STATE OF MICHIGAN
IN THE SUPREME COURT
Appeal from the Michigan Court of Appeals
Gadola, P.J., Kelly, K.F. and Riordan, JJ

TOMRA OF NORTH AMERICA, INC.,

Plaintiff-Appellee,

v

DEPARTMENT OF TREASURY,

Defendant-Appellant.
_____/

Supreme Court No. 158333

Court of Appeals No. 336871

Court of Claims No. 16-000118-MT

TOMRA OF NORTH AMERICA, INC.,

Plaintiff-Appellee,

v

DEPARTMENT OF TREASURY,

Defendant-Appellant.
_____/

Supreme Court No. 158335

Court of Appeals No. 337663

Court of Claims No. 14-000091-MT

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 MICHIGAN DEPARTMENT OF TREASURY

ORAL ARGUMENT REQUESTED

Dana Nessel
Attorney General

Fadwa A. Hammoud (P74185)
Solicitor General
Counsel of Record

Scott L. Damich (P74126)
Randi M. Merchant (P72040)

Assistant Attorneys General
Attorneys for Dep't of Treasury
Defendant-Appellant
Revenue and Tax Division
P.O. Box 30754
Lansing, MI 48909
(517) 335-7584

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TABLE OF CONTENTS

INDEX OF AUTHORITIES

Cases

Statutes

Other Authorities

Rules

Regulations

STATEMENT OF JURISDICTION

This Court has jurisdiction under MCR 7.303(B)(1) and MCL 205.22(3), as well as this Court's March 27, 2019 order granting Treasury's applications for leave to appeal.

STATEMENT OF QUESTIONS PRESENTED

The industrial processing exemption to the Sales Tax Act and Use Tax Act exempts from taxation property sold to certain taxpayers "for use or consumption in industrial processing," which the Legislature defined as an activity that occurs after tangible personal property begins "movement from raw materials storage" but before tangible personal property becomes a "finished good." Both exemption statutes identify potentially exempt industrial processing activities, including recycling, but also explicitly exclude "purchasing, receiving, or storage of raw materials" from eligibility for the exemption. Even if the reverse vending machines at issue in this case can be characterized as being used to ultimately facilitate a recycling operation at a later date, the industrial processing exemption is not available when the machines are not used in that function within the timeframe required by the statute. Based on this statutory framework, Treasury presents the following three questions:

1. Do the principles of statutory construction require a finding that the industrial processing exemption was not available in this case?

   Appellant's answer: Yes.

   Appellee's answer: No.

   Court of Claims' answer: Yes.

   Court of Appeals' answer: No.

2. Does the legislative history of the industrial processing statutes demonstrate that the temporal requirement included in the second sentence of the industrial processing definition must be given effect even when the exemption is claimed for an activity identified in subsection 3 of the statutes?

   Appellant's answer: Yes.

   Appellee's answer: No.

   Court of Claims' answer: Did not answer.

   Court of Appeals' answer: Did not answer.

3. Do prior decisions from this Court require the Court of Appeals' decision to be reversed?

   Appellant's answer: Yes.

   Appellee's answer: No.

   Court of Claims' answer: Did not answer.

   Court of Appeals' answer: Did not answer.

STATUTES INVOLVED

The relevant provisions of MCL 205.54t and MCL 205.94o central to the issues in this case contain identical language, as set forth below:

> (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.
>
> (b) Research or experimental activities.
>
> (c) Engineering related to industrial processing.
>
> (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.
>
> (e) Planning, scheduling, supervision, or control of production or other exempt activities.
>
> (f) Design, construction, or maintenance of production or other exempt machinery, equipment, and tooling.
>
> (g) Remanufacturing.
>
> (h) Processing of production scrap and waste up to the point it is stored for removal from the plant of origin.
>
> (i) Recycling of used materials for ultimate sale at retail or reuse.
>
> (j) Production material handling.
>
> (k) Storage of in-process materials.
>
> * * *
>
> (6) Industrial processing does not include the following activities:

(a) Purchasing, receiving, or storage of raw materials.

* * *

(e) Plant security, fire prevention, or medical or hospital services.

(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 or for use in the manufacturing of a product to be ultimately sold 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.

INTRODUCTION

The industrial processing exemption is not a wholesale release from the obligation to remit sales and use tax on all of the purchases made by those involved in the manufacturing of tangible personal property for sale at retail. To the contrary, the plain language of the industrial processing statutes demonstrates that the Legislature explicitly limited the exemption to eligible property actually used in industrial processing, which was defined not only by describing the nature of the actions that would qualify as industrial processing activities, but also by the acceptable time frame within which those activities must occur for the exemption to apply.

Treasury acknowledges that the nearly verbatim industrial processing exemption statutes contained in the Sales Tax Act and the Use Tax Act include "recycling" in the list of possible industrial processing activities. Treasury further recognizes that the reverse vending machines at issue in this case, and used by everyday consumers to return cans and bottles in order to recover the 10-cent deposit they paid when purchasing them, can reasonably be characterized as ultimately facilitating the recycling process. But there can be no doubt that the industrial processing exemption is not available to every item of property that can be so characterized. In addition to identifying potential industrial processing activities, the Legislature explicitly defined "industrial processing" as an activity that occurs after tangible personal property begins "movement from raw materials storage" but before tangible personal property becomes a "finished good." The property at issue here was not used within this required timeline, and therefore cannot benefit from the exemption.

The temporal requirement included in the second sentence of the industrial processing definition must be given effect in order to prevent an expansion of the exemptions' availability beyond what was intended by the Legislature. The facts of this case, under which a homeowner returning the cans from a weekend barbeque is deemed to be engaged in industrial processing, plainly demonstrate the danger of eliminating the timing limitations set forth in the statute.

The Court below effectively overturned the Legislature's decision to limit the tax exemptions' availability to property that performs an activity during a specific time period. Instead of applying the definition as written, the Court of Appeals held that property can qualify for the exemption based solely on an examination of the *type* of action performed by a machine without regard for *when* the action is performed.

This ruling constitutes a judicially created tax loophole that will potentially result in the loss of many millions of tax dollars. This Court should reverse the decision below because it violates well-established rules of statutory construction, enlarges the industrial processing exemption beyond that contemplated by the Legislature, and is not consistent with this Court's holdings in previous decisions.

The dissent opinion recognized the errors inherent in the majority opinion's reasoning and correctly concluded that the Court of Claims' decision to grant summary disposition in favor of Treasury was consistent with the plain language of the industrial processing exemption, when read in its entirety.

Failure to correct the error made by the Court of Appeals will have substantial and far-reaching consequences, as evidenced by the fact that the amount at stake in this case, which involves only a single taxpayer and a limited tax period, measures in the millions of dollars. This Court should reverse the Court of Appeals and reinstate the trial court's decision in favor of Treasury.

STATEMENT OF FACTS AND PROCEEDINGS

Michigan's Bottle Law and reverse vending machines.

Michigan consumers are required to pay a deposit when they purchase specific beverage containers (bottles and cans) from retailers. MCL 445.571. The deposit is returned to the consumer by Michigan retailers when the consumer returns the beverage container. Retailers do not create a new product with the used beverage containers. Instead, they return the used beverage containers to a beverage distributor or manufacturer. In exchange, the beverage distributors or manufacturers reimburse the retailers the amount of deposits the retailer paid to everyday consumers. MCL 445.572(6).

