STATE OF MICHIGAN
IN THE SUPREME COURT

TOMRA OF NORTH AMERICA, INC.,

Plaintiff-Appellee,

v.

DEPARTMENT OF TREASURY,

Defendant-Appellant.

_____/

Supreme Court No. 158333

Court of Appeals Case No. 338784

Court of Claims Case No. 16-42-MT

AMICUS CURIAE BRIEF OF THE MICHIGAN MANUFACTURERS ASSOCIATION

Miller, Canfield, Paddock and Stone, PLC
Clifford W. Taylor (P21293)
Paul D. Hudson (P69844)
Michael C. Simoni (P70042)
One Michigan Avenue, Suite 900
Lansing, MI 48933
Attorneys for Amicus Curiae
Michigan Manufacturers Association

TABLE OF CONTENTS

INDEX OF AUTHORITIES

Page(s)

Cases

Statutes

Rules

Constitutional Provisions

Other Authorities

STATEMENT OF QUESTIONS PRESENTED

The MMA adopts the Statement of Questions Presented in Appellee's Brief.[1]

[1] Under MCR 7.312(H)(4), MMA confirms that no counsel for any party authored this brief in whole or in part and that no party made a monetary contribution intended to fund the preparation or submission of this brief.

INTRODUCTION AND SUMMARY OF THE ARGUMENT

Michigan is manufacturing. This case involves a tax exemption for "industrial processing" and raises a question vital to Michigan's manufacturers: When is property purchased for and used in manufacturing taxable and when is it exempt? The Michigan Manufacturers Association (MMA) urges the Court to answer that question by following the plain text of the statute. The Court should reject the Department of Treasury's invitation to tip the scales in its favor by "strictly construing" the exemption against the manufacturer taxpayer. Tax exemptions, like any other unambiguous statutory provisions, should not be read "strictly" or with a thumb on the scale in favor of one party or the other. They should instead be read fairly, dispassionately, in context, and according to their plain text. So read, the machines used for the industrial process here squarely qualify for the tax exemption, and the Court should reject the Department's tangled construction to the contrary.

Michigan exempts from sales and use taxation equipment and materials used for "industrial processing." In simple terms, industrial processing means making something from other things. A car manufacturer designs and builds finished cars from various components. A chemical company combines ingredients to make a household cleaning product. A utility company burns coal to create steam that turns a turbine to make electricity. Each of them is engaged in industrial processing. And each of them purchases and uses materials, components, equipment, machines, and other things to make a finished product. The industrial-processing exemption helps avoid double taxation by making sure the property used to make the end products isn't taxed at every point along the way. This helps manufacturers keep their costs down and lowers prices for consumers.

But industrial processing isn't a static concept. As manufacturing processes have evolved, the Legislature has amended the industrial-processing exemption to meet the times. In the early days of mass production, manufacturers typically stockpiled mountains of inventory onsite to ensure no disruptions in the process. See Womack, Jones & Roos, *The Machine that Changed the World* (New York: Free Press 1990), ch 2, p 28 ("*Machine*"). But manufacturing processes developed. One change—lean manufacturing—was well underway when the Legislature amended the industrial-processing exemption in 1987 and then expanded it in 1999. Lean manufacturing first took root in Japan in the 1950s, *id*., ch 3, p 61, but spread to American automakers and other manufacturers in the 1980s and '90s, see Holusha, *"Just-in-Time" System Cuts Japan's Auto Costs*, New York Times (March 25, 1983), p A1. Gone were the days of raw-material stockpiling; in were "just-in-time" inventory methods, where "parts would only be produced at each previous step to supply the immediate demand of the next step." *Machine*, *supra*, ch 3, p 61. This "eliminated practically all inventories," and "[i]t is now almost universally the practice in the best lean-production companies to deliver components directly to the assembly line, often hourly, certainly several times a day, with no inspection at all of incoming parts." *Id*., ch 6, p 154.

The Michigan Legislature was not oblivious to these changes. The prevalence of automated manufacturing led directly to the 1987 amendment to the industrial-processing exemption, which expanded the exemption to cover things like computer-related equipment. Then, in 1999, the Legislature expanded the exemption again to cover even more activities and materials. In its current form, the industrial-processing exemption covers a wide swath of activities, from "research and experimental activities" to "engineering" to "design" and "inspection," from "quality control" to "recycling" and "remanufacturing."

The Department of Treasury, however, argues that it is still the 1950s. The manufacturer here, TOMRA of North America, Inc., is engaged in a Pure Michigan industrial process. It sells and leases the cans-and-bottles recycling machines we all use to get our ten-cent refund at Meijer and grocery stores across the state. These machines are engaged in "industrial processing" under the plain language of the exemption. Indeed, the exemption *specifically* says that industrial processing includes "Recycling," see MCL 205.54t(3)(i), and the Department concedes that the machines' activity meets the standard definition in the statute: "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).[2] The Department argues, however, that industrial processing can never really be "industrial processing" unless the manufacturer first places the materials in raw-materials storage. Only the 1950s-style manufacturer who stockpiles raw materials, says the Department, is ever eligible for the industrial-processing exemption.

