished goods inventory storage.

(4) Property that is eligible for an industrial processing exemption includes the following:

(a) Property that becomes an ingredient or component part of the finished product to be sold ultimately at retail or affixed to and made a structural part of real estate.

(b) Machinery, equipment, tools, dies, patterns, foundations for machinery or equipment, or other processing equipment used in an industrial processing activity and in their repair and maintenance.

(c) Property that is consumed or destroyed or that loses its identity in an industrial processing activity.

(d) Tangible personal property, not permanently affixed and not becoming a structural part of real estate, that becomes a part of, or is used and consumed in installation and maintenance of, systems used for an industrial processing activity.

(e) Fuel or energy used or consumed for an industrial processing activity.

(f) Machinery, equipment, or materials used within a plant site or between plant sites operated by the same person for movement of tangible personal property in the process of production. Property exempt under this subdivision includes front end loaders, forklifts, pettibone lifts, skidsters, multipurpose loaders, knuckle-boom log loaders, tractors, and log loaders used to unload logs from trucks at a saw mill site for the purpose of processing at the site and to load lumber onto trucks at a saw mill site for purposes of transportation from the site.

(5) Property that is not eligible for an industrial processing exemption includes the following:

(d) An industrial processor's own product or finished good that it uses or consumes for purposes other than industrial processing.

(i) Tangible personal property used or consumed for the preservation or maintenance of a finished good once it first comes to rest in finished goods inventory storage.

(6) Industrial processing does not include the following activities:

(b) Sales, distribution, warehousing, shipping, or advertising activities.

(7) As used in this section:

(a) "Industrial processing" means the activity of converting or conditioning tangible personal property by changing the form, composition, quality, combination, or character of the property for ultimate sale at retail. . . . Industrial processing

begins when tangible personal property begins movement from raw materials storage to begin industrial processing and ends when finished goods first come to rest in finished goods inventory storage.

(b) "Industrial processor" means a person who performs the activity of converting or conditioning tangible personal property for ultimate sale at retail or use in the manufacturing of a product to be ultimately sold at retail. . . .

R 205.115 Public utilities; gas, electricity, and steam.

Rule 65.

(3) The sale of tangible personal property is not taxable when consumed or used in the process of manufacturing or generating electricity, gas, or steam which is taxable when sold at retail. Transformers used in industrial processing are not taxable.

(4) The sale of tangible personal property consumed or used in the transmission or distribution of electricity, gas, or steam is taxable. Such transmission or distribution starts at the place where the product leaves the immediate premises from which it is manufactured.

R 205.90 Industrial processing.

Rule 40. (1) This rule applies to sales, purchases and rentals of tangible personal property to persons for use or consumption in industrial processing, and the word "sales" hereafter used shall be construed to be either sale, purchase or rental. The word "manufacturing" as used in this rule is included within those activities which are considered "industrial processing."

(2) "Industrial processing" means the activity of converting or conditioning tangible personal property by changing the form, composition, quality, combination or character of the property for ultimate sale at retail or use in manufacturing of a product to be ultimately sold at retail.

(3) The sale of tangible personal property to manufacturers, which property becomes an ingredient or component part of the finished product or that which is consumed, destroyed or loses its identity in a manufacturing process, together

with the processing machinery and equipment (including maintenance and repairs thereof) used in the manufacturing of a product which is either to be sold ultimately at retail or to be used as tangible personal property in the manufacture of a product to be sold ultimately at retail, is not taxable. The consumption or use of the tangible personal property rather than the kind or character of the property sold is the determining factor as to whether or not such a sale is taxable. The industrial processing exemption does not include:

(a) Tangible personal property permanently affixed and becoming a structural part of real estate. This includes building utility systems such as heating, air conditioning, ventilating, plumbing, lighting and electrical distribution. Example: all electrical transmission and distribution materials and equipment which are installed in the construction of plant facilities for, or by, an industrial processor for use in transmitting electrical energy is taxable up to the last transformer, switch or other device at which point usable power is diverted from distribution circuits for use in industrial processing.

(h) Tangible personal property used or consumed for the preserving or maintaining of a product in the form and condition in which it is to be sold.

(4) The following examples of nontaxable sales illustrate the application of the industrial processing exemption:

(a) Property which becomes an ingredient or component part of the finished product to be sold ultimately at retail.

(b) Machinery, tools, dies, patterns, machinery and equipment foundations and other processing equipment, including repair and maintenance of all of these, used in an industrial processing operation.

(c) Property which is consumed, destroyed or loses its identity in a manufacturing or other production process.

(f) Machinery, equipment and materials used within a plant site for movement of tangible personal property in process of production.

(5) Industrial processing includes the following activities:

(a) Production.

(g) Production material handling.

(6) Industrial processing does not include the following activities:

(b) Sales, distribution, warehousing, shipping and advertising departments.
(See R 205.68.)

(7) The foregoing examples of taxable and exempt activities shall not be considered as exclusive in either category but are included as generally descriptive of industrial processing operations which are considered exempt as distinguished from nonexempt activities.

(8) Where the industrial processing areas or spaces are not separate and distinct from other departments or activities, or where the same tangible personal property can be used or consumed in the industrial processing area and 1 or more other areas, the tax will apply to such property unless it can be determined and substantiated to the satisfaction of the revenue division, department of treasury that a percentage or other apportionment thereof is equitable and practical.

**STATEMENT OF JUDGMENT /
ORDER APPEALED FROM AND RELIEF SOUGHT**

Appellant Michigan Department of Treasury seeks leave to appeal the published opinion of the Court of Appeals dated January 9, 2014. Treasury seeks reversal of the Court's affirmation of the trial court's grant of summary disposition in favor of Appellee Detroit Edison Company.

Treasury seeks specifically this Court's determination that Detroit Edison's use of transformers and other related equipment, located outside of its generation facility, to transmit and distribute electricity is not entitled to the industrial processing exemption from use tax, MCL 205.94o.

INTRODUCTION

The industrial processing exemption from use tax is one of the most, if not the most, contentious and frequently litigated Use Tax Act provisions. Accordingly, it is crucial to ensure that court decisions accurately reflect the Legislature's intended use of the exemption. In crafting the exemption, the Legislature specifically excluded certain activities and property that would otherwise fall within the definition of industrial processing, and one of those exclusions is for distribution. This more specific exclusion controls over the general definition of industrial processing, which means that if something qualifies as distribution, it does not qualify as industrial processing.