Reverse vending machines are a "device designed to properly identify and process empty beverage containers and provide a means for a deposit refund on returnable containers." MCL 445.572a(12)(j). Reverse vending machines do not form new products. They perform a task that facilitates the collection of used beverage containers, the retailers' obligation to refund previously paid deposits to the consumer, and the storage of used beverage containers until they are returned to beverage distributors or manufacturers in exchange for a cash refund. (App pp 170a–171a.) Everyday consumers place their used beverage containers in the reverse vending machines. (App p 189a.) The machines read the UPC code on the beverage containers to determine if a deposit refund was previously paid. (*Id.*) The machines reject the beverage containers if a deposit was not previously paid, the barcode on the beverage containers is not readable, or the beverage containers

contain waste. (App pp 178a, 189a.) If a used beverage container is accepted, the container is dropped into a storage bin located behind the reverse vending machine. The machines also provide the consumer returning the beverage containers with a coupon indicating the deposit refund amount to which the consumer is entitled. (App p 174a.)

Tomra's business operations.

Tomra is a Connecticut company that purchases reverse vending machines from Tomra Systems ASA and then sells the machines to supermarkets and liquor stores in States that require consumers to pay a deposit on recyclable beverage containers. (App pp 170a–171a.)

Tomra sells reverse vending machines specifically for aluminum cans, plastic bottles, and glass bottles. (App p 174a.) There is no evidence to suggest that Tomra's customers purchased the reverse vending machines for the purpose of using them to create or form a new product created from the used cans and bottles collected from everyday consumers. Instead, the machines served to facilitate Tomra's customers' obligations related to the Bottle Bill. Primarily, the reverse machines are used to count the number of cans and bottles returned by a consumer seeking to collect the 10-cent deposit that was paid when the beverage was purchased. When an item is placed in the machine, the barcode is scanned to determine information about the container; while this information may be useful for companies that later process and sell aluminum, plastic, and glass on the commodity market, the information is used to determine whether the container

could be accepted at that location. (App pp 216a–217a.) The machines also place the accepted used bottles and cans into bins. (App p 182a.) Those bins are then stored at the supermarket or liquor store. (*Id.*)

Thereafter, a third-party comes to the customers' location, loads the bins containing the used beverage containers onto trucks, and then takes the bins to a new location. (App p 183a.) When the bins arrive at the new location, the bins containing aluminum cans and plastic bottles are dumped into separate hoppers. (App p 186a.) The hopper combines the cans into an aluminum cube. (*Id.*) The same is true for plastic bottles. (App p 206a.) When glass bottles arrive at the third-party location, they are placed on a conveyer that drops the bottles into a storage pit where they await transfer to a purchaser. (App p 199a.) The third-party may sell the aluminum and plastic cubes and glass to other third-parties, which in turn could process the post-consumer products into a product that can become a material part of a finished good. (App pp 186a, 193a, 197a.) However, there is no guarantee that the aluminum and plastic beverage containers will ultimately become part of a finished good.

At times, the reverse vending machines require maintenance or service. Tomra formed a joint venture with Shupan Recyling named UBCR, LLC. UBCR maintains and services reverse vending machines in Michigan. (App pp 056a–057a.) This is consistent with UBCR's website, where you can "[r]equest parts or service here" and Tomra's Senior Vice President of Government Affairs affidavit

"UBCR services all [reverse vending machines] in at least 600 Michigan stores." (App pp 234a–235a; App p 224, ¶ 34.)

Tomra did not claim the industrial processing exemption on its 2003 through 2006 annual sales tax returns, and it filed no returns for the 2007 and 2008 tax years.

Tomra filed Annual Returns for Sales, Use, and Withholding Taxes (Annual Returns) for the 2003, 2004, 2005, and 2006 tax years. (Collectively App pp 049a–055a.) Those returns reported gross sales but they did not claim any deductions. (*Id.*, see ln 1 & ln 5.) Tomra did not file Annual Returns for the 2007 and 2008 tax years. (App p 140a.)

Treasury audits Tomra's 2003 through 2008 sales tax liability.

Treasury performed a sales tax audit of Tomra's records for the period October 1, 2003 through December 31, 2008. (App p 139a.[1]) The purpose of the audit was to verify whether Tomra had the records to substantiate its sales tax liability. (*Id.*)

Treasury's auditor compared Tomra's sales tax returns with Tomra's internal records. Treasury's auditor became concerned because the amount of gross sales that Tomra reported on its Annual Returns were substantially less than the gross sales amounts listed in Tomra's own internal accounting records. (App pp 129a–130a; App pp 140a–141a.) Specifically, the gross sales Tomra reported on line 1 of its Annual Returns were less than the sales amounts Tomra recorded in its

[1] Tomra was also under a Michigan use tax audit at the same time.

Michigan sales sub-ledger. (App pp 140a–141a; App pp 130a, 135a.) Treasury's auditor attempted to reconcile the difference between Tomra's own internal accounting records and the amounts Tomra reported on its annual sales tax returns as gross sales. (App pp 139a–158a.) Specifically, the auditor requested a "complete tie out to the customer" to determine who paid sales tax and whether or not the sale would be exempt. (App p 132a.) The auditor limited his request to a six-month sampling period. (App p 140a.) Tomra did not provide a single customer invoice for the six-month sampling period. (*Id.*; App pp 128a, 131a, 136a.) In fact, Tomra's representative failed to produce any documents to support the transactions Tomra excluded from gross sales. (App pp 131a, 133a-134a, 137a.) Tomra could not even identify who their customers were during the audit period. (App p 127a.) Consequently, the auditor was left with no other option but to recreate Tomra's sales tax liability for the 2003–2008 tax years based on the best available information: Tomra's internal accounting records. MCL 205.68(4).

Treasury's auditor used Tomra's own internal accounting records, specifically Tomra's general ledger, to determine the amount of gross sales Tomra should have reported on its 2003–2008 Annual Returns. (App pp 140a–141a.) The amounts the auditor included as gross sales were "parts income," "Sales of Equip & Product income," and "Leased Equipment." (App pp 152a–157a.) The auditor did not include "installation income," "service income," "freight revenue," or "Canadian revenue" as gross sales. (*Id.*) Applying the determined gross sales amount to the 6% sales tax, the auditor arrived at Tomra's computed sales tax liability. The

auditor then subtracted that amount from Tomra's as-reported sales tax liability. The result was Tomra's sales tax deficiency for the 2003–2008 tax year: $516,562. (App pp 139a–158a; App pp 058a–059a.) The auditor also added a 10% negligence penalty because Tomra did not accurately report its Michigan gross sales on its Annual Returns and did not provide records during the course of the audit. (App pp 139a–158a.)

Tomra challenges Treasury's Intent to Assess before Treasury's Hearings Division and requests a $2,458,452 refund.

After receiving the Notice of Intent to Assess No. TH82977, Tomra requested an informal conference to dispute Treasury's determinations regarding the unsubstantiated exempt sales, the underreported gross sales, and the resulting intent to assess. (App pp 060a–071a.) In the same letter, Tomra requested a $2,458,452 refund from Treasury claiming that Tomra charged and collected $2,458,452 in sales tax from its Michigan customers for the October 1, 2003 through December 31, 2008 period—the same time period covered by Treasury's intent to assess. According to the letter, "[t]hese taxes were erroneously collected because the equipment sales to TOMRA's customers qualified for the Michigan industrial processing exemption." (*Id.*) The letter did not mention the 10% negligence penalty. (*Id.*)

Twelve days after Tomra challenges Treasury's assessment, Tomra files amended Annual Returns.

