STATE OF MICHIGAN
IN THE SUPREME COURT
Appeal from the Michigan Court of Appeals
Fitzgerald, P.J., Meter and Boonstra

NACG Leasing f/k/a Celtic Leasing, LLC,

Petitioner-Appellee,

vs. Supreme Court No. 146234

Michigan Department of Treasury, Court of Appeals No. 306773

Respondent-Appellant. Lower Court Case No. 338928

_____/

# BRIEF ON APPEAL OF PETITIONER-APPELLEE

ORAL ARGUMENT REQUESTED

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## COUNTER STATEMENT OF QUESTIONS PRESENTED

I. WHETHER THE MERE SIGNING OF A LEASE, WHERE THE LESSOR NEITHER TAKES POSSESSION OF NOR OTHERWISE EXERCISES DOMINION AND CONTROL OVER THE LEASED PROPERTY, CONSTITUTES "USE" OF TANGIBLE PERSONAL PROPERTY FOR PURPOSES OF THE MICHIGAN USE TAX ACT?

The Michigan Court of Appeals answered "no."

Respondent-Appellant answers "yes."

Petitioner-Appellee answers "no."

II. WHETHER THE TAX TRIBUNAL'S UPHOLDING OF A USE TAX ASSESSMENT IN THE AMOUNT OF $414,000 IS SUPPORTED BY COMPETENT, MATERIAL, AND SUBSTANTIAL EVIDENCE ON THE WHOLE RECORD?

The Michigan Court of Appeals did not address the question.

Respondent-Appellant implicitly answers "yes."

Petitioner-Appellee answers "no."

## I. INTRODUCTION

In its opinion below, the Michigan Court of Appeals, in a unanimous decision issued less than a week after oral argument, held that Michigan's use tax does not apply to the purchase of an aircraft where that aircraft never comes into the possession of the purchaser but is simultaneously leased to a third party and, pursuant to the lease, the purchaser retains no dominion or control over the aircraft. This is a correct and entirely unremarkable conclusion, notwithstanding the Michigan Department of Treasury's questionable reading of it, and is completely consistent with the entirety of applicable existing Michigan jurisprudence on this same topic. The decision below in no way imperils the State's fiscal health, nor does it rest – as Treasury claims – on a rogue interpretation of the Michigan Use Tax Act. Accordingly, Petitioner-Appellee Celtic Leasing[1] respectfully requests that the decision of the Court of Appeals be upheld.

## II. STATEMENT OF FACTS

The facts of this case are contained entirely within the parties' Stipulation of Facts in the Michigan Tax Tribunal together with the exhibits to that Stipulation, (Petitioner-Appellee's Appendix, pp. 1b -102b). The salient facts are these:

1. The aircraft in question was delivered to the lessee, Murray Air, on January 7, 2005, in anticipation of being leased from a different party that was to have purchased the plane.

[1] In the interests of consistency, if not necessarily accuracy, Petitioner-Appellee will adopt Treasury's description of it as "Celtic Leasing" for purposes of this brief.

2. The proposed purchase and lease fell through, and as a result Celtic Leasing stepped in and, on April 19, 2005, purchased the aircraft and, simultaneously with taking title, leased it to Murray Air for a five-year term.[2]

3. As the Court of Appeals held, and Treasury does not really contest, Celtic Leasing "ceded total control [of the aircraft] to Murray pursuant to the lease." (Slip op at 5.)

## III. STANDARD OF REVIEW

This Court has stated as follows:

> The standard of review of Tax Tribunal cases is multifaceted. If fraud is not claimed, this Court reviews the Tax Tribunal's decision for misapplication of the law or adoption of a wrong principle. We deem the Tax Tribunal's factual findings conclusive if they are supported by "competent, material, and substantial evidence on the whole record." But when statutory interpretation is involved, this Court reviews the Tax Tribunal's decision de novo. We also review de novo the grant or denial of a motion for summary disposition. *Briggs Tax Service LLC v Detroit Public Schools*, 485 Mich 69, 75; 780 NW2d 753 (2010) (citations omitted).

Review is *de novo* in the present case to the extent it involves a question of statutory interpretation. But this case potentially also presents an issue with respect to which this Court must determine whether a finding of the Tribunal has sufficient evidentiary support based on the stipulated factual record.