Contrary to this and other principles of statutory construction, the lower courts here inferred a broad expansion of the exemption statute that gives electricity producers special treatment and disregards the statute's plainly expressed limitation that distribution is *not* industrial processing.

Preemptory reversal or leave to appeal the lower courts' decisions is warranted for a number of reasons:

- This case presents an issue of significant public interest, MCR 7.302(B)(2), because it treats a single type of industrial processor differently from all others and because of its impact on the State's budget (\$20 million is at issue in this case alone, and similar refund claims from other electricity producers could amount to \$55 million or more).
- It concerns fundamental legal principles of major significance, MCR 7.302(B)(3), because it expands a tax exemption by inference (ignoring the unambiguous-expression requirement) and incorrectly invalidated a promulgated rule that had the force of law.

- The published decision below is clearly erroneous, MCR 2.302(B)(5), because the processing exemption expressly does not apply to the shipping or distribution of the product, yet the Court of Appeals still gave Detroit Edison the exemption even after conceding that Detroit Edison's equipment was used to distribute electricity.
- The decision is also clearly erroneous because when a taxpayer uses equipment for both exempt and non-exempt uses, the statute explicitly allows the exemption only if taxpayers to apportion between the exempt and non-exempt uses. Here, the Court of Appeals allowed Detroit Edison to take the exemption on its mixed use equipment *in full*, even though Detroit Edison made no attempt to apportion the uses.
- The decision will cause material injustice to the State, MCR 2.302(B)(5), because it created an enormous loophole that enables widespread abuse. Under the decision, all a person must do to gain the exemption for all of its delivery machinery and equipment is to purposefully not finalize production of a product within the plant or facility. For example, an automobile manufacturer could decide to require its dealerships to complete some simple steps to finalize the automobile's manufacture, and then equipment used to store and then transport its "partially finished" automobiles would be exempt. In short, the potential for abuse and the impact on the State's tax revenue is very significant.

STATEMENT OF FACTS

Detroit Edison generates, transmits, and distributes electricity to residential, commercial, and industrial customers in Southeast Michigan. Treasury audited Detroit Edison for use tax for the period of January 1, 2003, through September 30, 2006. As a result of the audit, Treasury assessed use tax on all of Detroit Edison's transformers and related distribution equipment located outside of its generation facility, and on its use of certain research and training services. The basis for Treasury's treatment of those transformers and equipment was that they are used for the transmission and distribution of electricity to customers and not the generation of electricity. Consequently, that property was not used for industrial

processing activities that would entitle Detroit Edison to an exemption from use tax.

Detroit Edison paid the use tax assessed under protest and also claimed that it erroneously paid use tax on additional equipment. Detroit Edison requested a refund of use taxes paid in the amount of \$19,603,187.06, plus statutory interest, costs, and attorney's fees. Treasury denied that request.

Detroit Edison is an industrial processor, pursuant to the Use Tax Act, MCL 205.94o, when it generates electricity within its generation facility. Therefore, Detroit Edison's use of tangible personal property, including transformers, to generate electricity is exempt from use tax under the industrial processing exemption.

But Detroit Edison also uses transformers and other related equipment outside of its generation facility to transmit and distribute electricity. Shipping and distribution activities are expressly excluded from industrial processing activities. MCL 205.94o(6)(b). Consequently, based on the express statutory definition, Treasury concluded that Detroit Edison's transformers and other related equipment outside of its facility are not exempt from use tax under the exemption statute.

PROCEEDINGS BELOW

The Court of Claims holds that the exemption applies.

The Court of Claims considered Detroit Edison's affiants' testimony on the physics of electricity and electricity generation in developing the Court's analysis

and conclusion. (Att A: Opinion and Judgment Granting In Part and Denying in Part Motions for Summary Disposition.)

As found by the Court: electricity is an organized flow of electrons endowed with voltage. The organized flow of electrons is generated by Detroit Edison when a direct current travels through a coil on a metal shaft creating a magnetic field resulting in a current. It is that product that leaves the Detroit Edison's generator. Electricity at this point has a voltage range of 15,000 to 20,000 volts. Detroit Edison causes the electricity to pass through a step up transformer that increases the voltage range to 115,000 to 500,000 volts. This stepped up electricity then moves through high voltage transmission and subtransmission lines. During this phase the electricity is continually monitored for voltage and current to maintain its frequency in response to changes in demand load, faults, and other problems that may occur while in transit. At the end of high voltage transmission there are subtransmission stations that reduce the voltage of the electricity to around 5000 to 13000 volts before connecting to lower voltage distribution lines. All the while, the electricity is still being monitored for voltage and current to maintain its frequency in response to changes on the distribution system. Next, the electricity passes through a final step down transformer that reduces voltage further still—to the 120/240 volt range, at which point electricity becomes a finished good, usable by Detroit Edison's residential customers. Finally, electricity passes through the customers' meters undergoing still further monitoring to ensure compliance with regulations.

The Court found further support for those factual findings from Treasury's expert witness affiant who admitted that stepping up and then down the voltage conditions the electricity.

The Court of Claims also took note of Detroit Edison's supplemental affidavit to bolster the Court's conclusion that electricity is never a finished product which ends the industrial processing activities. According to this affidavit, Detroit Edison's generator equips free electrons with voltage and becomes electricity. But because electrons will return to their natural state they must be continually processed in order to remain endowed with voltage. And that role is performed by Detroit Edison's transformers and other related equipment along the transmission and distribution system.

In addition, the Court adopted Detroit Edison's evidence that there was a dual use of the transformers and related equipment along the transmission and distribution system. The Court found that the system served to transport electricity while it also processes the electricity. Even though the industrial processing exemption requires apportionment of exempt use from non-exempt use, MCL 205.94o (2), the Court held that the exemption applies to 100% of Detroit Edison's equipment.

The Court of Appeals affirmed the exemption's applicability.

Similar to the lower court, the Court of Appeals found Detroit Edison's affiant testimony about the physics of electricity during transmission and distribution factually dispositive on the issue of whether electricity was continually processed

throughout transmission and distribution, and that electricity was never a finished product until passing through customers' meters. (Att. B: Slip Opinion, FOR PUBLICATION, Docket No 309732, January 9, 2014).

Consistent with the Court of Claims, the appellate court acknowledged that there was no dispute that after electricity left the generation facility the transformers and related equipment increased and decreased voltage to allow for transmission and distribution.

