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

NACG LEASING f/k/a
CELTIC LEASING, LLC,

Petitioner-Appellee,

v

DEPARTMENT OF TREASURY,

Respondent-Appellant.
_____/

Supreme Court No. 146234

Court of Appeals No. 306773

Tax Tribunal No. 338928

The appeal involves a ruling that a provision of the Constitution, a statute, rule or regulation, or other State governmental action is invalid.

BRIEF ON APPEAL OF APPELLANT DEPARTMENT OF TREASURY

ORAL ARGUMENT REQUESTED

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STATEMENT OF JURISDICTION

This Court has jurisdiction under MCR 7.301(2) and the Court's order of May 22, 2013, granting Treasury's application for leave to appeal.

STATEMENT OF QUESTIONS PRESENTED

The Use Tax Act imposes a tax on the use of tangible personal property in this State. "Use" is defined as "the exercise of a right or power over tangible personal property incident to the ownership of that property including the transfer of the property in a transaction where possession is given." MCL 205.92(b). This Court has asked the parties to address the following question:

1. Is there "use" by the purchaser/lessor under the Act in 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.

   Appellant's answer: Yes.

   Appellee's answer: No.

   Court of Appeals' answer: No.

STATUTES INVOLVED

MCL 205.93(1) (Use Tax)

> There is levied upon and there shall be collected from every person in this state a specific tax for the privilege of using, storing, or consuming tangible personal property in this state at a rate equal to 6% of the price of the property or services specified in section 3a or 3b. . . .

MCL 205.92(b) (definition of "use")

> "Use" means 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.[1]

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[1] This was the definition of "use" during the 2006 tax period at issue. The statute was later amended, by PA 2007 103, to add a second sentence: "Converting tangible personal property acquired for a use exempt from the tax levied under this act to a use not exempt from the tax levied under this act is a taxable use." MCL 205.92(b). This post-assessment sentence is not relevant here.

INTRODUCTION

When the Legislature defines a word in a statute, that definition controls the word's meaning. In the Use Tax Act, the Legislature defined the word "use" to mean "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." MCL 205.92(b). Leasing one's property to another falls squarely within this definition: granting a lease *is* exercising a right incident to ownership. *Attorney General v Pere Marquette Ry Co*, 263 Mich 431, 433; 248 NW 860 (1933) ("An incident of ownership is the right to sell or lease or use the property in any lawful way.").

The Court of Appeals nonetheless concluded that leasing an aircraft was not a "use" under the Act. In the Court of Appeals' view, the lessor (Celtic Leasing) did not "use" the aircraft because it never took possession of the aircraft and instead through the lease "ceded total [control] of the aircraft" to the lessee (Murray Air). But while transferring possession of the property is one type of "use" given as an example in the statute, it is just that—an example—not a requirement.

Further, the Court of Appeals' approach lends itself to easy circumvention of the 6% tax Michigan expects to receive on all tangible personal property. So long as the lessor never has actual possession of tangible personal property, it can be leased for use in Michigan exempt from use tax.

For these reasons, this Court should reverse and hold that leasing property is exercising a right incident to ownership and therefore subject to the use tax.

STATEMENT OF FACTS

The relevant facts of this case are neither extensive nor disputed, being drawn from the parties' stipulation of facts and supporting documentation. (App 34a–150a.) Essentially, Celtic Leasing, a Michigan LLC, bought an airplane already located in Michigan and then leased it to another Michigan company.

I. The purchase and lease of the aircraft

In January of 2005, a foreign lease servicer (debis AirFinance Ireland, PLC) approached Murray Air, Inc., a Michigan corporation, and offered to lease Murray Air an aircraft owned at the time by a Florida business (AerCoUSA, Inc.). (App 35a–36a, 113a.) The foreign lease servicer provided Murray Air an unexecuted, but detailed, letter of intent to lease the aircraft to Murray Air. (App 35a, 99a–108a.) Before the letter of intent was even executed, Murray Air personnel took possession of the aircraft on January 7, 2005, and ferried it from Arkansas to Murray Air's facility in Ypsilanti. (App 35a–36a.)