[2] Treasury's Statement of Facts contends that "the purchase was executed at the Willow Run Airport in Ypsilanti" (Treasury's Brief, p. 3). In fact, there is no indication in the Stipulation of Facts as to where the purchase documents were executed, if that is what is meant. The plane was delivered at Willow Run, inasmuch as it had been there three months before Celtic Leasing decided to buy it.

## IV. ARGUMENT

### A. THE DECISION BELOW IS SOLIDLY IN THE MAINSTREAM OF WELL-REASONED MICHIGAN JURISPRUDENCE ON THE APPLICATION OF THE USE TAX TO LEASED AIRCRAFT

This case arises under the Michigan Use Tax Act, MCL 205.91 *et seq*. "The use tax is complementary to the sales tax and is designed to cover those transactions not covered by the General Sales Tax Act," *Sharper Image Corporation v Department of Treasury*, 216 Mich App 698, 701; 550 NW2d 596 (1996). The issue and guiding principles presented by this case are the same as in *Sharper Image*:

> The UTA applies to every person in this state "for the privilege of using, storing, or consuming tangible personal property *in this state*." MCL 205.93 (1); MSA 7.555 (3)(1) (emphasis added). At issue here is the definition of the term "use," which is defined as
>
> > The exercise of a right or power over tangible personal property incident to the ownership of that property including transfer of the property in a transaction where possession is given.
>
> In order to determine the meaning of this term, we must examine the intent of the Legislature in enacting the definition. We do so with the following principles in mind. The authority to tax must be expressly provided. *Molter v Dep't of Treasury*, 443 Mich 537, 543; 505 NW2d 244 (1993). Tax laws generally will not be extended in scope by implication or forced construction. When there is doubt, tax laws are to be construed in favor of the taxpayer. *Michigan Bell Telephone Co v Dep't of Treasury*, 445 Mich 470, 477; 518 NW2d 808 (1994).
>
> 216 Mich App at 701-702.

In its Order granting Treasury's application for leave to appeal in this case, this Court directed the parties to "address the applicability of the use tax to a transaction where tangible personal property is purchased by one party and leased to another party when the purchaser/lessor does not obtain actual possession of the property." As will be discussed below, the concept of possession is important to the issue of "use," but is not necessarily determinative.

Nevertheless, Michigan's Court of Appeals has, in the context of fact patterns similar to that of the present case, thoroughly analyzed this issue in a series of cases decided over the past fifteen years. Treasury here implicitly asks this Court to overrule this entire line of cases, upon which taxpayers and the Tax Tribunal have come to rely.

The Court of Appeals has developed a comprehensive, analytically rigorous, and thoroughly consistent rationale as to when the use tax should apply in cases such as this. Where the purchaser/lessor of the aircraft exercises physical dominion and control over the aircraft – or reserves the right to do so – the purchaser has "used" the aircraft for purposes of the Use Tax Act and the tax applies. Where the purchaser/lessor relinquishes to the lessee all right to dominion and control over the aircraft and never exercises that right itself, the purchaser is not subject to the tax.

The earliest of these cases for present purposes is *Czars, Inc v Department of Treasury*, 233 Mich App 632; 593 NW2d 209 (1999). In *Czars*, the purchaser of the aircraft claimed to have leased it to a third party and therefore not to have "used" it. However, there was no written lease whatever, making it impossible to determine whether the purchaser could exercise dominion and control over the plane. Since there was no "lease or other documentary evidence showing that [the purchaser] totally or permanently relinquished control of the aircraft to [the lessor]," 233 Mich App at 639, the Court of Appeals upheld the Tax Tribunal's determination that the purchaser had "used" the aircraft.

Soon thereafter, the Court of Appeals distinguished *Czars* on its facts in two cases: a published opinion entitled *WPGP1, Inc v Michigan Department of Treasury*, 240 Mich App 414; 612 NW2d 432 (2000) and an unpublished opinion entitled *M & M Aerotech, Inc v Department of Treasury*, COA Docket No. 211460 (1999) (App., p. 103b). In *WPGP1*, the petitioner had

purchased title to two airplanes at a foreclosure sale conducted on behalf of the lender that had financed the original purchase of the planes. Both planes were subject to existing leases to Southwest Airlines, Inc., which operated them in interstate commerce. Those operations included numerous landings in and takeoffs from locations in Michigan.

