

STATE OF MICHIGAN  
IN THE SUPREME COURT

DETROIT EDISON COMPANY,

Plaintiff-Appellee,

v

DEPARTMENT OF TREASURY,  
STATE OF MICHIGAN,

Defendant-Appellant.

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Supreme Court No. 148753

Court of Appeals No. 309732

Court of Claims No. 10-104-MT

REPLY BRIEF OF APPELLANT MICHIGAN DEPARTMENT OF  
TREASURY

Bill Schuette  
Attorney General

Aaron D. Lindstrom (P72916)  
Solicitor General  
Counsel of Record

Matthew Schneider (P62190)  
Chief Legal Counsel

Michael R. Bell (P47890)  
Nate Gambill (P75506)  
Zachary C. Larsen (P72189)  
Assistant Attorneys General  
Attorneys for Michigan Department of  
Treasury  
Defendant-Appellant  
Revenue & Collections Division  
P.O. Box 30754  
Lansing, MI 48909  
517.373.3203

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## INTRODUCTION

The mere fact that electricity cannot be stored in finished goods inventory and must instead be distributed by transmission lines does not entitle persons who generate electricity to a unique status distinct from other manufacturers of tangible personal property under the industrial-processing exemption. This is especially true given that the exemption specifically excludes “distribution . . . activities.” MCL 205.94o(6)(b). Detroit Edison’s theory, accepted by the Court of Appeals, that it is entitled to an exemption for equipment it uses to *transmit* and *distribute* its product to customers conflicts with the statute’s plain language and would create a broad exemption unavailable to any other industrial processor.

The Court of Appeals’ published opinion requires this Court’s review. The Court of Appeals ignored longstanding rules of statutory construction that require narrowly construing tax exemptions in the State’s favor, and instead construed the industrial-processing statute broadly to exempt Detroit Edison’s equipment used to transmit and distribute electricity. The Court also treated an APA promulgated rule, which it initially concluded was dispositive and would have resulted in denying Detroit Edison the exemption, as a mere interpretative statement by a state agency rather than giving it the full force and effect of law. And most surprising of all, the Court missed express and unambiguous statutory language that required Detroit Edison to apportion its dual use of equipment for exempt and non-exempt purposes. In doing so, the Court relied on outdated case law to grant Detroit Edison a 100% exemption from use tax on equipment that the Court and Detroit Edison agreed was used for both exempt and non-exempt purposes.

## ARGUMENT

**I. Detroit Edison's reiterating facts regarding the manufacture of electricity, and the historical contentions between it and Treasury regarding the scope of the exemption, does not alter the need for this Court's review.**

In its brief in opposition, Detroit Edison attempts to rehabilitate its affiants' explanation of the uses of the transmission and distribution equipment at issue in this case. Detroit Edison had to because, as Treasury's application demonstrated, its affiants did not accurately explain the factual basis underpinning its case. But these factual conclusions are beside the point. Proper interpretation of the industrial-processing statute requires denying Detroit Edison the exemption it seeks even if its factual statements were correct.

The Legislature implemented its tax policy in drafting the language that became MCL 205.94o. The Legislature used language that envisioned a straightforward manufacturing scenario as defined by the parameters of the term industrial processing.

In MCL 205.94o(7)(a), the Legislature expressed two contours regarding industrial processing. In the first sentence of the subsection, it defined industrial processing. In the second sentence it stated that industrial processing began when raw materials were moved from storage and ended when "finished goods first come to rest in finished goods inventory storage." But this subsection cannot be read in isolation either from the rest of the section or Treasury's promulgated rule, 2014 AC, R 205.115.

In the subsection, the Legislature never addressed the scenario where industrial processing activity produces a good that cannot be stored in finished goods inventory. By presenting evidence that electricity cannot be stored and that continued monitoring during transmission to customers is required, Detroit Edison tries to make more of this omission than is proper. Contrary to the well-established rule that tax exemptions can never be inferred or enlarged, Detroit Edison argues that the Legislature intended to grant Detroit Edison a broader exemption than it granted other industrial processors. But entitlement to the industrial processing exemption is not based on the economic viability or technological efficiency of a process or activity. See *Town & Country Dodge, Inc. v Dept of Treasury*, 420 Mich 226, 243; 362 NW2d 618 (1984) (“statutory exemptions from taxation are construed strictly against the taxpayer. The propriety of a deduction does not turn upon general equitable considerations, such as a demonstration of effective economic and practical equivalence. Rather, it depends upon legislative grace; and only as there is clear provision therefor can any particular deduction be allowed.”).