Regarding the exemption statutory language, the Court focused on the definition of "industrial processing", MCL 205.94o (7)(a), and on that part of the statute which included the activities of inspection, quality control, or testing within industrial processing activities. MCL 205.94o(3)(d). The Court held that the terms "form, composition, quality, combination, or character" as used to define industrial processing were sufficiently broad and expansive to encompass changing voltage and current in electricity as it is transmitted and distributed. Therefore, electricity was not a finished product ready for sale until it reached Detroit Edison's customers' meters. Further, the Court determined that transformers and related equipment were used to inspect, test, and control the quality of electricity during transmission and distribution in response to load demand.

The Court also specifically rejected Treasury's argument that the activities of transmission and distribution were expressly and unambiguously excluded from industrial processing activities under MCL 205.94o(6)(b). That provision states that industrial processing activities do not include shipping and distribution.

Instead, the Court construed MCL 205.94o (7)(a), which in part specifies that industrial processing ends when a finished good becomes part of finished goods inventory, in conjunction with the reference to inspection, testing, quality control with respect to finished goods inventory in MCL 205.94o(3)(d). The result of the Court's construction was to rationalize that the Legislature envisioned a simple manufacturing situation where there is a "clean line of demarcation between production and distribution" such that the shipping and distribution exclusion from industrial processing activities, MCL 205.94o(6)(b), applied only in the simple manufacturing situation.

But the Court held this case was not such a simple situation. And because that was true, the Court further held that caselaw from 1942 required Detroit Edison be entitled to the exemption "*in full*" for all its transformers and related equipment located outside of the generation facility. In this regard, the Court never considered that during the relevant time period the law expressly required an apportionment of taxable use from non-taxable use. MCL 205.94o(2). That subsection provides, "[t]he exemption is limited to the percentage of exempt use to total use determined by a reasonable formula or method approved by the department."

Lastly, the Court addressed Treasury's promulgated rule, 1979 AC, R 205.115. The rule provides in relevant part that property used in transmission and distribution of electricity is taxable and that transmission and distribution starts after electricity leaves the generation facility. Rule 205.115(4). The Court admitted

that “Rule 205.115(4) would clearly preclude the exemption sought by DTE.” But the Court concluded that the rule was merely interpretive and conflicted with the Court’s construction of the exemption statute in this case. Therefore, the rule was held invalid and unenforceable.

ARGUMENT

I. The Court of Appeals erred by holding that Detroit Edison’s transmission and distribution equipment is entitled to the industrial processing exemption.

A. Standard of Review

Whether Detroit Edison is entitled to the tax exemption it seeks is a question of law that turns on the interpretation of a statute and promulgated rule, which this Court reviews *de novo*. *Klooster v City of Charlevoix*, 488 Mich 289, 295; 795 NW2d 578 (2011).

B. Analysis

Generally, a person who purchases machinery and equipment is subject to a use tax for the use and consumption of that tangible personal property in this State. MCL 205.93(1). However, a person will be exempt from the use tax on the purchase price of such machinery and equipment where that tangible personal property is used in an industrial processing activity that results in a “finished good” to be sold at retail and subject to sales tax. MCL 205.94o(7)(b). The concept underlying the exemption is to limit multiple levels of taxation: if sales tax will be collected on the final sale of a product, the equipment used to produce the product should not be

taxed. *Elias Bros Rests, Inc v Treasury Dep't*, 452 Mich 144, 152; 549 NW2d 837 (1996).

The Court of Appeals erred when it disregarded the statute's limiting provisions and instead granted Detroit Edison's request for a tax exemption based on Detroit Edison's description of electricity as an unfinished product. The Court of Appeals should have enforced the Legislature's clearly expressed tax policy rather than create its own tax policy. Indeed, the Court of Appeals disregarded its own acknowledgement that the Legislature drafted the exemption language "evision[ing] a simple manufacturing situation in which a company engages in industrial processing at its plant to produce a product, the product is in the form of a finished good and ready for retail sale while awaiting transport at the company plant, and then the company ships or distributes the product to the customer." (Att B: Slip Op p 11.)

The Court of Appeals created a broad, special exemption specific to electricity generators that is nowhere contemplated in the exemption statute, and that is much broader than the exemption language allows for. In doing so, the Court also created a loophole for all other manufacturers to abuse the exemption by simply not finishing a good until it reaches some later stage closer to customers, and thereby gain the exemption for machinery and equipment used to deliver the unfinished good to the customer.

1. **The Legislature's decisions to tax electricity and create an industrial processing exemption were not scientifically based – they were politically drawn tax policy decisions, and must be interpreted accordingly.**

The Legislature's decision to deem electricity tangible personal property subject to tax and to define industrial processing in relation to a finished good were matters of tax policy, not an attempt to conform the State's tax laws to the laws of physics. Unlike the laws of physics, the State's tax policy is a compromise between constituent interests and the State's budget needs.

According to the common understanding of electricity, selling electricity is actually the sale of a service, not the sale of tangible personal property. (Att C: Jack Casazza et al, *Understanding Electrical Power Systems*, p 24 (2003)¹ (Electricity "is a flow of energy as a result of electron vibrations, [therefore electricity generators] provide a service, energy in a usable form, not a product, to consumers."). If something sold to a customer is a service rather than tangible personal property, then the transaction is generally not subject to tax, *Catalina Mktg Sales Corp v Dep't of Treasury*, 470 Mich 13, 19; 678 NW2d 619; 542 (2004).

But the Legislature made a deliberate policy choice to deem electricity tangible personal property for the purposes of both sales and use taxation, and to subject the sale or use of electricity to taxation. MCL 205.51a(q); MCL 205.52(1); MCL 205.52(2), MCL 205.92(k); MCL 205.93(1); MCL 205.93a(1)(e). By legislative

¹ Note that Bruce F. Wollenberg, one of Detroit Edison's expert witnesses, was the Technical Reviewer for this book.

decision the sale of, the use of, and the transmission and distribution of electricity are entirely taxable.

By deeming electricity tangible personal property and its provision a sale at retail of tangible personal property rather than a service, the Legislature made a policy decision that actually runs contrary to the way electricity and its sale are commonly understood. As a result, the exemption is now available to the production of electricity when it otherwise would not be. The taxation of electricity and the exemption of its production, therefore, must be examined as a political and legal act – not a scientific one.