The Court of Appeals held in *WPGP1* that the use tax did not apply because:

> [T]he leases gave exclusive authority over the use, storage, and consumption of the airplanes during the duration of the leases to Southwest, and thus plaintiff exercised no right or power over the airplanes. In other words, by virtue of the leases, plaintiff ceded control of the airplanes to Southwest, and therefore could not have "used" the airplanes for purposes of use tax liability under the [Use Tax Act]. 240 Mich App at 418.

In *M & M Aerotech, Inc*, the aircraft was purchased and, on the same day, leased pursuant to an Aircraft Lease Agreement. As in this case, "[t]he lease was drafted in anticipation of the aircraft's purchase." Although the aircraft was subsequently brought into Michigan for the installation of avionics equipment within 90 days following the purchase, the Court of Appeals held that the use tax did not apply because the purchaser/lessor "intended to and did relinquish total control of the aircraft to [the lessee] for the lease term."

In two subsequent unpublished cases, *Glieberman Aviation, LLC v Department of Treasury*, COA Docket No. 242532 (2004) (App. p. 109b), and *Aerogenesis, Inc v Department of Treasury*, COA Docket No. 300266 (2011) (App., p. 113b) the Court of Appeals further refined its analysis. In *Glieberman*, the Court of Appeals distinguished both *WPGP1* and *M & M Aerotech* on the basis that the aircraft owner in *Glieberman* retained the right under the lease to use the aircraft. The facts of *Aerogenesis, Inc* followed the same pattern: there was a lease, but as in *Glieberman* the lease contained exceptions to the lessee's complete control of the aircraft. In both cases, consistent with *Czars*, the Court of Appeals held that the purchaser's reservation of the right to use the aircraft was itself a sufficient "use" to trigger the use tax. In neither case

did the Court of Appeals question the holdings in *WPGP1* and *M & M Aerotech*. In *Glieberman*, the Court stated: "The cases cited by petitioner [*WPGP1* and *M & M Aerotech*] establish that ownership of an aircraft leased to another entity is not 'use' under the UTA" (*id*) (emphasis supplied).

The unifying theme underlying all of these opinions is that in every case in which the use tax was imposed and upheld, from *Czars* to *Aerogenesis*, the owner/lessor had exercised – or at least reserved the right to exercise – physical dominion over the aircraft in some respect. This flows logically from the very nature of tangible personal property.

The Use Tax Act taxes the exercise of the "privilege of using, storing, or consuming tangible personal property in this state," MCL 205.93(1). It is completely obvious that to "consume" personal property entails some exercise of physical dominion over that property; likewise with the act of "storing" tangible personal property. Logically, the same must be true of "using" tangible personal property. The teaching of the long-established case law discussed above is that it is not enough simply to shuffle paper with respect to tangible personal property in order to "use" it. To be subject to tax, the owner must touch it, feel it, move it, repair it, have some physical contact with it of some sort – or at least reserve the right to do so.

Treasury has searched in vain for a case in Michigan jurisprudence that would equate the leasing of property with a "use." *Attorney General v Pere Marquette Ry Co*, 263 Mich 431; 248 NW 860 (1933), is not such a case. Rather, that case stands for the proposition that "a surface owner owns the oil and gas beneath his land," *Manufacturers National Bank v Director of the Department of Natural Resources*, 420 Mich 128, 141; 362 NW2d 572 (1984). The opinion's passing reference to the ability of such an owner to lease mineral rights tells us nothing at all about the "use" of tangible personal property.

Nor is *Wolverine Sign Works v City of Bloomfield Hills*, 279 Mich 205; 271 NW2d 823 (1937) of aid to Treasury's cause. That was a billboard regulation case, and has been extensively and exclusively cited as such. This Court's employment of the expression "lease use" in the opinion surely does not constitute a holding that "lease" equals "use" for any purpose, much less for Use Tax Act purposes.