The MMA urges the Court to reject the Department's antiquated reading of the statute, just as the Court of Appeals did. The Department relies on the second sentence of MCL 205.54t(7)(a), which states that "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." But as the Court of Appeals correctly noted, this does not mean that "industrial processing" can never happen without a stockpile of raw materials. The statute makes clear that industrial processing does not

[2] The industrial-processing exemptions in the General Sales Tax Act (GSTA) and Use Tax Act (UTA) are identical. For simplicity, the MMA will cite the exemption in the GSTA, MCL 205.54t. All of MMA's arguments apply equally to the exemption in the UTA, MCL 205.94*o*.

cover "storage of raw materials," so this second sentence provides helpful "guidance for determining exactly when in the continuum tangible personal property makes the transition from storage (not exempt) to activities of industrial processing (exempt)." (COA Slip Op at 7.) But "[t]his provision does not attempt to foreclose the possibility that industrial processing could occur without the initial step of moving raw materials from storage, or when tangible items are never in raw-materials storage[.]" (*Id.*; footnote omitted.)

The Department's position would be bad for manufacturers and thus bad for Michigan. Conditioning the industrial-processing exemption on whether tangible personal property has left "raw materials storage," as the Department does, would effectively deny the exemption to countless lean manufacturers across the state. Manufacturers, in essence, would be punished for their efficiency. The Department's position would perversely incentivize manufacturers to slow down their industrial processes, letting raw materials pile up in storage before beginning to process them. But this sort of bureaucrat-induced inertness is not and should not be an option for manufacturers in the city (and state) that moves the world, and this Court should decline the Department's invitation to make it one.

The MMA urges the Court (1) to reject once and for all the oft-repeated but legally baseless trope that "tax exemptions are strictly construed against the taxpayer"; and (2) to confirm that the manufacturer's industrial process here qualifies for the industrial-processing exemption under the plain and fair reading of the statute.

STATEMENT OF INTEREST OF AMICUS CURIAE

The MMA is an association of Michigan businesses. The MMA was organized, and exists, to promote the interests of both Michigan businesses and the public in the proper administration of laws, to study matters of general interest to its members, and otherwise to

promote the general business and economic climate of the State of Michigan. A significant aspect of the MMA's activities involves representing its members' interests before the state and federal courts, legislatures, and administrative agencies. Through effective representation of its membership before the judicial, legislative, and executive branches of government on issues of importance to the manufacturing community, the MMA works to foster a strong and expanding manufacturing base in Michigan. The MMA appears before this Court as a representative of approximately 2,500 private business concerns, all potentially affected by the dispute in this case.

The interests of manufacturers are coextensive with the interests of the citizens of Michigan. Simply put, manufacturing is the backbone of Michigan's economy. Manufacturing generates 15.1 percent of the gross state product, comprises 13.9 percent of total nonfarm employment, and employs 602,500 people in Michigan. And growing: from June 2009 through April 2016, employment in Michigan's manufacturing sector rose by 169,600 jobs (39.2 percent), and 34.4 percent of nonfarm jobs added in Michigan since the recession ended have been in the manufacturing sector. Michigan has been the national leader in new manufacturing job creation since the recession ended, outpacing the next closest states by more than 10 percent.

Manufacturing has always contributed substantially to Michigan job growth and economic output, and the promotion of a thriving manufacturing sector in Michigan is of the utmost importance to the future economic survival of this state. The issues in this case, therefore, substantially affect not only the manufacturing sector, but also the economy of the State of Michigan as a whole, including employment levels, economic growth, and the ability of Michigan industries to compete in the regional, national, and global marketplaces.

The issues before the Court are of critical concern for all manufacturers. This case involves the interpretation of the industrial-processing exemption in the General Sales Tax Act (GSTA), MCL 205.51, *et seq*., and the Use Tax Act (UTA), MCL 205.91, *et seq*. The MMA's members have a clear and significant interest in the application of this exemption. Nearly all of the MMA's members rely on the industrial-processing exemption. Affirming the Court of Appeals' decision will help give effect to the Legislature's goal of making the industrial-processing exemption more widely available and will provide clarity necessary for the MMA's members to arrange their businesses in a productive and beneficial manner.

STATEMENT OF FACTS

The MMA adopts the statement of facts set forth in Appellee's Brief.

STANDARD OF REVIEW

The MMA adopts the standard of review set forth in Appellee's Brief.

ARGUMENT

I. THE COURT SHOULD MAKE CLEAR THAT UNAMBIGUOUS TAX EXEMPTIONS—LIKE ANY OTHER STATUTORY PROVISION—ARE APPLIED ACCORDING TO THEIR PLAIN TEXT; THEY ARE NOT "STRICTLY CONSTRUED AGAINST THE TAXPAYER."