While Tomra's informal conference was pending before Treasury's Hearing Division, Tomra filed amended Annual Returns for the 2003 through 2006 tax years. (App pp 072a–97a.) Tomra also filed 2007 and 2008 Annual Returns for the first time. (App pp 072a–074a, 098a–125a.) According to the cover letter filed with these Annual Returns, the returns "reflect the claim for refund for all Michigan sales tax collected from TOMRA's customers and paid during the relevant periods in the amount of $2,258,229."[2] (App p 072a.) The 2003 through 2006 amended Annual Returns reported nearly the same gross sales as Tomra's original Annual Returns. (App pp 049a & 081a (2003), 051a & 083a (2004), 053a & 091a (2005), 055a & 093a (2006).) But these amended returns, unlike the original returns, listed specific deductions from gross sales for industrial processing. (*Id.*)

Treasury's Hearing Division affirms Treasury's assessment and denies Tomra's 2003–2008 refund request.

Treasury rejected Tomra's refund claim and upheld Intent to Assess TH82977. Treasury then issued Final Assessment TH82977 against Tomra for $516,562 in tax, $58,502 penalty, and interest. (App p 138a.)

Tomra appealed Treasury's decision to deny the sales tax refund request to the Court of Claims on May 8, 2014. (Compl in 14-000091-MT.) On July 29, 2014, Tomra filed a second complaint in the Court of Claims challenging Final

[2] This is $200,223 less than the refund amount listed in Tomra's 12/02/2011 letter.

Assessment TH82977. (Compl in 14-000185-MT.) Because both complaints requested a determination from the Court of Claims that the reverse vending machines and repair parts Tomra sold to Michigan customers were exempt from Michigan's sales tax under the industrial processing exemption, the Court of Claims consolidated the cases on September 10, 2015.

Tomra requests a $673,511.65 sales tax and $24,992.95 use tax refund for the period of March 1, 2011 through December 31, 2011.

While Tomra's consolidated cases were pending, Tomra filed a sales and use tax refund request for the period of March 1, 2011 through December 31, 2011. (App pp 231a–233a.) Like its previous refund request, Tomra asked Treasury to refund $673,511.65 in sales tax that Tomra allegedly "collected in error because Tomra's sales of [reverse vending machines] in Michigan are exempt pursuant to the industrial processing exemption." (*Id.*) The same letter also requested a $24,992.95 refund from Treasury for the use tax that Tomra allegedly "self-assessed" on "spare parts" that Tomra reportedly "used for the repair and maintenance of the exempt machines." (*Id.*)

Because a year had passed since Tomra's refund request, Tomra exercised its right under MCL 205.30(2) to consider the refund requests denied and then filed a verified complaint with the Court of Claims. Like Tomra's previous complaints filed in the Court of Claims, this complaint requested a determination from the Court of Claims that the reverse vending machines Tomra sold to Michigan customers were exempt from Michigan's sales tax under the industrial processing exemption.

The Court of Claims affirms Treasury's denial of Tomra's 2003–2008 sales tax refund, the corresponding assessment, and Treasury's denial of Tomra's 2011 sales and use tax refund.

The Court of Claims granted summary disposition in favor of Treasury affirming Treasury's assessment and refund denials, holding that Tomra failed to meet the industrial processing exemptions' statutory requirements. (App pp 030–037a; App pp 021a–028a.) In its rulings, the Court of Claims held that reverse vending machines "are not themselves part of the industrial process." (App p 035.)

To reach that result, the Court of Claims relied on the second sentence of MCL 205.54t(7)(a) and MCL 205.94o(7)(a), which limits exempt industrial processing to activities occurring during a specific time period: some point after "tangible personal property begins movement from raw materials storage to begin industrial processing" but before "finished goods first come to rest in finished goods inventory storage." (App pp 034a–035a, 037a.) The Court of Claims then found that the reverse vending machines do not perform an activity falling within the industrial processing time frame. As the Court of Claims reasoned, finding otherwise would have required it to find that everyday consumers hold used beverage containers in raw material storage and thus were engaged in industrial processing by collecting used bottles and cans in their homes. In the Court of Claims' own words, "[s]uch a result is simply irrational." (App p 035a.) The Court of Claims also determined that the reverse vending machines are "[a]t best, . . . the means of receiving and storing raw materials"—events the Legislature specifically excluded from the industrial process. (*Id.*)

The Court of Claims then discredited Tomra's reliance on four different modifiers found in MCL 205.54t(3) and MCL 205.94o(3) that identify specific activities that are considered industrial processing activities. Those subsections, the Court of Claims reasoned, "do not alter when the process begins and ends. Rather, these latter statutes enumerate specific activities [e.g., inspection, quality control, recycling] that, when they occur between the start and end point of the industrial process, are industrial processing activities." (App p 036a.)

Reasoning again that "industrial processing" begins only after there is raw material storage from which to remove tangible personal property, the Court of Claims agreed with Treasury that Tomra does not qualify for the industrial processing exemption, "regardless of whether Plaintiff's recycling machines perform tasks that might fit within any specific provision of MCL 205.54t(3) or MCL 205.94o(3), because those activities occur before the industrial process begins[.]" (App p 037a.)

Concluding that Tomra cannot use the industrial processing exemption to avoid paying sales tax on its reverse vending machine and repair part sales to Michigan customers, the Court of Claims dismissed in Treasury's favor in both Docket No. 16-000118-MT and Docket No. 14-000091-MT (consolidated with 14-000185-MT). Tomra appealed both decisions to the Court of Appeals, which administratively consolidated Tomra's appeals.

The Court of Appeals reverses and rules that the availability of the industrial processing exemption is determined by what use the customer makes of the property without regard to the timing of the activity.

The Court of Appeals' majority reversed Judge Talbot's decision. *Tomra of N Am, Inc v Dep't of Treasury*, 325 Mich App 289 (2018). The Court began by acknowledging that the Court of Claims construed the second sentence of MCL 205.54t(7)(a) and MCL 205.94o(7)(a) "as meaning precisely what it says—that industrial processing begins when tangible personal property begins movement from raw-materials storage to begin industrial processing. We agree." *Id.* at 299. The Court then asserted that, despite this statutory language, that the statute does not "mean that industrial processing can *never* occur unless, first, tangible personal property begins movement from raw-materials storage." *Id.*

The justification of that conclusion involved a three-step process. The Court of Appeals first determined that entitlement to a tax exemption "is determined by what use the customer makes of the product sold by the taxpayer." *Id.* at 296. Second, the Court looked beyond the statutory definition to activities listed in another subsection that are considered industrial processing activities. The Court of Appeals interpreted those activities as an expansion of the industrial processing definition. And third, the Court of Appeals declared that "read[ing] the language of subsection (7)(a) . . . as a temporal requirement . . . would render" the activities enumerated in subsection (3) "meaningless." *Id.* at 301. According to the Court of Appeals, the Legislature included the second sentence of the industrial processing definition so that "one can rest assured that industrial processing has begun." *Id.*

Judge Kirsten Frank Kelly dissented. *Tomra*, 325 Mich App at 303 (Kelly, K.F., dissenting). In her dissent, she noted that "[t]he analysis in this case should begin and end with the statutory definition of 'industrial processing' . . . ." *Id.* at 304. Like Judge Talbot, Judge Kelly noted that "[i]n order to be exempt, the machines must perform an activity at some point after tangible personal property begins movement from raw-materials storage and before the finished goods first come to rest in inventory." *Id.* at 305. Also, Judge Kelly reasoned that "only after the definition in subsection (7)(a) is met do the activities set forth in subsection (3) have any relevance. Those activities must occur within the statutory defined time period in subsection (7)(a)." *Id.* at 304. Applying her reasoning here, Judge Kelly agreed with Judge Talbot that machines that do not perform an activity falling within the industrial processing time frame cannot qualify for the industrial processing exemption. *Id.* at 306.