As noted above, the Use Tax Act's definition of "use" is "[t]he exercise of a right or power over tangible personal property incident to the ownership of that personal property including transfer of the property in a transaction where possession is given," MCL 205.92(b). Treasury's interpretation of this provision would obliterate any distinction between "ownership" and "use." For example, Treasury provides a list of things that, as owner of the plane, Celtic Leasing "could have" done with the aircraft (Treasury's Brief on Appeal, p. 9).[3] Of course it "could have" done any of those things, because as owner of the aircraft, Celtic Leasing had all the incidents of ownership of the plane. The question for this Court to answer, however, is not whether the incidents of ownership accrued to Celtic Leasing as owner, but rather whether Celtic Leasing "exercise[d] a right or power" over the plane incident to ownership. The mere signing of lease documents, which could have taken place in Manila as easily as Willow Run, is simply not such an exercise.

To be plain, the mere vesting of incidents of ownership in the purchaser of tangible personal property does not constitute an "exercise of a right or power over" that property (emphasis supplied) by the owner. The Legislature's use of the phrase "over tangible personal property" suggests the exercise must involve the property itself in a physical sense, and not merely the intangible, incorporeal aspects of ownership. Accordingly, the Court of Appeals in

[3] Treasury's inclusion in this list of "used it as collateral on a loan, or sold it" begs the question of whether those actions actually comprise a "use" as defined in the statute. Taking out a loan against a plane, or immediately reselling it, need not involve the owner "using" it in the sense of exercising physical dominion and control over it.

this and other like cases is correct in insisting upon some element of physical dominion and control in order to find a "use."

### B. THE COURT OF APPEALS CORRECTLY AND APPROPRIATELY DISTINGUISHED ITS DECISION IN *FISHER* BASED ON ITS UNIQUE FACTS

The turning point in the proceedings in the Tax Tribunal below was Treasury's citation to the Tribunal of the Court of Appeals' opinion in *Fisher & Company v Department of Treasury*, 282 Mich App 207; 769 NW2d 740 (2009). The Tribunal had previously entered summary disposition in favor of Celtic Leasing on the stipulated facts, based on the line of cases discussed in Part A above. Subsequently, persuaded by Treasury's reliance on *Fisher* in a Motion for Reconsideration, the Tribunal summarily reversed itself and entered judgment for Treasury. The Court of Appeals, in its opinion below, correctly concluded that *Fisher* did not apply, and that the Tribunal had committed an error of law in relying on it to enter judgment for Treasury.

The facts of *Fisher* are utterly unlike the facts of this case, or any of the other aircraft lease Use Tax Act cases cited above. The plaintiff in *Fisher* purchased what was nominally a 25% undivided interest in a personal jet. Pursuant to a series of interlocking agreements between Fisher, other part owners, and NetJets Aviation, Fisher was assured of a certain number of hours use of any one of a number of aircraft in the NetJets fleet, including but not exclusive to the plane in which Fisher purchased a fractional interest. While it was stipulated that the aircraft in which Fisher nominally purchased an interest never entered Michigan, Fisher did make use of other planes in the NetJets fleet within Michigan. 282 Mich App at 209. On this fact pattern, the Department of Treasury assessed use tax against Fisher measured by the purchase price of the fractional ownership interest.

The principal issue in *Fisher* (as the Court of Appeals noted in its decision below) was not whether Fisher had used tangible personal property within the state, but whether there had

been a purchase of tangible personal property at all. The dissent in *Fisher* argued at length, and with complete justification, that what Fisher purchased was actually transportation services by the hour. The majority, however, although split on the issue of application of sales tax paid in another jurisdiction, held that Fisher had actually purchased tangible personal property to which the use tax could apply. 282 Mich App at 210.

As the Court of Appeals noted below, "*Fisher* involved a vastly different fact pattern than the instant case" (slip op at 4). Tellingly, the opinion in *Fisher* cited not one of the cases discussed in the previous section of this brief. Nor did it disturb the Court of Appeals' consistent holding, as expressed in *Glieberman*, that "ownership of an aircraft leased to another entity is not 'use' under the [Use Tax Act]." *Fisher* was likely wrongly decided, but it is also easily distinguishable on its unique facts. Accordingly, the Court of Appeals in its opinion below was entirely correct in not applying *Fisher* to this case.

Treasury's description of the Court of Appeals opinion below, in the context of the court's discussion of *Fisher*, misstates the outcome. Treasury would have this Court believe that the holding of the Court of Appeals is that "a transfer of property unaccompanied by a transfer of possession is simply not 'use' that is subject to tax" (Treasury's Brief on Appeal, p. 8). That is not what the Court of Appeals held.