2. The industrial processing statute requires that the industrial processing ends when the shipping and distribution of electricity begins.

The exemption statute broadly defines “industrial processing” as follows:

(a) Industrial processing means the activity of converting or conditioning tangible personal property by changing the form, composition, quality, combination, or character of the property for ultimate sale at retail or for use in the manufacturing of a product to be ultimately sold at retail or affixed to and made a structural part of real estate located in another state. Industrial processing begins when tangible personal property begins movement from raw materials storage to begin industrial processing and ends when finished goods first come to rest in finished goods inventory storage. [MCL 205.94o(7)(a)].

The statute then uses at least 34 specific modifiers to demarcate what kinds of activities and property either do or do not qualify for exemption— regardless of whether the activity satisfies the broad definition of industrial processing. For example, even though neither “research” nor “planning” converts tangible personal property by changing its composition, those activities are all still deemed industrial

processing. MCL 205.94o(3)(b), (e). And for another example, even though preparing meals to sell at a restaurant *does* convert tangible personal property by changing its composition, restaurant equipment is explicitly *excluded* from the exemption. MCL 205.94o(5)(h).

Section 3(a) of the exemption statute identifies “production” as an activity that qualifies as industrial processing. The parties agree that when Detroit Edison consumes raw materials, such as coal, to create the steam that turns turbines connected to a shaft within its electricity generators, Detroit Edison is producing electricity. Since the sale of electricity is taxed as a retail sale, the equipment used for its production qualifies for the exemption.

However, the Legislature unequivocally deems “shipping” or “distribution” *not* to be industrial processing. MCL 205.94o(6)(b). The power lines and equipment that connect Detroit Edison’s generating plants to its customers are the means by which Detroit Edison ships and distributes its electricity to customers. Therefore, the equipment Detroit Edison uses to ship (or “transmit” in the vernacular of the industry) and distribute electricity does not qualify for the exemption. It really is that simple.

The Court of Appeals erred when it failed to read subsection (7)(a) of the statute defining industrial processing consistent with subsection (6)(b). Courts must read statutory language in context and as a harmonious whole. *McCahan v Brennan*, 492 Mich 730, 739-740; 822 NW2d 747 (2012). When a general definition in a statute conflicts with a specific modifier to that definition, the specific modifier

trumps the general definition. *Evanston YMCA Camp v State Tax Comm'n*, 369 Mich 1, 8; 118 NW2d 818; 542 (1962). This rule of interpretation respects the Legislature's authority to formulate policy, weigh budgetary needs, and balance constituent interests by creating an internal framework of definitions. It does not matter if the shipping and distribution of electricity, as opposed to ordinary tangible personal property, happens to also satisfy the general definition of "industrial processing," because the specific modifier to the general definition is what governs.

The exemption statute is the formation of tax policy – it is not an attempt to conform taxation to scientific observations of the physical world. And the Court of Appeals' responsibility was to enforce the Legislature's policy by respecting the Legislature's internal framework of definitions, not create a policy of its own.

The Court based its decision simply on its conclusion that the shipping and distribution of electricity presents a different "fact pattern" than the Legislature's envisioned simple manufacturing situation that results in the shipping and distribution of ordinary tangible personal property. (Att B: Slip Op at 11). But changing the statute because of a specific fact pattern is creating an exemption for a particular category, and that is a legislative function, not a judicial one. Doing that here, where the Legislature has expressly identified and given particular treatment to at least 34 items of property or activities, is especially improper, for it violates the basic principle of statutory interpretation that the Legislature's decision to include one thing implies that it intends to exclude other things it did not specifically mention. E.g., *Smitter v Thornapple Tp*, 494 Mich 121, 137 n 34;

833 NW2d 875, 885 (2013). The Court of Appeals was not authorized to abandon the plain language of the statute in favor of its own redetermination of what would be the best tax policy. *Toaz v Dep't of Treasury*, 280 Mich App 457, 462-63; 760 NW2d 325, 328 (2008).

In addition, the Court of Appeals failed to adhere to this Court's longstanding rule of construction that exemption statutes are disfavored and, if construction is necessary, they must be construed narrowly in favor of the taxing authority. *Ladies Literary Club v Grand Rapids*, 409 Mich 748, 754; 298 NW2d 422 (1980), quoting 2 *Cooley on Taxation* (4th ed), § 672, pp 1403-1404, and *Detroit v Detroit Commercial College*, 322 Mich 142, 148-149; 33 NW2d 737 (1948).

The policy the Court of Appeals created grants a windfall to electrical generators by improperly exempting the equipment they use to ship and deliver their product to customer from taxation – an exemption far broader than that granted to other industrial processors, and in no way contemplated by the exemption statute's actual language.

3. Rule 65 has the force of law and precludes the exemption sought by Detroit Edison.

The Court of Appeals also made a serious legal error by summarily invalidating a promulgated rule that it acknowledged “would clearly preclude the exemption sought by DTE.” (Att B: Slip Op at 13). Rule 65 reads, in pertinent part, as follows:

(3) The sale of tangible personal property is not taxable when consumed or used in the process of manufacturing or generating

electricity, gas, or steam which is taxable when sold at retail. Transformers used in industrial processing are not taxable.

(4) The sale of tangible personal property consumed or used in the transmission or distribution of electricity, gas, or steam is taxable. Such transmission or distribution starts at the place where the product leaves the immediate premises from which it is manufactured. [2014 AC, R 205.115].

Rule 65 was first published in Michigan's Administrative Code in 1943, and was re-promulgated in 1979 following the passage of the Michigan Administrative Procedures Act (MAPA). Rule 65 remains in effect today, does not contradict the exemption statute, and, as the Court of Appeals acknowledged, precludes Detroit Edison from obtaining the exemption it seeks. (Slip Op at 13). However, the Court of Appeals erroneously invalidated Rule 65.

Because Rule 65 has the force of law and speaks to the precise issue decided by the courts here, the Court of Appeals should have applied it.

a. The Court of Appeals applied the wrong standard of review to a promulgated rule.

The Court of Appeals cited *In Re Rovas Against SBC Mich*, 482 Mich 90; 754 NW2d 259 (2008), but conflated a promulgated rule with the Department's interpretation of a statute in a contested case administrative hearing as informal agency guidance. Without analysis, the Court relied on *Guardian Industries Corporation v Department of Treasury*, 243 Mich App 244; 621 NW2d 450; 543 (2000), to conclude that Rule 65 was simply "interpretative." Apparently, based on *Guardian Industries* and the *Rovas* standard it had discussed earlier in the opinion,

the Court invalidated the rule because it “conflicts with the UTA and the industrial processing exemption as construed by us today.” (Att B: Slip Op at 13).