Treasury filed applications for leave to appeal, which this Court granted on March 27, 2019. Treasury requests that this Court reverse the Court of Appeals and hold that the exempt activities listed in subsection (3) of the industrial processing statute must occur within the timeframe set forth in the second sentence of subsection (7).

STANDARD OF REVIEW

This Court applies a de novo review to questions of law, which includes both issues of statutory interpretation and whether a trial court properly ruled on a motion for summary disposition. *Klooster v City of Charlevoix*, 488 Mich 289, 295 (2011).

ARGUMENT

I. Well-established principles of statutory construction prohibit determining whether property is eligible for the industrial processing exemption by examining the function of the property without regard for when the activity occurs.

Both the Sales Tax Act and the Use Tax Act provide for an exemption for "industrial processing," which the Legislature defined in terms that consider both the nature of the process and when it is performed. Treasury properly determined that the reverse vending machines at issue here did not qualify as industrial processing because they were purchased by Tomra's customers to comply with their obligations under the Bottle Bill rather than to operate a recycling enterprise and thus did not satisfy the temporal requirement of the exemption because the machines were not used at some point after the "movement from raw materials storage" but before tangible personal property becomes a "finished good." This determination is consistent with the plain language of the statute. The property at issue can only be eligible for the exemption if the temporal requirement included in the second sentence of the industrial processing definition is rendered nugatory, a result not permitted under bedrock principles of statutory construction.

The Court of Appeals' majority erred when it reversed the Court of Claims' ruling that Treasury was entitled to summary disposition in its favor because the industrial processing exemption was not available for the reverse vending machines Tomra sold to its Michigan customers. In order to reach this result, the majority opinion effectively rendered nugatory the timing requirement set forth in the industrial processing definition. This is contrary to the general rules of statutory

construction that apply to all statutes. In addition, to the extent the Court of Appeals concluded that subsections (3) and (7) of the statutory text are irreconcilable, they should have resolved that conflict in favor of Treasury, consistent with the rules of statutory construction applicable to tax exemption statutes. Therefore, this Court should reverse the Court of Appeals and reinstate the trial court's decision granting summary disposition in favor of Treasury.

A. The Sales Tax Act and the Use Tax Act, are general tax statutes that include exemptions, including the industrial processing exemption.

The General Sales Tax Act, MCL 205.51 *et seq*. (GSTA), imposes a 6% tax on the retail sale of tangible personal property in Michigan. The Use Tax Act, MCL 205.91 *et seq*. (UTA), imposes a 6% tax on persons in the state for the privilege of consuming, storing, or using tangible personal property in Michigan. MCL 205.93(1); *Podmajersky v Dep't of Treasury*, 302 Mich App 153, 162 (2013). The UTA complements the GSTA and is designed to cover transactions not covered by the GSTA, but the two taxing statutes relate to two entirely separate taxable events. *Andrie, Inc v Dep't of Treasury*, 496 Mich 161, 168 (2014). The legal responsibility for the sales tax falls on the retailer. The legal responsibility for the use tax falls on the consumer of the property. *Id.* at 169.

Both the GSTA and the UTA include several exemptions; at issue in this case is the industrial processing exemption, which appears at § 94o of the UTA, MCL 205.94o, and § 54t of the GSTA, MCL 205.54t. The industrial processing exemption statute is complex and includes many exceptions to the exemption. It is

not appropriate to rely on one portion of the statute without reference to, or consideration of, other applicable sections of the statute. Statutes must be read as a whole and courts are required to avoid a construction that renders any part of the statute surplusage or nugatory or leads to an absurd result. *Johnson v Recca*, 492 Mich 169, 177 (2012); *King v State of Mich*, 488 Mich 208, 218 (2010). A construction that would render any part of a statute surplusage or nugatory is to be avoided. *Zwiers v Growney*, 286 Mich App 38, 44 (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 (2003).

B. Under general principles of statutory construction, the temporal requirement in the industrial processing definition cannot be disregarded.

As noted above, the industrial processing exemption is not a wholesale release from the obligation to remit sales and use tax on all of the purchases made by industrial processors or those that perform activities on behalf of industrial processors. Instead, the plain language of the industrial processing statute demonstrates that the Legislature intended to limit the availability of the exemption to only eligible property that is purchased by certain taxpayers and that is actually used in the performance of activities that qualify as industrial processing, which was explicitly defined to include a temporal requirement. This temporal requirement is the central issue in this appeal.

Both the GSTA and the UTA use two sentences to define "industrial processing." The first sentence identifies the general type of activity that constitutes industrial processing:

> 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[.] [MCL 205.54t(7)(a); MCL 205.94o(7)(a).]

The second sentence identifies when industrial processing commences and when it concludes:

> 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." [*Id.*]

Thus, the plain language of the industrial processing definition makes clear that both the nature *and the timing* of an activity are relevant when determining whether the exemption applies.

The reverse vending machines at issue here are purchased from Tomra by supermarkets and liquor stores and used by everyday consumers returning beverage containers to supermarkets and liquor stores to facilitate the recovery of the bottle deposit previously paid on beverages. While it is entirely possible that those cans and bottles sorted and crushed by the machines will at some point be recycled into new products, this fact alone is insufficient to conclude that the machines are exempt. Instead, the taxpayer seeking the benefit of the exemption must demonstrate that the potentially exempt activity takes place within the timeframe provided for in the statute. Tomra cannot meet this burden unless this

Court concludes that the supermarkets, liquor stores, and everyday consumers are engaged in industrial processing, rather than simply meeting their respective obligations under the Bottle Bill.

Nor is the fact that the cans and bottles may at some point properly be characterized as the "raw materials" used to create a new product by an exempt recycling facility determinative to the exemption analysis. The Legislature did not provide an exemption based on an item's potential future classification as a "raw material" used in a legitimate industrial processing activity. If it had intended to do so, it would have clearly stated so. Instead, the Legislature took pains to designate a class of taxpayers that might be eligible for the exemption and describe the activities and property that could be exempt, but also explicitly placed limitations on the availability of the exemption. For example, property used for receiving or storage of materials is expressly excluded from the exemption. MCL 205.54t(5)(e); MCL 205.94o(5)(e). At best, the reverse vending machines are used for receiving or storing materials that may later be used in an exempt industrial process. Again, to conclude otherwise, requires a finding that an individual returning an empty soda bottle is engaged in industrial processing within the temporal framework described in the second sentence of subsection 7.

Consistent with this analysis, the Court of Claims recognized the importance of the temporal requirement and concluded that the Sales Tax Act's and Use Tax Act's plain language requires property to perform an activity within the statutory defined time period to qualify for the industrial processing exemption.