The Court of Appeals' opinion below for all intents and purposes ends at the top of page 4 of the slip opinion, with this paragraph:

> It is undisputed that the lease executed contemporaneously with plaintiff's purchase of the aircraft ceded total [control][4] of the aircraft to Murray. Murray was responsible for repairs and maintenance of the aircraft and was responsible for all insurance and taxes, including specifically the Michigan use tax. Murray was assigned all warranties in the aircraft and bore all the risk of loss of the aircraft. The aircraft was in Murray's possession prior

[4] Obviously the word intended, but inadvertently omitted, by the Court of Appeals.

> to plaintiff's purchase and that possession was not interrupted. We therefore conclude that plaintiff did not "use" the aircraft under the UTA. MCL 205.92(b) [footnote omitted].

The entire balance of the opinion below consists of the Court of Appeals' refutation of Treasury's arguments based on *Fisher* because of the utter dissimilarity of the facts of this case to those of *Fisher*. One important fact is the obvious one that Celtic Leasing never had possession of the aircraft. The Court of Appeals' statement on which Treasury hangs its entire argument is simply an acknowledgement that, for purposes of the statutory definition of "use," Celtic Leasing had no possession to give.

Celtic Leasing actually agrees with Treasury's position regarding the proper interpretation of the word "including" in that statutory definition (Treasury's Brief on Appeal, p. 8). Indeed, the very cases upon which Celtic Leasing relies, and upon which the Court of Appeals relied below as well, include instances in which the use tax was imposed on a lessor even though there is no indication the lessor ever had "possession" of the aircraft. In *Czars*, *supra*, for example, the lessor was not even licensed to operate the plane, 233 Mich App at 637. Likewise, in *Aerogenesis*, *supra*, there is no evidence that the lessor ever exercised its contractual "right to use the aircraft for its own purposes," which the Court of Appeals found fatal to the lessor's claim of exemption.

These cases demonstrate that while "possession" is obviously both an important word in and an important concept in the definition of "use," it is not the entire key to that definition. Certainly, the Legislature intended a "transfer of the property in a transaction where possession is given" to be an example of a "use." This does not answer the question of what other actions might – or might not – constitute the "exercise of a right or power over the tangible personal property."

Treasury jumps directly to the conclusion that any action an owner might take with respect to property it owns constitutes a use because it involves an incident of ownership. In this reading, the concept of "use" is swallowed by the concept of "ownership." The Court of Appeals, in its long series of well-reasoned cases that includes the present one, has declined to accept this interpretation. The Court of Appeals is correct, and should be upheld.

### C. THE COURT OF APPEALS' DECISION IN *MUSASHI* DOES NOT REQUIRE REVERSAL OF THE COURT OF APPEALS' DECISION IN THIS CASE.

Although Treasury claims that the present case involves merely a straightforward exercise in statutory interpretation, it makes an additional, completely policy-based argument centered on the Michigan Court of Appeals unpublished opinion in *Musashi Auto Parts of Michigan, Inc v Department of Treasury* (COA Docket No. 305268, December 13, 2012) (App., p. 117b).

Musashi Auto Parts, an automotive parts manufacturing business located in Battle Creek, Michigan, rented uniforms for its employees from Gallagher Uniform, another Battle Creek business. Treasury audited Musashi Auto Parts, and included in its audit an assessment of use tax based on the rental it had paid to Gallagher. Musashi Auto Parts paid the tax under protest, sued for a refund in the Court of Claims, and prevailed.

On appeal, the Court of Appeals affirmed the Court of Claims' holding that Musashi Auto Parts, as lessee of the uniforms, was not subject to the use tax. Treasury now claims that this unpublished decision, in combination with the Court of Appeals' decision in the present case, opens wide the floodgates to designing any purchase of tangible personal property whatever to be free of sales or use tax by structuring it as a lease. Treasury complains, as it invariably does when it loses a case, that the State of Michigan will be pauperized if these two decisions are left standing.

The principal problem with *Musashi*, of course, is that it is a case in which Treasury audited the wrong party. The nature of a uniform rental business is for the lessor to obtain, deliver, retrieve, launder, and redeliver the uniforms. There is not the slightest doubt that Gallagher "used" the uniforms in the most literal sense of the Use Tax Act. Had Treasury bothered to audit Gallagher, rather than Musashi Auto Parts, the applicable use tax on the purchase price of the uniforms would unquestionably have been owing and would unquestionably have been paid.