Yet in *Rovas*, this Court clearly explained that “the rulemaking function” was “not at issue” in that case. *Rovas*, 482 Mich at 100-101. Moreover, this Court has clearly distinguished promulgated rules from “interpretive” agency statements. The *Clonlara, Inc v State Board of Education*, 442 Mich 230; 501 NW2d 88 (1993). As stated by this Court, interpretive rules are agency statements issued without the agency exercising its delegated legislative power to make law through rules. *Id.*, 442 Mich at 239. Therefore, neither *Rovas* nor case law referring to interpretive rules is applicable, and the Court of Appeals erred.

b. Rule 65 is a valid administrative rule and has the force of law.

Contrary to the Court of Appeals’ conclusion, Rule 65 is not an interpretive rule. See MCL 24.207(h). Rather, Rule 65 is an authorized, properly promulgated rule. MCL 24.207. Therefore, it has “the force of law,” and is “enforceable in and of [itself].” *Clonlara, Inc v State Board of Education*, 442 Mich 230, 239; 501 NW2d 88 (1993); *Danse Corp v City of Madison Heights*, 466 Mich 175, 181; 644 NW2d 721; 542 (2002).

Rule 65 was first published in Michigan’s Administrative Code in 1943. It was again promulgated in 1979 following the passage of the Michigan Administrative Procedures Act (MAPA). And Rule 65 remains in effect today and does not contradict the industrial processing exemption.

The Legislature explicitly delegated authority to Treasury to promulgate rules consistent with the Revenue Act and necessary to the enforcement of the taxes administered by Treasury. MCL 205.3(b); MCL 205.100(2). Consistent with that delegation, Treasury promulgated Rule 65. The rule remained in effect following the passage of MAPA. MCL 24.231(1). And by its publication in the Administrative Code, Rule 65 is legally presumed to have been promulgated in compliance with MAPA's procedural requirements. MCL 24.261. Accordingly, all courts must take judicial notice of the rule. MCL 24.261(3).

The Court of Appeals should have reviewed Rule 65 using the standard for promulgated rules this Court explained in *Rovas*. First, the Court of Appeals should have determined if the Legislature properly delegated the rulemaking authority to Treasury. *In re Complaint of Rovas*, 482 Mich at 101. In this case, the Legislature's delegation to Treasury includes the requirements that rules be consistent with the Revenue Act, and necessary to the enforcement of taxes administered by Treasury. MCL 205.3(b). Since the Legislature's requirements are intelligible principles, the delegation was proper. *Taylor v Smithkline Beecham Corp*, 468 Mich 1, 9–10; 658 NW2d 127; 542 (2003).

The only remaining question for the Court of Appeals should have been whether Rule 65 exceeded the Legislature's delegation of rulemaking authority to Treasury. *In re Complaint of Rovas*, 482 Mich at 101. It did not. Rule 65 does not contradict the exemption statute. Rule 65 instead effectuates the Legislature's

intent by filling in an interstice in the statute. *Clonlara, Inc v State Bd of Educ*, 442 Mich 230, 240; 501 NW2d 88; 542 (1993).

c. **Rule 65 harmonizes with the industrial processing exemption and precludes the exemption Detroit Edison seeks.**

Rule 65 provides, in pertinent part, that “[t]he sale of tangible personal property consumed or used in the transmission or distribution of electricity, gas, or steam is taxable. *Such transmission or distribution starts at the place where the product leaves the immediate premises from which it is manufactured.* [2014 AC, R 205.115(4)].” (Emphasis supplied).

Unlike ordinary tangible personal property, electricity cannot be stored. (Att C: Jack Casazza et al, *Understanding Electrical Power Systems*, p 24 (2003) (Noting that one of electricity’s “unique characteristics” is that “it cannot be stored.”) But in order to demarcate the beginning and end of industrial processing activities, the Legislature only used language “envision[ing] a simple manufacturing situation,” (Att B: Slip Opinion p 11), that applies to tangible personal property that *can* be stored:

Industrial processing begins when tangible personal property begins movement from raw materials storage to begin industrial processing and ends when finished goods **first come to rest in finished goods inventory storage.** [MCL 205.94o(7)(a) (emphasis added)].

Industrial processing includes . . . Inspection, quality control, or testing to determine whether particular units of materials or products or processes conform to specified parameters at any time before materials or products **first come to rest in finished goods inventory storage.** [MCL 205.94o(3)(d) (emphasis added)].

Property that is not eligible for an industrial processing exemption includes . . . Tangible personal property used or consumed for the preservation or maintenance of a finished good once it **first comes to rest in finished goods inventory storage**. [MCL 205.94o(5)(i) (emphasis added)].

For ordinary tangible personal property, industrial processing ends when the finished good “first comes to rest in finished goods inventory storage.” MCL 205.94o(7)(a). But this language leaves a gap in the statute because electricity cannot be stored and does not come to rest in finished goods inventory.

Even if Treasury had not promulgated a rule, had the Court of Appeals narrowly construed the exemption language like it was required to do, it would have denied Detroit Edison’s exemption claim because Detroit Edison’s distribution activities did not unambiguously satisfy the exemption’s requirements.

But Treasury did properly promulgate Rule 65 to clarify that the “sale of tangible personal property consumed or used in the transmission or distribution of electricity . . . is taxable. Such transmission or distribution starts at the place where the product leaves the immediate premises from which it is manufactured.” 2014 AC, R 205.115(4). By identifying the end of electricity production as when the electricity leaves the generation plant and enters the transmission and distribution system, Rule 65 defines the scope of the exemption for electricity producers consistently with the scope of the exemption for ordinary industrial processors. As explained above, no industrial processor can claim the exemption for shipping or distributing its products out of its factory. MCL 205.94o(6)(b). Additionally, no other industrial processor can claim the exemption for equipment it uses to simply preserve or maintain its products. MCL 205.94o(5)(i).

Rule 65 neither expands nor constricts the exemption available to electricity producers. It simply filled a gap left by the exemption statute – which is precisely what promulgated rules are designed to do. *Clonlara*, 442 at 240 (“rules fill in the interstices of the statute and presumably carry out its intent in greater detail”). Therefore, the Court should have applied the rule with the force of law. *Id.* at 230.