Before the lease was finalized, the lease servicer notified Murray Air that it could not service the lease as the parties had planned. (App 36a.) As a result, Murray Air approached Celtic Leasing to purchase the aircraft from its Florida owner and lease it to Murray Air. (App 36a.) Celtic Leasing (as NACG Leasing, LLC was then known) had ties to Murray Air: Murray Air owned 50% of Celtic Leasing, and its predecessor (Murray Aviation) had helped form Celtic Leasing for purposes including "aircraft leasing." (App 34a, 41a, 52a, 58a.) Celtic Leasing agreed to the plan, executed an aircraft sale agreement, and purchased the aircraft from the Florida owner on April 19, 2005. (App 34a–36a, 109a–136a.)

Though the purchase was executed at the Willow Run Airport in Ypsilanti, Michigan, no sales tax was collected or remitted to the State on the sale. And throughout this process, the aircraft remained in Murray Air's possession. (App 36a.)

After purchasing the aircraft, Celtic Leasing leased it to Murray Air for a five-year term. (App 35a–36a, 141a–158a.) Through the lease, Celtic Leasing granted Murray Air the right to use the aircraft; in exchange for that right, Murray Air agreed to pay $50,000 per month—the plane is a DC-8 cargo plane—plus additional reserve payments. (App. 141a–142a, 35a.) Celtic Leasing provided Murray Air a covenant of "peaceable and quiet enjoyment . . . free of any interference or hindrances from lessor or any other party," so long as Murray Air continued to perform its obligations under the lease. (App 144a.) Consistent with its continued ownership of the plane, Celtic Leasing retained the right to "enter upon any premises where the aircraft is stored, for the purpose of inspection, and may remove the aircraft forthwith, without notice to Lessee, if, in the opinion of the Lessor, the aircraft is being improperly used or maintained." (App 146a; see also App 147a. ("No passage of title. This Agreement is a Lease, and the Lessee does not acquire hereby any right or title, legal or equitable, in the Aircraft.")) Celtic Leasing also agreed to pay for certain maintenance of the aircraft and retained the right of repossession if Murray Air breached its obligations under the lease. (App 145a, 146a.)

II. The assessment of use tax

Treasury determined that Celtic Leasing's act of entering into an agreement with Murray Air to lease the aircraft it had just purchased was the exercise of a right over the aircraft incidental to its ownership and thus, met the definition of "use" under the statute. Treasury accordingly assessed Celtic Leasing $414,000 in use tax, plus a $103,500 penalty for failure to file and pay, as well as statutory interest. (App 33a.)

PROCEEDINGS BELOW

I. Michigan Tax Tribunal

Celtic Leasing challenged the assessment in the Michigan Tax Tribunal, alleging that it neither possessed nor exercised any right or power with respect to the aircraft and, therefore, was not liable for the use tax assessed. Treasury, on the other hand, maintained that Celtic Leasing's purchase and lease of the aircraft constituted a "use" of the aircraft by statutory definition. After entering into a stipulation of facts, the parties moved for summary disposition.

The Tribunal initially granted summary disposition in favor of Celtic Leasing, finding that because it "did not have possession of the aircraft and did not, at any time, take responsibility for such things as repairs and maintenance, insurance, potential benefit of warranties, or any options for use thereof, it did not use the airplane" and therefore was not liable for the use tax. (App. 17a.) The Tribunal did not analyze the statutory text, but instead focused on case law it conceded was not binding. (App 17a–18a.)

The Tribunal also concluded that the Florida seller had a sales tax nexus with Michigan (due to its aircraft's presence in Michigan), that the purchase transaction was not subject to Use Tax, and that Treasury could have collected sales tax from the seller. (App 18a.)

Treasury moved for reconsideration, citing *Fisher & Co v Dep't of Treasury*, 282 Mich App 207; 769 NW2d 740 (2009), an opinion issued after the parties had submitted their briefs on motion for summary disposition but before the Tribunal entered its June 10, 2011 Order. Granting Treasury's motion, the Tribunal, quoting *Fisher*, noted that "'[e]ntering into a contract to give up some of one's rights to possession or control is, itself, an exercise of those rights'" and therefore concluded that leasing the aircraft was a "use" in Michigan. (App 21a.) The Tribunal did not reference its earlier conclusion that Treasury should have collected sales tax from the seller, apparently accepting that Treasury was not required to do so. The Tribunal also denied Celtic Leasing's subsequent motion for reconsideration. (App 24a–26a.)