(App p 037a.) In contrast, the Court of Appeals majority opined that the second sentence of the industrial processing definition should not be viewed as a temporal requirement, but instead simply identifies one possible beginning for industrial processing without precluding additional alternative beginnings. *Tomra*, 325 Mich App at 299–303 (opinion of the Court). This Court should reject the Court of Appeals' reasoning because it is not consistent with well-established rules of statutory construction.

C. The majority decision of the Court of Appeals failed to apply the statutory language of the industrial processing exemption properly, leaving some of the text as surplusage.

Although the Court of Appeals acknowledged the existence of the language identifying the beginning and end of industrial processing, the majority opinion downplayed the significance of the second sentence of the industrial processing definition when it reasoned that the Legislature included the second sentence of the industrial processing definition so that "one can rest assured that industrial processing has begun." *Tomra*, 325 Mich App at 301 (opinion of the Court). The Court of Appeals' attempt to explain the purpose of including the second sentence, but still afford it no meaningful impact, is contrary to the rules of statutory construction that prohibits treating statutory language as surplusage or nugatory. *Zwiers*, 286 Mich App at 44. And it runs afoul of the bedrock principle of statutory interpretation that requires effect be given to each word, phrase, and clause. *Gardner v Dep't of Treasury*, 498 Mich 1, 5–6 (2015). The Court of Appeals'

proposed explanation for the purpose of the second sentence of the definition of industrial processing lacks merit.

The Court of Appeals' explanation of the temporal language in the industrial processing definition is also illogical. The Court reasoned that the language serves to provide assurance that industrial processing has begun when raw materials begin movement from raw materials storage, but should not be viewed as precluding a finding that industrial processing has begun under other hypothetical circumstances that the Court did not explain. But there is no need to provide assurances that industrial processing must have some beginning. Of course there must be a beginning, otherwise there would be no need for an industrial processing exemption. Instead, the Legislature established a discrete timeline within which activities must occur to qualify for the exemption. In fact, the House Legislative Analysis prepared in connection with 1999 PA 117 (the legislation that adopted the definition of industrial processing along with its temporal language) specifically noted that "[p]roponents of the package say it would re-define when industrial processing begins and ends." App p 246a.

Moreover, the Court of Appeals' failure to afford adequate meaning to the temporal requirement set forth in the industrial processing definition must be rejected because every word and phrase in a statute should be read to provide harmony with the whole statute. *South Dearborn Envtl Improvement Assoc, Inc v Dep't of Envtl Quality*, 502 Mich 349, 386 (2018). The industrial processing exemption statutes, when read as a whole, indicate that the timing of the use of the

property is equally pertinent as the nature of the use of the property when determining whether the exemption applies.

For example, the industrial processing exemption language describes the journey of a product from raw materials to a consumer's acquisition in discrete stages. A manufacturer begins with the "raw materials," or the ingredients and component parts necessary to create a product that it receives and holds in "raw materials storage." MCL 205.54t(4)(a) & (7)(a); MCL 205.94o(4)(a) & (7)(a). It then engages in an "industrial processing" activity by manufacturing a "product" from those materials. *Id*. Manufacturing occurs at the "plant site" or "job site." MCL 205.54t(3)(h), (4)(f), & (5)(g); MCL 205.94o(3)(h), (4)(f), & (5)(g). The manufacturer then places a finished product in its post-production storage facility, termed "finished goods inventory storage." MCL 205.54t(3)(d), (5)(i), & (7)(a); MCL 205.94o(3)(d), (5)(i), & (7)(a). And thereafter it markets and sells the product and conveys it to the consumer through distribution and shipping. MCL 205.54t(6)(b); MCL 205.94o(6)(b).

All activity before and including "raw material storage"—such as "[p]urchasing, receiving, or storage of raw materials"—is taxable. MCL 205.54t(6)(a); MCL 205.94o(6)(a). All activity after and including "inventory storage"—such as "sales, distribution, warehousing, shipping, or advertising" of the product—is taxable. MCL 205.54t(6)(b); MCL 205.94o(6)(b). Thus, the non-exempt activities in subsections (6)(a) & (b) book-end the beginning and ending points of

"industrial processing." MCL 205.54t(7)(a); MCL 205.94o(7)(a). Only the production process between these storage points is exempt.

D. The language in subsection (3) and subsection (7) can be harmonized.

The Court of Appeals' majority opinion indicates that it declined to treat the second sentence of the industrial processing definition as a temporal requirement because it believed that doing so would render portions of subsection (3) of the industrial processing statutes meaningless. *Tomra*, 325 Mich App at 301–303 (opinion of the Court). This reasoning should be rejected because subsection (7) and subsection (3) can be harmonized without rendering the language of either provision meaningless. To the extent that the activities listed in subsection (3) can be characterized as an enlargement of the definition of industrial processing set forth in subsection (7), they should be viewed only as an enlargement of the first sentence, not as eliminating the temporal requirement set forth in the second sentence of subsection (7). Stated differently, the Legislature identified certain activities in subsection (3) that may not themselves change the form, composition, quality, combination or character of property to be sold at retail, but may still qualify as an industrial processing activity when performed within the temporal guidelines set forth by the statute.

An examination of the activities set forth in subsection (3) demonstrate that the Legislature did not intend to eliminate the temporal requirement included in the general industrial processing definition when it provided the list of approved

industrial processing activities. The identified activities either fall unquestionably within the timeframe contemplated in the general definition or have been tied back to the requirement in some way.

For example, the following activities would clearly occur within the bookends identified in the second sentence of subsection (7): production or assembly; processing of production scrap and waste up to the point of removal from the plant of origin; production material handling; and storage of in-process materials. See subsections (3)(a),(h), (j–k).

Admittedly, there are other activities listed in subsection (3) that appear to fall outside the timeframe set forth in the second sentence of subsection (7). In each case, however, there is some indication that the activity listed must be tied to another activity that would fall within that timeframe. For example, the Legislature did not simply identify engineering as an exempt activity, but instead stated that "[e]ngineering *related to industrial processing*" was an exempt activity. MCL 205.54t(3)(c) (emphasis added); MCL 205.94o(3)(c) (emphasis added). Likewise, the Legislature did not simply provide an exemption for "planning and scheduling," but instead provided that "planning, scheduling, supervision, or control *of production or other exempt activities"* could be characterized as an industrial processing activity. MCL 205.54t(3)(e) (emphasis added); MCL 205.94o(3)(e) (emphasis added). In addition, the Legislature made clear that some design and construction activities (which would commonly take place before the timeframe set forth in the general industrial processing definition) may qualify for the exemption,

but only if the design and construction was for exempt machinery, which would be used within the timeframe set forth in subsection (7).

In light of the above, the Court of Appeals incorrectly held that the timing requirement included in subsection (7) could not be applied without rendering subsection (3) nugatory. This Court must correct this error.

E. If an unreconcilable conflict exists between subsection (3) and subsection (7), the conflict must be resolved in favor of Treasury rather than expand the availability of the exemption.

Even if this Court were to conclude that the language of subsection (7) and subsection (3) cannot be reconciled—a point that Treasury does not concede—the Court of Appeals erred when it failed to resolve the ambiguity in favor of Treasury and instead interpreted the statute in a manner that improperly expands the exemption. It is well settled that exemptions "must be narrowly construed" in favor of the taxing authority. *Wexford Med Group v City of Cadillac*, 474 Mich 192, 204 (2006). This is because Michigan courts recognize that tax exemptions "upset the desirable balance achieved by equal taxation." Moreover, an exemption "must not be enlarged by construction, since the reasonable presumption is that the [Legislature] has granted in express terms all it intended to grant at all, and that unless the privilege is limited to the very terms of the statute the favor would be extended beyond what was meant." *Evanston YMCA Camp v State Tax Comm*, 369 Mich 1, 8 (1962).