4. The Court of Appeals gave a much broader exemption to electricity producers than the statute gives to any other industrial processor.

Detroit Edison exploited the fact that electricity cannot be stored and argued that electricity was not a finished product until it reached the customer’s location, so none of the limiting language in either the statute or the rule applied to it. Detroit Edison’s argument persuaded the Court of Appeals that the Court could, therefore, justifiably jettison the limiting language in both the exemption statute and Rule 65. But the Court of Appeals committed serious legal error by adopting Detroit Edison’s position.

Even though the Court of Appeals accurately quoted the doctrine that tax exemptions cannot be made out by inference or implication and must not be enlarged by construction, the Court promptly ignored the doctrine. (Att B: Slip Op at 5). The Court instead decided that electricity presents a different “fact pattern” than ordinary tangible personal property and proceeded to infer a special exemption that applies only to electricity producers. (Att B: Slip Op at 11). The result of the Court of Appeals’ construction is an exemption for electricity producers that is far

beyond that given to any other industrial processor by the exemption statute's language.

a. Detroit Edison's "finished product" theory is wrong.

The "finished product" theory presented by Detroit Edison and adopted by the Court of Appeals is without legal justification. First, as a matter of law, electricity is a finished product when it becomes the tangible personal property that will be "sold at retail." MCL 205.94o(7)(a). There is no electricity when Detroit Edison burns coal (or harnesses a nuclear reaction) to make steam that turns a turbine, but once the shaft attached to the turbine spins inside the generator, electricity is generated. After that point, Detroit Edison's task is to deliver the electricity it has just generated to its customers—to transmit and distribute it. But the product that will be sold to customers, electricity, has already been produced. (Att F: Barnett et al, *Electric Power Generation: A Nontechnical Guide*, pp 109-113, 225 (2000) (describing the generation of electricity and distinguishing it from the delivery of electricity). The electricity is legally a finished product as soon as it is generated.

Secondly, Detroit Edison states the science inaccurately. As the Court of Appeals observed, Detroit Edison's engineers insist that plant-generated electricity cannot be used by any of its customers unless the voltage of the electricity is significantly decreased. (Att B: Slip Op at 10-11). But that is not true. As Mr. Cook averred in his deposition testimony quoted by the Court of Appeals, large

industrial customers can use electricity directly from high voltage transmission lines. (Att B: Slip Op at 10). One of Detroit Edison's experts, Bruce Wollenberg, confirms this in his affidavit. (Att D: Wollenberg Aff, ¶ 25). The attached graphic demonstrates that different customers use electricity at different voltages. (Att E). *So whether electricity is a finished product under Detroit Edison's theory is not a matter of scientific fact – it simply depends on who Detroit Edison's customer is.*

Detroit Edison's experts also incorrectly imply that it is physically necessary to increase and decrease electricity's wattage in order for electricity to be delivered to residential customers (the only kind of customer the Court of Appeals' analysis takes into account). (Att B: Slip Op at 2). But that is not true, either. When Thomas Edison first began generating and delivering electricity to residential customers, he generated and delivered the electricity at a residential 110/220 voltage level. (Att F: Barnett et al, Electric Power Generation: A Nontechnical Guide, p 232 (2000); Att G: Mohamed E. El-Hawary, Introduction to Electrical Power Systems, p 1 (2008)) The result of delivering electricity at such a low voltage is that the electricity could not travel very far – customers had to be located within a mile or two of the generating plant. *Id.*

The truth is that electricity is a physical phenomenon. (Att H: Cook, ¶ 10). It is "a flow of energy as a result of electron vibrations." (Att C: Jack Casazza et al, Understanding Electrical Power Systems, p 24 (2003)) The reason modern electricity generators deliver their electricity at a high voltage rate is to reduce electrical energy losses inherent to the transmission of electricity over long

distances. (Att H: Cook Aff, ¶ 21); *see also* Att F: Barnett et al, *Electric Power Generation: A Nontechnical Guide*, pp 236-238 (2000). Increasing and decreasing the voltage does not actually change the nature of electricity – it simply makes it possible to deliver the energy to locations farther than a mile or two from the generator. (Att H: Cook Aff, ¶¶ 18-21).

Detroit Edison's only response to Mr. Cook's statement was a supplemental affidavit from Ewald F. Fuchs. Mr. Fuchs states that at the atomic level, electricity generation and transmission are the same process: both events endow tangible electrons with voltage so that the electrons can "flow from the generation plant to the customer's meter." (Att I: Fuchs Supp Aff, ¶¶ 8, 15).

But Detroit Edison's other expert, Bruce Wollenberg, told the U.S. Supreme Court that the idea that electrons flow through transmission lines is "inaccurate and highly misleading." (Att J: Brief Amicus Curiae in *New York v FERC*, 535 US 1 (2002), at 5) Instead, Mr. Wollenberg explained that the "'thing' that is transmitted by the wire conduits suspended from those high-tension towers one sees is *energy*, not electrons . . . [e]lectrons do not 'flow' – but *electric current* does." (*Id* at 6.) Mr. Casazza, who joined Mr. Wollenberg on the Supreme Court amicus brief, also flatly declares that "[often] electric current is described as a physical flow of electrons. It is not. The electrons do not flow." (Att C: Jack Casazza et al, *Understanding Electrical Power Systems*, p 24 (2003))

Detroit Edison relied on Mr. Fuch's supplemental affidavit below to continually assert that electricity is actually just electrons being "processed"

between the generation plant and the customer's location. But the premise upon which Detroit Edison based its argument is flawed. The electricity that generators produce and people buy is actually a flow of energy. The voltage levels applied to the energy are primarily to ensure that the energy can flow far instead of near. And the equipment Detroit Edison uses to preserve and maintain the flow of energy against its natural dissipation is explicitly excluded from industrial processing activity. MCL 205.94o(5)(i).

Ultimately, however, as explained above, it does not matter if both the generation and delivery of electricity satisfy the general definition of industrial processing, because § (6)(b) specifically modifies the general definition to exclude shipping and distribution from industrial processing activities. And when a general definition conflicts with a specific modifier to the definition – the specific modifier trumps the general definition. *Evanston YMCA Camp*, 369 Mich at 8. Indeed, the whole point of the 34 or so statutory modifications is to exclude items that, like electricity or restaurant equipment, would otherwise qualify as industrial processing.