II. Court of Appeals

The Court of Appeals reversed. It rejected Treasury's plain language interpretation of MCL 205.92(b) on the theory that the phrase "including transfer of the property in a transaction where possession is given" imposed a restriction on the preceding clause, requiring a transfer of possession from seller to purchaser before a "use" could occur under the statute. In the Court of Appeals' view, "the UTA's definition of 'use' provides that it includes 'transfer of the property *in a transaction*

where possession is given.'" (App 31a, quoting MCL 205.92(b).) "Thus, for the purposes of the UTA," the Court of Appeals continued, "a transfer of property unaccompanied by a transfer of possession is simply not 'use' that is subject to tax." (App 31a.)

The Court went on to assert that there was no important distinction between a purchase subject to a preexisting lease and a purchase followed by a subsequent lease if "*total* control" is instantly in the hands of the lessee at the time of purchase. (App 29a–30a.) The Court of Appeals limited *Fisher* to its facts, maintaining that the statement from *Fisher* on which the Tribunal had relied—"'[e]ntering into a contract to give up some of one's rights to possession or control is, itself, an exercise of those rights'"—had not arisen "in the context of an aircraft lease, as here." (App 31a, quoting 282 Mich App at 212–213.)

On May 22, 2013, this Court granted Treasury leave to appeal.

STANDARD OF REVIEW

This Court reviews *de novo* questions of law, including issues of statutory interpretation. *Klooster v City of Charlevoix*, 488 Mich 289, 295; 795 NW2d 578 (2011). If the language of a statute is unambiguous, the Legislature intended the meaning clearly expressed, and the statute must be enforced as written; no further judicial construction is required or permitted. *Universal Underwriters Ins Co v Kneeland*, 464 Mich 491, 499–500; 628 NW2d 491 (2001) (citing *Tryc v Michigan Veterans' Facility*, 451 Mich 129, 135; 545 NW2d 642 (1996)).

"[I]n any question of statutory tax interpretation, . . . taxing is a practical matter and . . . the taxing statutes must receive a practical construction. While they will not be extended by implication, . . . neither will the words thereof be so narrowly interpreted as to defeat the purposes of the act." *Michigan Bell Telephone Co v Dep't of Treasury*, 445 Mich 470, 478; 518 NW2d 808 (1994), quoting *In re Brackett Estate*, 342 Mich 195, 205; 69 NW2d 164 (1955). A construction which would render any part of a statute surplusage or nugatory is to be avoided. *Zwiers v Growney*, 286 Mich App 38, 44; 778 NW2d 81 (2009). Courts may not read into the statute what is not within the Legislature's intent as derived from the language of the statute. *AFSCME v City of Detroit*, 468 Mich 388, 400; 662 NW2d 695 (2003).

ARGUMENT

I. Leasing tangible personal property is exercising of a right or power incident to ownership, and therefore subject to the use tax.

A. The Legislature's definition of "use" covers leasing.

The Legislature defined "use" in MCL 205.92(b) as the "exercise of a right or power over tangible personal property incident to the ownership of that property including transfer of that property in a transaction where possession is given." Leasing falls squarely within this definition.

As this Court has long recognized, "[a]n incident of ownership is the right to sell or *lease* or use the property in any lawful way." *Attorney General v Pere Marquette Ry Co*, 263 Mich 431, 433; 248 NW 860 (1933) (emphasis added); see also *Wolverine Sign Works v City of Bloomfield Hills*, 279 Mich 205, 207; 271 NW 823

(1937) (describing "the lease use" as "a property right"); *Winter v Mackie*, 376 Mich 11, 19; 135 NW2d 364 (1965) ("fee simple title includes . . . as an incident of ownership, the right to . . . lease . . . the property"). This is a basic principle of property law. And, as the Court of Appeals recognized in *Fisher*, "[e]ntering into a contract to give up some of one's rights to possession or control is, itself, an exercise of those rights." 282 Mich App at 212–213.

The statute's plain language thus should have been both the beginning and the end of this case. But the Court of Appeals misread the "including" clause of MCL 205.92(b) as imposing a possession requirement, such that "a transfer of property unaccompanied by a transfer of possession is simply not 'use' that is subject to tax." (App 31a.) This interpretation conflicts with the plain meaning of "including." As this Court has explained, "[w]hen used in a statutory definition, the word 'includes' is a term of enlargement, not of limitation." *Michigan Bell Telephone Co v Dep't of Treasury*, 445 Mich 470, 479, 518 NW2d 808 (1994). The word "includes" "'conveys the conclusion that there are other items includable, though not specifically enumerated . . . .'" *Id.*, quoting 2A Singer, Sutherland Statutory Construction (5th ed), § 47.07, pp 151–156; see also Antonin Scalia & Bryan Garner, *Reading Law: The Interpretation of Legal Texts* (Thomson/West, 2012), § 15, pp 132–133 ("[T]he word *include* does not ordinarily introduce an exhaustive list . . . . That is the rule both in good English usage and in textualist decision-making.") (footnotes omitted).