The Court of Appeals' decision below determined that the non-exhaustive list of possible industrial processing activities set forth in subsection (3) of the

respective industrial processing exemption statutes included in the UTA and the GSTA trumped the temporal requirement set forth in subsection (7). In doing so, the Court of Appeals improperly expanded the availability of the industrial processing exemption because it eliminated a disqualifier that would otherwise preclude a taxpayer from benefiting from the exemption. This is not just Treasury's view of the impact of the decision below—Tomra also shares this view. Specifically, Tomra's brief in opposition to Treasury's application for leave to appeal states that equipment that performs "[s]ubsection (3) activities are exempt *without regard to subsection (7)(a).*" (Appellee Br in Opp'n, p 13, emphasis added.)

Thus, the practical effect of the Court of Appeals' holding below will be that a taxpayer will argue that whenever one engages in an action or performs a function that could fall within the activities listed in subsection (3), that taxpayer is engaged in exempt activity—regardless of when that activity takes place or for what purpose that activity was performed. The following hypothetical scenario demonstrates why this should be viewed as an expansion of the statute. Under the Court of Appeals' holding, a taxpayer need only demonstrate that it participates in an activity that could be characterized as part of the "stream" of recycling to be considered to be engaged in exempt activity. For example, an individual who decides not to collect the 10-cent deposit available under the Bottle Bill for his soda cans, and instead crushes them himself and delivers them to a scrapper that pays him based on the total weight of the returned cans, would be engaged in exempt activity simply because the act of crushing the can changed its form and the can at some point *may*

be used in the creation of another item that is ultimately sold at retail. This result would not conform to the well settled principle that tax exemption statutes cannot be expanded. *Evanston*, 369 Mich at 8. If the Legislature had intended to provide a blanket exemption for all recycling activities regardless of who performed the activity or in what context, it could have easily done so by so stating explicitly. But that is not the case here. The Legislature included numerous qualifiers, prerequisites, and exclusions in other subsections of the industrial processing statute, all of which must be given effect.

Not only must the temporal requirement in second sentence of subsection (7) be given effect under the principles of statutory construction that require all words be given meaning, *Zwiers*, 286 Mich App at 44, its significance is highlighted by the fact that the Legislature included a temporal requirement in at least one other exemption statute, but did not include similar language in other tax exemption statutes. For example, the extractive operations exemption provided for in the GSTA and the UTA also includes language detailing when the extractive operation begins. See MCL 205.54u(5)(a); MCL 205.94p(5)(a). In contrast, the GSTA and the UTA both include an exemption for tangible personal property used in a mineral producing operation that does *not* include a definition that includes a temporal limitation. MCL 205.54dd; MCL 205.94aa.[3] Likewise, the GSTA and the UTA both include an exemption for property used in a qualified business activity without

[3] These exemption statutes include a reference to the definition of "mineral producing property" that appears at MCL 211.782(d).

further limitation as when the property may be used in relation to the qualified business activity in order for the exemption to apply. See MCL 205.54j; MCL 205.94h.[4]

The Legislature is presumed to be fully aware of existing laws. *Walen v Dep't of Corrections*, 443 Mich 240, 248 (1993). Given that the GSTA and the UTA include multiple exemption provisions, some of which include a temporal limitation and some of which do not, it is clear that the Legislature was aware of and able to craft language demonstrating when it intended to include an additional limitation or requirement that must be met for a taxpayer to escape its tax burdens. The Court of Appeals majority disregarded this clear intention when it failed to give proper effect to the second sentence of subsection(7).

The inclusion of recycling in the list of potential industrial processing activities is admittedly a factor to be considered when evaluating whether the property at issue in this case is eligible for the industrial processing exemption. But the determination cannot be made without regard to the temporal requirement included in subsection (7), the qualified entity prerequisites included in subsection (1), or the requirement that the property actually be used for an exempt purpose set forth in subsection (2). Until or unless a taxpayer can establish that all of the requirements have been met, including the timing requirement, no benefit under the exemption statute should be permitted. See *Andrie*, 496 Mich at 171–172

[4] These exemption statute include a reference to the definition of "qualified business activity that appears at MCL 208.1429(7)(i).

("The burden of proving entitlement to an exemption rests on the party asserting the right to the exemption.") Affording Tomra the benefit of the exemption under the facts of this case would constitute an impermissible enlargement of the exemption. See *Evanston*, 369 Mich at 8.

Treasury has issued an audit manual specific to the topic of industrial processing that is available for public view on Treasury's website.[5] The manual makes clear that not all property connected to recycling activities is exempt. For example, if a taxpayer that acts as a recycler places a roll off dumpster at its location to receive recyclable materials, the dumpsters are characterized as taxable containers due to their use as receipt and storage of raw materials. (App p 320a.) In contrast, the manual recognizes that the equipment used to sort those materials after they have been removed from raw materials storage is exempt because the equipment is being used as part of an industrial processing activity (recycling) that occurs within the temporal bookends set forth in the industrial processing definition. (App p 321a.)

This Court has recognized that an agency's interpretation is entitled to respectful consideration that should not be overruled absent cogent reasons, *In re Rovas Compl*, 482 Mich 90, 108 (2008), and has later clarified that when an

[5] See Michigan Dep't of Treasury, *Industrial Processing Manual* <https://www.michigan.gov/documents/taxes/Industrial_Processing_Manual_-_June_2015_492779_7.pdf> (accessed May 3, 2018) (hereinafter "IP manual") (attached at App pp 248a–343a).

agency's interpretation does not conflict with the Legislature's expressed intent, such cogent reasons are not present. *Younkin v Zimmer*, 497 Mich 7, 10 (2014).

Here, Treasury has issued guidance set forth in the IP manual indicating that when a product is used matters when determining whether the exemption applies, even when the product is used in connection with recycling. This guidance does not conflict with the express language of the statute because it honors the temporal requirement contained in subsection (7), while still recognizing that recycling is an exempt activity when performed within the permitted timeline. Accordingly, there were no cogent reasons for the Court of Appeals' majority to overrule Treasury's interpretation of the statute requiring that the timing requirement be given effect when determining whether the exemption applies.

II. The Court of Appeals' majority decision must also be reversed because the effect of the decision does not serve the purpose of the exemption as demonstrated by the legislative history of the industrial processing statutes.

If questions related the applicability of an exemption statute cannot be answered by the language of the statute alone, the purpose behind an exemption statute is a key factor to be considered. In the event this Court determines that the language of the statute does not clearly answer the question, the purpose behind this exemption supports the conclusion that the temporal requirement is important and is not met here.

A. The Court of Appeals' majority decision does not serve the purpose of the industrial processing exemption.

This Court has previously held that the purpose of an exemption should inform the outcome of a controversy involving the availability of a tax exemption that cannot be resolved on the language of the statute alone. *Elias Bros Restaurants, Inc v Treasury Dep't*, 452 Mich 144, 150–151 (1996). The industrial processing exemption from sales and use tax has been recognized as serving the purpose of avoiding pyramiding, or double taxation, on a product sold at retail to a consumer. *Id.* at 152. Specifically, the Legislature intended that the components used or consumed to produce in item be exempt from tax when the end product was subject to tax. *Id.*, quoting Senate Fiscal Agency Analysis, SB 323, June 2, 1987.