The Court of Appeals clearly erred by relying on Detroit Edison's stilted description of electricity as justification to ignore the statute and promulgated rule. As a result, electricity producers can now exempt the equipment they use to ship and distribute their product to their customers – a privilege nowhere contemplated by the statute and which no other industrial processor enjoys. MCL 205.94o(6)(b).

II. The Court of Appeals erred when it ignored the statute and gave Detroit Edison the full exemption because Detroit Edison has never proposed an apportionment formula nor submitted evidence to support receiving the full exemption.

A. Standard of Review

Michigan appellate courts review both a decision on summary disposition and a court's interpretation of a statute *de novo*. *Willett v Waterford Charter Twp*, 271 Mich App 38, 45; 718 NW2d 386 (2006); *Guardian Envtl Serv's v Bureau of Constr Codes & Fire Safety*, 279 Mich App 1, 6; 755 NW2d 556 (2008).

B. Analysis

The Court of Appeals committed clear legal error by holding, in direct contradiction to the statute's plain language, that the industrial processing exemption is not subject to apportionment between exempt use and non-taxable use. By an apparent oversight, the Court of Appeals incorrectly relied on case law that has since been overruled by statute.

Because the law requires apportionment and Detroit Edison never met its burden or even attempted to establish the percentage of exempt use over total use, this Court should reverse.

1. The Court of Appeals mistakenly relied on bad law.

In determining that the industrial processing exemption applies to the machinery and equipment *in full*, (Att B: Slip Op. at 13), the Court of Appeals erred by overlooking the fact that the cases it relied on have all been superseded by statute.

All three cases cited by the Court in support of its page-long analysis on apportionment involved tax years preceding 1999—well before the effective date of PA 117 of 1999. Those cases had held that “[c]oncurrent taxable use with an exempt use does not remove the protection of the exemption.” *Mich Milk Producers Ass’n v Dep’t of Treasury*, 242 Mich App 486, 495; 618 NW2d 917 (2000); see also *Mich Bell Telephone Co v Dep’t of Treasury*, 229 Mich App 200, 211-212; 581 NW2d 770 (1998) (full exemption allowed “when the equipment involved is put to mixed use, but in a unified process.”); *Mich Allied Dairy Ass’n v State Bd of Tx Admin*, 302 Mich 643, 649-651; 5 NW2d 516 (1942) (ruling that use in industrial processing made property exempt “notwithstanding the fact that they are also put to another” non-exempt use).

But with the passage of PA 117 of 1999, the Legislature amended the industrial processing exemption to require apportionment between exempt and non-exempt use where property had dual use. The Legislature declared that in determining the exemption “for periods beginning April 1, 1999, *the tax shall be apportioned*. This amendatory act clarifies that existing law as originally intended *provides for a prorated exemption*.” (Att K: Pub Act 117 of 1999 at Enacting Section 1 (emphasis supplied))

Accordingly, the law from the 1999 amendment onward has read that “[t]he tax levied under this act does not apply to property sold to the following *after March 30, 1999, subject to subsection (2)* . . . “ MCL 205.94o (1) (emphasis supplied). Subsection (2) affirms that “[t]he property under subsection (1) is exempt *only to the*

*extent that the property is used for the exempt purpose stated in this section.” MCL 205.94(2) (emphasis supplied). Further, “[t]he exemption is limited to the percentage of exempt use to total use determined by a reasonable formula or method approved by the department.” *Id.**

The tax period at issue in this case is January 1, 2003 through September 30, 2006. Thus, there is no question that the amendment enacted by PA 117 of 1999 applies to this case. The Court of Appeals determined that “the machinery and equipment in dispute are used, in part, for a nonexempt purpose, i.e. distribution . . .” (Att B: Slip Op. at 12). But the Court did not apportion between taxable and exempt usage. *Id.* (ruling “DTE is entitled to the claimed ‘industrial processing’ exemption *in full* . . .”). Consequently, by overlooking the 1999 amendment to the industrial processing exemption and relying on cases that no longer are the law, the Court of Appeals committed reversible error.

2. Detroit Edison’s failure to submit evidence to support apportionment requires reversal.

Since the Court of Appeals failed to require apportionment, and Detroit Edison has not supported and cannot support a discrete percentage of exempt use, this Court should reverse the Court of Appeals outright and hold that Detroit Edison is not entitled to the industrial processing exemption.

The burden of proving the percentage of exempt use is on Detroit Edison, as taxpayers always bear the burden to prove their entitlement to any exemption.

Ladies Literary Club v City of Grand Rapids, 409 Mich 748, 754; 298 NW2d 422;

542 (1980). Consistent with the requirement in MCL 205.94o(2) that taxpayer's apportionment between exempt and non-exempt uses with a "reasonable formula or method approved by the department," and case law placing the burden of proof for exemptions on the taxpayer, Treasury's promulgated Rule 40, among other things, requires taxpayers to prove the reasonableness of any apportionment to Treasury's satisfaction. Mich Admin Code R 205.90(8).

- a. **Rule 40 has the force of law and articulates the requirement that Detroit Edison either substantiate its apportionment or lose the exemption all together.**

In pertinent part, Rule 40 states the following:

[w]here the industrial processing areas or spaces are not separate and distinct from other departments or activities . . . the tax will apply to such property unless it can be determined and substantiated to the satisfaction of the revenue division, department of treasury that a percentage or other apportionment thereof is equitable and practical. [2014 AC, R 205.90(8).]

The Court of Appeals has twice discussed the effect of Rule 40. Each time, the Court has held that Rule 40 is a binding, legislative rule that has the force and effect of law. (Att L: *K & S Industrial Services v Dep't of Treasury*, unpublished opinion per curiam of the Court of Appeals issued Sept 27, 2012 (Docket No 305516); Att M: *Escanaba Paper Co v Dep't of Treasury*, unpublished opinion per curiam of the Court of Appeals issued Nov 19, 2009 (Docket No 286144)).