In short, the phrase introduced by the word "including" is but one example of a "use." *Any* "exercise of a right or power over tangible personal property incident to that ownership of that property," not just a transfer of possession, constitutes a "use" pursuant to the plain and unambiguous statutory language.

Here, Celtic Leasing purchased the aircraft from an owner who conveyed title free of any preexisting lease. After that, Celtic Leasing was at all times the titled owner of the aircraft. As the owner of the aircraft, it could have exercised its rights over the aircraft in any number of ways. Celtic Leasing could have flown its members to Mackinac Island, donated the aircraft to a charitable cause, used it as collateral on a loan, or sold it—to name just a few possibilities. Celtic Leasing instead chose to exercise its rights of ownership by leasing the aircraft to Murray Air. That is a "use" of the aircraft within the plain meaning of MCL 205.92(b).

Another section of the statute also shows that ownership itself can occur without actual possession, so surely incidents of ownership can also be exercised without possession. Specifically, MCL 205.92(e), which defines the term "purchase," acknowledges that one can "own" something by either "a transfer of title, of possession, or of both." In other words, since ownership itself can be acquired by the passage of title, without possession, so too can incidents of ownership over property be exercised without possession of the property.

B. By focusing on "control" of the aircraft, the Court of Appeals has departed from the statute's plain language.

The Court of Appeals also went astray by following some of its prior cases that have read a requirement of "control" into the statute. The Court of Appeals relied, for example, on *WPGP1 v Department of Treasury*, 240 Mich App 414; 612 NW2d 432 (2000), in which the Court of Appeals asserted that because a taxpayer "ceded control" of airplanes to a lessee, it "therefore could not have 'used' the airplanes for purposes of use tax liability under the UTA." (App 29a, quoting *WPGP1*, 240 Mich App at 417. The Court of Appeals also relied on *M & M Aerotech, Inc v Department of Treasury*, 1999 Mich App LEXIS 2745 (Nov 23, 1999) (App 151a–154a), for the proposition that because a lease relinquishes control of the aircraft, a lease is not a use under the statute. (App 30a n 3.)

Both of these cases failed to follow the statutory definition of "use." As already shown, the statutory definition of "use" includes granting a lease; put simply, an owner "cede[s] control" to a lessee precisely by exercising the owner's right, incident to ownership, to relinquish possession and use of the personal property for a time in exchange for rent. That is a valuable right and use for the property; here, Celtic Leasing received more than $50,000 per month by exercising its right to lease the aircraft.

The panel's focus on "control" appears to have arisen from prior Court of Appeals cases addressing whether the taxpayer has overcome the statutory presumption that tangible personal property is subject to the use tax if it was brought into the state within 90 days of its purchase. MCL 205.93(1)(a). In that

context, the Court of Appeals held in several cases that lessors who retained some control over the aircraft despite the leases had in fact used the aircraft in Michigan. For example, in *Mastercraft Engineering, Inc v Department of Treasury*, 141 Mich App 56, 70; 366 NW2d 235 (1985), the panel held that the lessor exercised its power of ownership by directing that the aircraft should be repaired and hangared in Michigan. *Id.* at 493. Similarly, in *Kellogg Co v Department of Treasury*, 204 Mich App 489, 493; 516 NW2d 108 (1994), another airplane use-tax case, the panel held that the lessor exercised its "rights and powers of ownership" by determining that the subject aircraft be hangared and registered in Michigan. *M & M Aerotech* cites both cases.

But the fact that retaining these elements of control was *sufficient* to exercise a right or power incident to ownership does not make retaining those elements of control *necessary* for such an exercise. To the contrary, every lease is an exercise of a right or power incident to ownership, and therefore a "use" under MCL 205.92(b).