The trial court and the Court of Appeals erred when they did not limit their statutory interpretation to apply the Legislature’s tax policy choice. These courts determined that electricity generators are a different breed of industrial processor justifying unique exemption treatment that other manufacturers cannot receive under the express language of the exemption statute. In other words, the courts usurped the legislative function. The courts do not develop tax policy, do not decide the wisdom of the Legislature’s tax policy choice, but rather only construe the

statute as written. See for example, *Boyer-Campbell Co v Fry*, 271 Mich 282, 299-300; 260 NW 165 (1935) (“If the true construction be followed with harsh consequences, it cannot influence the courts in administering the law. The responsibility for the justice or wisdom of legislation rests with the legislature, and it is the province of the courts to construe, not to make, the laws.”). One purpose of this rule of statutory interpretation is to ensure that judges do not disrupt the politically bargained contours of a tax exemption enacted by democratically elected legislators. See John F. Manning, *Textualism and the Equity of the Statute*, 101 Colum. L. Rev. 1, 18 (2001) (“ . . . statutory details may reflect only what competing groups could agree upon . . . accordingly, departing from a precise statutory text may do no more than disturb a carefully wrought legislative compromise.”).

Detroit Edison’s concern for the historical interactions of Treasury and Detroit Edison regarding the tax treatment of the property at issue are irrelevant to the significant legal issues raised by Treasury in its application. This case is solely about the statutory language as it exists during the relevant timeframe, its scope in view of Treasury’s promulgated rule, and whether equipment used to transmit and distribute electricity to customers is exempt.

**A. Properly construing the exemption statute’s language requires reversing the Court of Appeal’s opinion.**

In its opposition brief, Detroit Edison discusses rules of statutory construction that are not applicable to tax exemptions.

Exemptions are the exception to the rule of taxation. Therefore this Court has limited the grant of an exemption from tax to the language used by the Legislature, and held that any construction is strictly construed against the taxpayer and in favor of the State. *Detroit v Detroit Commercial College*, 322 Mich 142, 148-149; 33 NW2d 737 (1948).

Justice Cooley explained what it means for the statute to be narrowly construed: “[a]n intention on the part of the legislature to grant an exemption from the taxing power of the state will never be implied from language which will admit of *any other reasonable construction*.” 322 Mich at 148-149 (emphasis added). That is, tax exemptions “are never presumed,” cannot “be made out by inference or implication,” and the burden is on the taxpayer to show “beyond reasonable doubt” that the Legislature gave the taxpayer the exemption it seeks using “clear and unambiguous terms.” *Id.* And even if the taxpayer has done all that and “an exemption is found to exist,” the Judiciary must not enlarge the exemption “by construction.” *Id.*

In this case, the Court of Appeals cited *Detroit Commercial College* for the foregoing proposition, but then ignored it. Detroit Edison does the same when it argues that all of the equipment it uses to transmit and distribute electricity is exempt from taxation because electricity never comes to rest in inventory storage, as that phrase is used in the second sentence of MCL 205.94o(7)(a). Detroit Edison’s argument creates a unique class of industrial processor with a greatly expanded exemption that includes property used to deliver an alleged unfinished

product to its customers' doorsteps. But the statute when read in its entirety is not that broad and all encompassing. Two specific subsections of the exemption statute, among others discussed in Treasury's application, make this point. MCL 205.94o(4)(f) and (6)(b).

Michigan Compiled Law 205.94o(4)(f) provides that property eligible for the exemption includes "[m]achinery, equipment, . . . 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." This provision establishes that there is a very limited exemption for property used to move an unfinished good. Notably, this limitation does not include property used to move even an unfinished product in the process of production to a customer's location. This may explain why Detroit Edison, while arguing that its generation facility and transmission and distribution lines are one unified integrated electric system, has never claimed that it is entitled to the exemption for its equipment located outside of the generation facility under this subsection.

In subsection (6)(b), the Legislature without qualification as to the state of a good in the process of manufacture (finished or unfinished) provided that "[i]ndustrial processing does not include the following activities: \*\*\* (b) . . . distribution, . . . [or] shipping . . . ." According to the *The American Heritage College Dictionary*, 4<sup>th</sup> Ed (2004), p1280, "shipping" is defined as the "act or business of transporting." Based on subsection (6)(b), the activities of transmitting and

distributing electricity along Detroit Edison's transmission and distribution system are not exempt activities.

But Detroit Edison convinced the Court of Appeals that it could construe the exemption broadly and expansively. Accordingly, the Court held that transmission and distribution equipment that regulated the voltage of electricity to efficiently deliver the electricity to customers constituted industrial processing, which exempted the entire transmission and distribution system from use tax. (Detroit Edison's Opp Brf, p 17, quoting the Court's Opn.)

Detroit Edison's arguments and the appellate court's reasoning and conclusion violate the statutory language and this Court's rules for interpreting, construing, and applying tax exemption statutes. See, *Town & Country Dodge; Boyer-Campbell Co*; and *Detroit Commercial College, supra*.