Yet, this purpose is not served by the Court of Appeals' holding that Tomra is entitled to the benefit of the industrial processing exemption related to its sales of the reverse vending machines. This is because there is no evidence indicating that Tomra's customers purchase the machines with the intent that they will be used in furtherance of the creation of a new item to be sold at retail. Instead, the machines are purchased in order to comply with the requirements set for in the Bottle Bill. MCL 445.571 *et seq*. The Bottle Bill requires that returnable beverage containers have scannable barcodes, but only for the purpose of determining whether the item being scanned is "returnable" or "nonreturnable" as those terms are defined in the Act. Whether the item is returnable or nonreturnable is determined solely by whether the deposit was applicable. MCL 445.571(d), (e). The color, weight, or

other characteristics of the items inserted into the reverse vending machines have no substantive meaning under the Bottle Bill.

The testimony and other evidence below demonstrate that Tomra's customers—supermarkets and liquor stores—are not industrial processors. They do not use reverse vending machines to create new products for ultimate sale at retail. They also do not use the machines to convert or condition the used cans and bottles for use in the manufacturing of a product ultimately sold at retail. These supermarkets and liquor stores use reverse vending machines to facilitate the collection of used beverage containers, to fulfill their obligation to refund previously paid deposits to consumers, and to store used beverage containers. (App pp 170a–171a.) Two factors that cut against Tomra's claim that the reverse vending machines are used as part of exempt recycling activities are that (1) the machines can reject beverage containers if a deposit was not previously paid or (2) if the brand was not sold at that location. These details would be irrelevant if the purpose of the machine was simply to process beverage containers that could be recycled.

Because there is no evidence to establish that the reverse vending machines are purchased with the aim of being used to create a new product that will be sold at retail (and thus subject to sales tax), there is nothing in the record that warrants the conclusion that the reverse vending machines should be exempt from tax in order to avoid pyramiding. In fact, the Court of Appeals' majority's holding has the practical effect of preventing the State from collecting sales or use tax for the property at issue at any point.

And this is not the only scenario one can envision in which the failure to apply the temporal limitation in the definition of industrial processing would result in potential availability of the exemption when there is no risk of double taxation. For example, many office settings utilize paper recycling services. Some offices may elect to shred those documents onsite to protect any confidential information contained in the documents prior to being picked up the by the recycling service. The shredded paper is not being "sold" to the recycling service. Thus, there is no danger of double taxation if the shredder is subject to sales or use tax. It strains credulity to imagine that the Legislature intended that the shredder purchased by the office for the purpose of meeting its obligations to maintain confidentiality be exempt from sales or use tax under the industrial processing exemption simply because it performs a function that contributes to the stream of recycling.

Now consider that the office that engages the paper recycling service is located within a plant that collects, sorts, and processes used appliances for recycling. This sort of operation would undoubtedly qualify as an industrial processor. But, as explained in detail above, an industrial processor is not granted a wholesale exemption from sales and use tax across the board. The industrial processor must also meet the temporal requirement contained in subsection (7), which identifies the bookends of the proper timeframe that otherwise exempt activities must occur within for the exemption to apply. Thus, to the extent that this hypothetical taxpayer engages in "recycling" by using equipment to modify or alter the used appliances into a form to be resold, those activities would be exempt.

But to the extent the same taxpayer engages in "recycling" by shredding its office paper, this activity would not be exempt because it does not take place within the bookends identified by the Legislature. The timing element is an essential consideration that must be given effect in order to effectuate the intent of the Legislature with respect to the industrial processing exemption. To the extent such a taxpayer purchases a shredder for use in its office space or bins to collect/store documents that could eventually be recycled for future use, those items should not be considered exempt simply due to the function of the items.

The danger of the Court of Appeals' majority decision is that disregarding the second sentence of subsection (7) creates uncertainty between when an item can be characterized as being used within the statutorily defined process or being used outside that time period. This distinction matters because the Legislature specifically excluded receiving and storage of raw materials as industrial processing activities. See MCL 205.54t(6)(a); MCL 205.94o(6)(a). Likewise, the property used for receiving and storage of materials, and property used for the preservation and maintenance of finished goods is not eligible for the exemption. MCL 205.54t(5)(e), (i); MCL 205.94o(5)(e), (i). But "in process storage" is included in the list of approved industrial processing activities. MCL 205.54t(3)(k); MCL 205.94o(3)(k). If, as the Court of Appeals' majority contends, the inquiry of whether the exemption applies need only consider the nature of the activity, i.e., whether it appears within the list set forth in subsection (3), without regard for the timing requirement set forth in the second sentence of subsection (7), the line between whether the

materials used in the recycling process are stored in-process or not, would be nearly impossible to distinguish and raises several questions regarding the taxability of many items. To name just a few, one questions whether the containers or bins used by individuals at their residences to store returnable cans and bottles, the vehicles used to transport the cans and bottles to the store, or the shopping carts used to move the items from the vehicles to the reverse vending machines would also qualify for the exemption.

B. The Legislative history of the amendment codifying the temporal requirement as a component of the industrial processing definition demonstrates that the Court of Appeals' ruling was incorrect.

The industrial processing exemption has a long history in Michigan and has changed over time to accommodate changes in the manufacturing landscape. The initial form of the exemption was a single statutory provision indicating that property sold to a buyer "for consumption or use in industrial processing" was not subject to tax. 1937 PA 94, § 94(g), former MCL 205.94(g). Industrial processing was not defined and there was no other language included to flesh out what was contemplated by the exemption. Over time, there were numerous amendments to the statutory language, including limitations as to what constituted industrial processing and what types of property qualified as eligible as reflected in 1949 PA 273; 1970 PA 15; 1978 PA 262; and 1987 PA 87.

One of the most significant revisions to the industrial processing exemption occurred by way of 1999 PA 116 and 1999 PA 117, which removed the exemption

from MCL 205.54 and MCL 205.94, respectively, and created new statutory sections at MCL 205.54t and MCL 205.94o. While these amendments to the industrial processing statute admittedly extended the availability of the exemption to taxpayers other than those that would themselves qualify as industrial processors, the Legislature also added language limiting the exemption, including the temporal language that is central to this dispute.

Prior to the amendments made by 1999 PA 116 and 1999 PA 117, Treasury had adopted an administrative rule that provided guidance for the industrial processing exemption and included an illustrative list of activities that could, but would not necessarily, constitute industrial processing activities. Mich Admin Code, R 205.90 (Rule 40). The list of activities set forth in subsection (3) of the current versions of the industrial processing statutes contained in the UTA and the GSTA largely mirrors that list. Yet the Legislature did not merely codify the list; it also adopted the limitation set forth in subsection (2) that property "is exempt only to the extent that the property is used for the exempt purpose stated in this section." MCL 205.94o(2); MCL 205.54t(2). The Legislature also included language that did not appear in the administrative rule: the temporal requirement set forth in the second sentence of subsection (7). These changes, when viewed together, indicate that the purpose of the amendment was not simply to enlarge the availability of the exemption but also provide limitations on the exemption.

The Court of Appeals failed to recognize or give meaning to the Legislature's clear intent to revise the availability of the industrial processing exemption as

reflected in the changes made to the statute when MCL 205.94o and MCL 205.54t were enacted.