In any event, Celtic Leasing did retain significant elements of control through the lease, so it used the property even under a "control" test. The lease provides that Celtic Leasing controlled Murray Air's ability to lend, rent, assign, or encumber the aircraft. (App 143a.) Celtic Leasing controlled the time that the aircraft could to be away from its designated home airport. (App 143a.) Celtic Leasing maintained the right to inspect the aircraft. (App 144a.) Celtic Leasing was responsible for the cost of all scheduled maintenance and major overhauls on gears, engines, and propellers, as well as the cost of implementing any major FAA

airworthiness directives. (App 145a.) Celtic Leasing maintained power to repossess the aircraft if Murray Air failed to pay its rent, breached any provision of the lease or became insolvent or filed for bankruptcy. (App 146a – 147a.) Thus, even under a "control" test, Celtic Leasing maintained rights and power over the aircraft under the terms of the lease sufficient to trigger use tax liability.

As for *Fisher*, the case that recognized that "[e]ntering into a contract to give up some of one's rights to possession and control is, itself, an exercise of those rights," 282 Mich App at 212–213, the Court of Appeals distinguished it on factual grounds. It noted, for example, that *Fisher* involved a fractional interest in the property in what was essentially a time-share arrangement for a fleet of airplanes. (App 31a.) The Court of Appeals then observed that *Fisher's* statement "did not arise in the context of an aircraft lease, as here, and in any event it is not apparent that more than a single judge endorsed the quoted language." (App 31a.) But the question whether the authority to lease property is an incident of property ownership is a legal question, not a factual one, and the answer is the same for an aircraft as for a parcel of land: as seven justices of this Court recognized long ago, "[a]n incident of ownership is the right to . . . *lease* . . . the property . . . ." *Pere Marquette Ry Co*, 263 Mich at 433. In short, the *Fisher* court was right when it said that "[t]he right to control what happens—in layman's terms—to one's property is one of the most fundamental rights incident to ownership. Entering into a contract to give up some of one's rights to possession or control is itself, an exercise of those rights." 282 Mich App at 212–213 (citations omitted).

II. The decision below allows lessors to evade tax liability.

By deviating from the Use Tax Act's language, the Court of Appeal's rule creates a tax avoidance scheme: a lessor may avoid use tax altogether by structuring a sale/lease transaction to avoid actual possession of the tangible personal property. And this avoidance means than no one will pay the use tax, because the Court of Appeals recently held that "the obligation to pay the use tax falls upon the lessor only" (and not the lessee). See *Musashi Auto Parts of Michigan, Inc. v Dep't of Treasury,* unpublished opinion of the Court of Appeals, issued December 13, 2012 (Docket No. 305268) (App 155a–159a).

These decisions create a gap in the coverage of the tax statutes large enough to fly an airplane through. Indeed, the Court of Appeals creates a perfect flight path for avoiding taxation on property that is being used in Michigan and that is subject to taxation. A lessor/purchaser can avoid any tax liability simply by purchasing property (either outside of Michigan or in Michigan) and executing a lease of the tangible personal property without taking any actual possession. The purchaser could avoid paying the sales tax by telling the seller that the purchaser has a lessor exemption. In tandem with *Musashi*, the effect of the Court of Appeals' decision in this case is to allow both the lessor and lessee to avoid the payment of both the sales tax and the use tax. This is precisely what the Use Tax Act sought to prevent. *Lockwood v Commissioner of Revenue*, 357 Mich 517, 546; 98 NW2d 753 (1959) (the use tax was enacted to "meet the threat of avoidance of [the sales tax.]")

For example, any person can easily create a single purpose entity to act as a related party lessor. The person and the "paper" lessor can create a lease, then show up at a local auto, boat, or aircraft dealer and make the purchase. When asked to pay the sales tax, they can claim the lessor exemption, show the lease to the dealer and have the "lessee" take possession, and then drive, float, or fly away tax free. This scenario will work for any type of tangible personal property and for any person who recognizes the loophole created by the Court of Appeals. The Court of Appeals restricted the use tax under *Musashi* to lessors only and now under the instant case allows the lessor to avoid tax by granting possession to a related party at the time the lessor purchases the property.

The simple application of the plain statutory language in MCL 205.92(b) would avoid these tax avoidance schemes. The Legislature did not intend that "use" require actual possession of the tangible personal property in Michigan, but rather that "use" would cover any exercise of a right incident to ownership, such as leasing.

CONCLUSION AND RELIEF REQUESTED

The Court of Appeals erred both by failing to recognize that granting a lease is exercising a right incident to ownership and by limiting the definition of "use" to require actual possession over tangible personal property. This result cannot be reconciled with the plain language of the Use Tax Act. Application of the correct standard of law requires a reversal of the Court of Appeals' decision and entry of an order affirming Treasury's assessment.

Respectfully submitted,

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