**B. The Court of Appeals wrongfully held that promulgated rule 205.115 was an interpretative rule and invalidated by 1999 PA 117.**

Rule 205.115 is not an interpretative rule. The rule has been promulgated, and expressly remains in force notwithstanding its age. MCL 24.231(1). Further, the Court of Appeals was bound to take judicial notice of the rule. MCL 24.261(3).

The Court of Appeals made a similar error before, holding that a promulgated rule was "interpretative", which this Court vacated. *Discount Tire v Dep't of Treasury*, 298 Mich App 367; 826 NW2d 769 (2012), vacated at *Discount Tire v Dep't of Treasury*, 494 Mich 875, 832 NW2d 391 (2013). The appellate court's repeated error in another published opinion merits this Court's review.

Rule 205.115 does not contradict any of the provisions of MCL 205.94o, as amended. The rule clarifies that electricity generators are treated the same as other industrial processors – an “interstice” left by the statute. *Clonlara, Inc v State Bd of Educ*, 442 Mich 230, 239-240; 501 NW2d 88 (1993). The rule clarifies that equipment used to generate electricity is exempt from taxation. Rule 205.115(3). But like other industrial processors, the equipment used to deliver electricity to customers is *not* exempt. Rule 205.115(4). Subrule (4) clarifies that the language in MCL 205.94o(6)(b) prohibiting the exemption for shipping and distribution equipment applies to electricity generators, as well – not just to industrial processors who can store their products. Therefore, there is no contradiction.

**II. Whether Detroit Edison must apportion the exempt and non-exempt uses of its property is preserved.**

Detroit Edison argues that Treasury waived the issue of apportionment required by MCL 205.94o(2) because it was never raised in the trial court.

This issue was created by the Court of Appeals. The Court found that Detroit Edison used its transmission and distribution equipment for both exempt and non-exempt purposes. Then, citing case law that predated statutory changes that inserted the apportionment requirement (1999 PA 117), the Court granted a 100% exemption to all of that equipment even though MCL 205.94o(2) limits the exemption to the exempt use expressed as a percentage of overall use. Treasury did not fail to preserve the issue. Instead, Treasury seeks this Court’s review of an issue that the Court of Appeals created.

Even if Treasury had somehow failed to preserve the issue<sup>1</sup>, “[t]he preservation requirement is not an inflexible rule; it yields to the necessity of considering additional issues when ‘necessary to a proper determination of a case . . . .’” *Klooster v City of Charlevoix*, 488 Mich 289, 310; 795 NW2d 578 (2011).

Further, this Court should see the obvious problem created by the Court of Appeals. In a published decision, involving one of the most litigated Use Tax Act exemptions, the Court of Appeals has simply bypassed MCL 205.94o(2). This published decision will be cited by relevant taxpayers claiming that they too can bypass a valid statute. Treasury will of course argue the statute controls and that the Court of Appeals’ failure to apply the statute was an omission that does not result in all taxpayers by-passing subsection (2). Only litigation will resolve the issue either on a taxpayer by taxpayer case basis or in one proceeding—this one.

The issue is ripe for the Court to review. It presents a pure legal issue whose decision is necessary for the proper determination of this case.

### CONCLUSION AND RELIEF REQUESTED

The industrial processing exemption must be uniformly applied to all industrial processors. The Court of Appeals erred when it created a uniquely broad

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<sup>1</sup> Detroit Edison asserts the apportionment issue was raised below when it claimed the exemption for all of its equipment – a “100%” apportionment formula. But by that rationale, Treasury preserved the issue by asserting that Detroit Edison is not entitled to any exemption – a “0%” apportionment formula. The more coherent view is that Detroit Edison’s failure to seek apportionment (even in the alternative) means it waived the claim. When the Court of Appeals ruled that Detroit Edison used its equipment for both exempt and non-exempt uses, it ruled on an issue that Detroit Edison had forfeited. By default, Detroit Edison gets a 0% apportionment exemption on the equipment.

exemption for Detroit Edison's transmission and distribution equipment. The Court also erred when it found that this equipment had dual uses but then ignored the exemption statute's requirement that only the exempt use expressed as a percentage of overall use was entitled to the exemption.

For those reasons and the reasons set forth in its application, Treasury respectfully requests that this Court either peremptorily reverse the Court of Appeals decision and hold Detroit Edison was not entitled to the exemption, or alternatively grant Treasury's application for full briefing and argument on the issues.

Respectfully submitted,

Bill Schuette  
Attorney General

Aaron D. Lindstrom (P72916)  
Solicitor General  
Counsel of Record

Matthew Schneider (P62190)  
Chief Legal Counsel



Michael R. Bell (P47890)  
Nate Gambill (P75506)  
Zachary C. Larsen (P72189)  
Assistant Attorneys General  
Attorneys for Michigan Department of  
Treasury  
Defendant-Appellant  
Revenue & Collections Division  
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517.373.3203

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