III. The Court of Appeals' majority decision must be reversed because it misconstrued several decisions from this Court.

The majority opinion also cannot be squared with prior decisions from this Court that are binding on lower courts, and therefore cannot be permitted to stand.

A. The Court of Appeals reliance on the *Elias Bros* decision is misplaced.

The Court of Appeals relied on this Court's decision in *Elias Bros Restaurants, Inc v Treasury Dep't*, 452 Mich 144 (1996), in support of its decision to reverse the Court of Claims. The Court of Appeals specifically stated that this Court "has emphasized that entitlement to an exemption under the GSTA is determined by what use the customer makes of the product sold by the taxpayer." *Tomra*, 325 Mich App at 303 (opinion of the Court). The Court of Appeals' reliance on the *Elias Bros* case was misplaced because that decision interpreted a prior version of the industrial processing statute, the holding was limited to the facts of that case, and the present case is factually distinguishable.

It is true that the *Elias Bros* Court stated that "the application of the industrial processing exemption depends on the use to which equipment is put." *Elias Bros*, 452 Mich at 156. However, this statement must be read in context of the issue the Court was faced with in that case. Specifically, the Court was tasked with determining the taxability of the equipment and supplies the taxpayer used to

produce food and beverages that were subsequently distributed to Big Boy restaurants, some of which were owned and operated by the taxpayer and some of which were franchised. *Id.* at 146. The Department had taken the position that the taxpayer was an industrial processor eligible for the exemption when it produced food and beverages that were sold to franchise restaurants, but that when it produced food and beverages that were ultimately sold in its own stores, the taxpayer was "merely a 'retailer' preparing its own food for retail sale and, therefore, is specifically excluded from the industrial processing exemption." *Id.* at 148–149. The *Elias Bros* Court disagreed.

In reaching this conclusion, the *Elias Bros* Court, after noting the absence of definitions for key terms and that "the application of the statute to the facts presented is ambiguous," determined that examination of the legislative intent behind the industrial processing exemption was necessary. *Id.* at 150–151. Recognizing that the industrial processing exemption was intended to prevent pyramiding, or double taxation, of use and sales tax, the Court concluded that if the industrial processing exemption were denied to the taxpayer in that case on the basis of the restaurant food preparation exclusion, the taxpayer would be subject to both sales and use tax for the products sold at the company owned restaurants, which would "contravene the clear and fundamental legislative intent to avoid a pyramiding of sales and use tax." *Id.* at 152–153.

This case differs from *Elias Bros* in several respects. As an initial matter, the taxpayer in *Elias Bros* was seeking an exemption based on its own use of the

property at issue, but Tomra is seeking to both avoid responsibility for assessments issued by Treasury following an audit and to benefit from refund claims based on its customers' purported use of the property at issue. Also, the dispute in *Elias Bros* was not related to when the property at issue in that case was used, but instead centered on whether the taxpayer should be characterized as a retailer (thereby triggering the food preparation exception to the exemption).

Moreover, the *Elias Bros* case involved a prior version of the industrial processing statute which then appeared at MCL 205.94(g). At that time, the industrial processing exemption was comprised of a single statutory provision that included the authority for the exemption, defined the "industrial processor," and set forth a list of activities that did not constitute industrial processing. There was no temporal requirement in the statute. Thus, the *Elias Bros* decision cannot be used as basis for disregarding the language later enacted.

B. The Court of Appeals misinterpreted the *Detroit Edison Co.* decision.

The Court of Appeals relied on this Court's decision in *Detroit Edison Co v Dep't of Treasury*, 498 Mich 28, 42 (2015), to support its conclusion that the temporal language in the second sentence of subsection (7) could be disregarded. *Tomra*, 325 Mich App at 302–303 n 5 (opinion of the Court). But there is a fundamental flaw in the Court of Appeals' analysis. It attempts to draw a parallel between the situation where there was no finished goods inventory as a basis for

concluding there is no need for raw materials storage. It is a logical fallacy to state that just because there is no end means that there does not need to be a beginning.

A complete reading of the *Detroit Edison* case demonstrates that the Court of Appeals erred by disregarding the second sentence of subsection (7). The *Detroit Edison* Court explicitly concluded that the analysis of whether industrial processing has occurred begins with the definition set forth in subsection (7) *and requires specific consideration of the second sentence of that provision*. Specifically, this Court stated this point:

> It is only logical, therefore, to first determine whether "industrial processing" has occurred. Because "industrial processing" is defined by MCL 205.94o(7)(a), the analysis begins there . . . . *The next inquiry required under MCL 205.94o(7)(a) is whether the industrial processing of the electricity outside the generation plant satisfies the second sentence,* which provides that "[i]ndustrial 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." [498 Mich at 39–41 (emphasis added).]

To the extent the Court of Appeals relied on the language in footnote 13 of the *Detroit Edison* opinion, when read in context with the discussion in that part of the *Detroit Edison* decision, that footnote indicates that the types of activity identified in subsection (3), that do not on their face appear to be consistent with the description of industrial processing in the *first* sentence of (7), could still qualify for the exemption. Otherwise, the only possible construction is that the second sentence of (7) has no meaning—a result that runs contrary to one of the bedrock principles of statutory construction as explained above. In addition, the last sentence of the footnote states: "Still, only property used for a single activity is

exempt from the use tax: property used for industrial processing." *Id.* at 49 n 13. Also, the Court explicitly rejected the idea that the portion of subsection referencing "finished goods inventory" can be read out of the statute entirely. *Id.* at 54. These statements make clear that the inquiry whether a taxpayer can benefit from the industrial processing exemption is not complete just because a taxpayer shows that it engages in conduct that can be described as "quality control" or any other activity described in subsection (3). Instead, the taxpayer must show that the action is undertaken as part of an industrial processing activity—an inquiry that is informed by the temporal requirement set forth in the second sentence of subsection (7).

Moreover, the Court of Appeals fails to recognize that the reason the property at issue in the *Detroit Edison* case could not come to rest in finished goods storage was due to the unique nature of electricity, which qualifies as "tangible personal property" for purposes of the GSTA and the UTA only because the Legislature deemed it so by explicitly including it in the definition of tangible personal property even though it does not share the typical characteristics of such property. *Detroit Edison* recognized this. 498 Mich at 38.

CONCLUSION AND RELIEF REQUESTED

The Court of Appeals reversed the Court of Claims by disregarding an entire sentence from a statutorily defined term and thereby reaching a result that created a tax loophole that expands the availability of the industrial processing exemption beyond that contemplated by the Legislature. This result is inconsistent with bedrock tenets of statutory construction, contrary to this Court's precedents, and a

violation of the principle of separation of powers. These errors could potentially remove millions of dollars from the public coffers by creating an unwarranted expansion of the industrial processing exemption that the Legislature never contemplated.

Accordingly, Treasury respectfully requests that this Court vacate the majority opinion and reaffirm the Court of Claims' decision granting summary disposition in favor of Treasury for the reasons stated in the trial court opinion and the dissenting opinion of Court of Appeals Judge Kelly.

Respectfully submitted,

Dana Nessel
Attorney General

Fadwa A. Hammoud (P74185)
Solicitor General
Counsel of Record

/s/ Randi M. Merchant
Scott L. Damich (P74126)
Randi M. Merchant (P72040)
Assistant Attorneys General
Attorneys for Dep't of Treasury
Defendant-Appellant
Revenue and Tax Division
P.O. Box 30754
Lansing, MI 48909
(517) 335-7584

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