The most important distinction between *Musashi* and the present case, however, is that the two cases involve interpretation of different portions of the Use Tax Act. Here, this Court is asked to determine whether there is any meaningful distinction between "ownership" and "use" for purposes of the definition of "use" found in Section 2(b) of the Act. Whichever way this Court answers that question, it will not provide an answer to the separate question presented in *Musashi,* arising under Section 5 of the Act, of whether a lessee can be assessed the use tax if the lessor elects to pay the tax from rental proceeds but does not do so. Although this Court is holding in abeyance Treasury's Application for Leave to Appeal in *Musashi* on the basis that a decision in the present case "may resolve an issue raised in" *Musashi,* the issues presented in the two cases are in fact distinct.

Is it possible that the Court of Appeals decided both this case and *Musashi* correctly? The answer is unquestionably yes, inasmuch as the two cases focus on different aspects of the Use Tax Act and are not interdependent. Might this Court's affirmance of both decisions raise the enormous tax avoidance problems described by Treasury? As a practical matter, it seems unlikely. There is certainly no way the tax could have been avoided in the *Musashi* situation had Treasury assessed it against the purchaser of the uniforms. As for cars and boats, the necessity

of registration in order to obtain a Michigan license insures that the appropriate sales or use tax will inevitably be collected.

In any event, these are matters of conjecture that need not concern this Court. It is jurisprudentially unnecessary and a waste of judicial ammunition for this Court to attempt to imagine and rule on every possible factual scenario involving the incidence of use tax in a lease of tangible personal property. The present case presents a limited issue of applying statutory language to a narrowly-drawn set of facts. The correct disposition of that issue has been reached in a number of Court of Appeals cases, most recently and most notably by the court below in this one, and that decision should be affirmed.

### D. THE TRIBUNAL LACKED SUFFICIENT FACTUAL BASIS FOR ENTERING JUDGMENT AGAINST CELTIC LEASING IN THE AMOUNT OF $414,000 PLUS INTEREST AND PENALTIES.

In granting Treasury's Motion for Reconsideration below, the Tribunal did not merely "reconsider" whether it was correct in previously granting summary disposition to Celtic Leasing, but rather entered judgment in favor of the Department of Treasury and affirmed Treasury's assessment in the amount of $414,000 plus interest and penalty. Even if the Tribunal had been correct on the law (which it was not), the Tribunal should at most have withdrawn its Final Opinion and Judgment and returned the case to its docket. To enter judgment against Celtic Leasing in the amount of $414,000 based on the existing record and pleadings was error.

The Tribunal lacked competent, material, and substantial evidence to support entering judgment in the amount of $414,000. The parties stipulated to all of the relevant facts applicable to this case. The only evidence in the record to establish the value of the aircraft is the purchase price stated in the Aircraft Purchase Agreement that was attached as an exhibit to the parties' Stipulation of Facts. That Agreement recites the purchase price of the aircraft as $2,700,000 (App. p. 69b). There is no evidence to the contrary.

The sales and use tax rate in Michigan is six percent, as it has been since 1994. Const art IX § 8; MCL 205.52 (1); MCL 205.93 (1). It is a mathematical certainty that six percent of $2,700,000 is $162,000. There is and can be no evidence to support an assessment in the amount of $414,000.

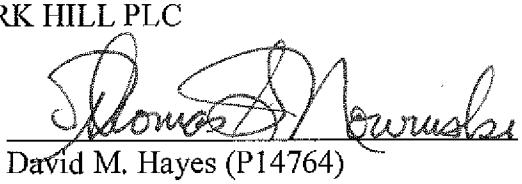
The Court of Appeals did not consider this issue below because it correctly held that no tax whatever is due. Likewise, the appropriate disposition of this case here is to affirm the Court of Appeals' reversal of the Tribunal's judgment in favor of the Department of Treasury. Any other result however, should require no less than that the case be remanded to the Tax Tribunal for accurate computation of any use tax for which Celtic Leasing may be liable.

## V. CONCLUSION AND RELIEF REQUESTED

For all of the foregoing reasons, Petitioner-Appellee respectfully requests that the decision of the Michigan Court of Appeals be affirmed.

Respectfully submitted,

CLARK HILL PLC

By: 

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