For instance, in *Escanaba Paper*, in an opinion joined by then-Judge Zahra, the Court of Appeals wrote that "Rule 40 is not simply an 'interpretive rule' . . . Here, [the Department] has been empowered to promulgate rules through the

exercise of delegated legislative power.” *Id.* at 16, fn 8. Finding that Rule 40 “does not conflict” with the industrial processing statute but “Rule 40 filled the void” in the question at issue in that case, the Court in *Escanaba Paper* applied the rule as having “the force and effect of law.” *Id.* at 15-18 (quoting from *Clonlara*, 442 Mich at 239). The Court reached the similar conclusions in *K & S Industrial Services*. *K & S Industrial, supra*, at 9-10 (stating that Rule 40 that ‘fills in a gap’ in the statute and has “the force and effect of law”).

b. Detroit Edison’s failure to substantiate an apportionment means it loses the exemption entirely.

Both MCL 205.94o (2) and Rule 40 require the taxpayer to propose how to apportion exempt and non-exempt use. The statute imposes on the taxpayer the duty to submit for Treasury’s consideration “a reasonable formula or method” from which to determine the “percentage of exempt use to total use” MCL 205.94o(2). Similarly, the rule is clear that “*unless it can be determined and substantiated to the satisfaction of the revenue division, department of treasury that a percentage or other apportionment thereof is equitable and practical*” then “*the tax will apply to such property . . .*” 2014 AC, R 205.90(8) (emphasis supplied). But Detroit Edison has not even attempted to meet its burden of proof.

Detroit Edison acknowledges that the machinery and equipment at issue is used in the transmission and distribution of electricity. And the Court of Appeals remarked that “the machinery and equipment in dispute are used, in part, for a nonexempt purpose, i.e. distribution” (Att B: Slip Op at 12). Thus, although

Treasury does not agree that any of the equipment is entitled to the industrial processing exemption, it is undeniable that the equipment is used in a non-exempt activity. Yet Detroit Edison has never submitted any calculations about “the percentage of exempt use to total use” to support its claim to exemption as required by law. MCL 205.94o (2).

Indeed, Detroit Edison cannot do so. The Court of Appeals referred to the distribution of electricity and what it determined was an exempt use as a “unified process or system.” (Att B: Slip Op at 12). All of the equipment at issue here is apparently used in distribution at all times. And because transmission and distribution is inextricably intertwined with the “industrial processing” that Detroit Edison claims is occurring, the doctrines governing the interpretation of tax exemptions forbid Detroit Edison from obtaining the exemption. That is, if they cannot prove apportionment, then they cannot satisfy their burden to prove entitlement to the exemption. When it comes to tax exemptions, a “tie” goes to Treasury.

In line with the governing statute and case law, Rule 40 also precludes the exemption because it is not practical to separate the two functions. 2014 AC, R 205.90(8) (“the tax will apply to such property unless it can be determined and substantiated . . . that a percentage or other apportionment thereof is equitable *and practical.*”) (emphasis supplied). If it is not practical to apportion use, then the whole property is taxable.

i. **It is too late for Detroit Edison to cure its failure at the trial level.**

Detroit Edison's failure at the trial stage of the proceeding precludes it from attempting to cure this defect now for two reasons.

First, the case was decided on cross motions for summary disposition under MCR 2.116(C)(10). (Att B: Slip Op. at 3). The Court Rules require parties to provide factual support for their positions at summary disposition, and it not sufficient to promise to do so later. MCR 2.116(G)(4); *see also Maiden v Rozwood*, 461 Mich 109, 597 NW2d 817 (1999) ("The reviewing court should evaluate a motion for summary disposition under MCR 2.116(C)(10) by considering the substantively admissible evidence actually proffered in opposition to the motion . . . A mere promise is insufficient under our court rules."). Thus, it is too late for Detroit Edison to attempt to provide factual support for apportionment at this stage.

Second, Detroit Edison was actually required to submit its method of apportionment to Treasury *before litigation* so that it could be reviewed and "approved by the department." MCL 205.94o(2); *see also* 2014 AC, R 205.90(8) (requiring the method apportionment to be "determined and substantiated to the satisfaction of the revenue division, department of treasury . . ."). A taxpayer may only litigate what has been submitted to and decided by the Department. See MCL 205.22 (taxpayer must be "aggrieved" by a "decision . . . of the Department"). Therefore, because Detroit Edison has failed to submit any method of apportionment to Treasury before suit, the Court may not review this issue. *Cf. Mich Supervisors Union OPEIU Local 512 v Dep't of Civil Serv*, 209 Mich App 573;

531 NW2d 790 (1995) (administrative remedies must be exhausted before seeking judicial review).

Thus, for all of these reasons, Detroit Edison's failure to provide support for its apportionment of the exemption requires a reversal of the Court of Appeals' decision and the entry of judgment in Treasury's favor.

CONCLUSION AND RELIEF REQUESTED

The Court of Appeals made three significant errors when it affirmed the Court of Claims grant of summary disposition in favor of Detroit Edison. First, the Court incorrectly inferred a tax exemption for electricity generators that directly conflicts with the express exclusion of shipping and distribution from exempt industrial processing activities. Second, the Court of Appeals recognized that Rule 65 would have precluded Detroit Edison's exemption request, but incorrectly deemed it an interpretative rule and invalidated it. Third, although the exemption statute requires a taxpayer to apportion its exempt use and non-exempt use, the Court relied on expired case law to grant Detroit Edison an exemption *in full* for equipment that the Court found was used for both an exempt use and a non-exempt use, and where Detroit Edison never complied with the statute's requirement that it apportion such dual use.

Treasury respectfully requests that this Court either peremptorily reverse or grant this application to consider and then reverse the Court of Appeals affirmation of the Court of Claims order granting Detroit Edison summary disposition. Specifically, Treasury requests this Court to hold that Detroit Edison's use of equipment outside of its generation facility to transmit and distribute electricity is not industrial processing exempt from use tax, and that Treasury's promulgated Rule 65 is a valid legislative rule with the force and effect of law. Treasury also respectfully requests this Court to hold that the exemption statute expressly requires a taxpayer to apportion its exempt use and a non-exempt use, and where

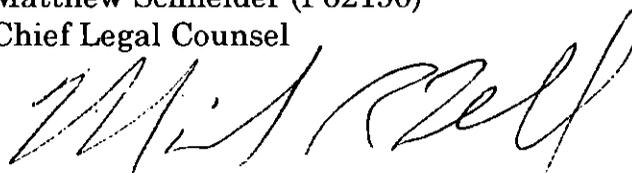
either the taxpayer failed to apportion such dual use, or such dual use cannot be apportioned, the taxpayer cannot claim the industrial processing exemption.

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