The Department of Treasury's error in interpreting the industrial-processing exemption begins at the first step. The Department argues that tax exemptions are "strictly construed" against the taxpayer and in favor of the taxing unit. This is an oft-repeated trope in the law, and the Court of Appeals below repeated it. (See COA Slip Op at 4: "tax exemptions are strictly construed against the taxpayer and in favor of the taxing unit"; see also *id.*: "Tax exemptions are disfavored[.]") But it is fundamentally wrong. Courts may not "strictly construe" unambiguous statutory provisions against one party or the other. Courts must simply give unambiguous statutory provisions their fair meaning, according to their plain text. The supposed canon of

construction that tax exemptions are strictly construed against the taxpayer is at most a rule of last resort that applies only after the court has found the statute *ambiguous* and after all other rules of construction have been exhausted. The Court should take this opportunity to clarify that lower courts may not apply layers of judicial gloss to *unambiguous* statutes.

As Scalia and Garner note in the "Thirteen Falsities Exposed" section of *Reading Law*, "[t]he false notion that tax exemptions—or any other exemptions for that matter—should be strictly construed" is of dubious origin. Scalia & Garner, *Reading Law: The Interpretation of Legal Texts* (St Paul: Thompson/West 2012), p 359 ("*Reading Law*"). The idea started in federal cases in which the state's sovereign power to tax was challenged. See *id.* at 360-61 ("Whereas a mere exemption from a tax can be eliminated by the taxing sovereign, these cases claimed that the state had, by its contractual commitment or by federal law, been deprived of its power to withdraw the exemption—that is, deprived of its power to tax. Small wonder that extraordinary clarity would be required to produce this result."). The source of Michigan's rule appears to be the same. See *East Saginaw Mfg Co v East Saginaw*, 19 Mich 259 (1869) (holding, based on federal precedent, that the State, by enabling the formation of certain corporations, did not waive in perpetuity its sovereign power to tax corporations formed under that act).

But when a state's sovereign power to tax is not at issue, the "strict construction" canon does not kick in. And even when courts do apply this dubious rule of construction, they are supposed to apply it only when a statute is *ambiguous*. "When a legislature has unambiguously conveyed its intent in a statute, the statute speaks for itself and there is no need for judicial construction[.]" *People v McIntire*, 461 Mich 147, 153; 599 NW2d 102 (1999). This Court has long maintained that where the language of a statute is unambiguous, no construction is required or permitted. *Ally Financial, Inc v State Treasurer*, 502 Mich 484, 493; 918 NW2d 662 (2018).

The type of statute makes no difference. Courts read unambiguous tax statutes the same way they read other statutes: according to their plain meaning. See *Reading Law*, *supra*, p 56 ("The words of a governing text are of paramount concern, and what they convey, in their context, is what the text means.") The Court of Appeals has nonetheless repeatedly applied the "strict construction" rule as a starting presumption when interpreting unambiguous tax statutes, rather than a rule of last resort applied only to resolve an ambiguity. See, e.g., *Ladies Literary Club v Grand Rapids*, 409 Mich 748, 753; 298 NW2d 422 (1980); *Delta Business Center, LLC v Delta Charter Twp*, __ Mich App __; __ NW2d __ (2019); *Spranger v City of Warren*, 308 Mich App 477, 479; 865 NW2d 52 (2014); *AutoInstitute in Basic Life Principles, Inc v Watersmeet Twp*, 217 Mich App 7, 12; 551 NW2d 199 (1996).

Starting with this sort of heavy thumb on the scale has hazardous consequences. For one, strictly construing tax exemptions effectively tilts the playing field against the taxpayer whether the Legislature actually intended that or not. Put bluntly, it encourages courts to reflexively rule for the Department whenever the case is not a slam-dunk winner for the taxpayer. As Scalia and Garner note, the rule finds its source "either in a judicial proclivity to make difficult interpretive questions easy, or else in an inappropriate judicial antagonism to limitations on favored legislation." *Reading Law*, *supra*, p 363. The automatic-strict-construction rule thus poses a real risk of tempting courts to decide for the Department by default or to uncritically defer to the Department's interpretation of an otherwise unambiguous tax exemption. And that is exactly what this rule has wrought: the Court of Appeals, for example, has strictly construed a tax exemption against the taxpayer not to resolve an ambiguity but simply because both parties' arguments were "plausible." See *Auto-Owners Ins Co v Dep't of Treasury*, 226 Mich App 618, 622; 575 NW2d 770 (1997).

This is not the way it should work. "Without some textual indication, there is no reason to give statutory exceptions anything other than a fair (rather than a 'narrow') interpretation." *Reading Law*, *supra*, p 363. At best, the rule of strict construction, properly understood, "simply means that if, *after the application of all rules of interpretation* for the purpose of ascertaining the intention of the legislature, a well founded doubt exists, then *an ambiguity occurs* which may be settled by the rule of strict construction." 2 Cooley & Nichols, *A Treatise on the Law of Taxation* (4th ed), § 674, pp 1415-16 (emphasis added). The rule

> does not relieve the court of the duty of interpreting the exemption by the ordinary rules of construction in order to carry out the intention of the legislature, and *does not apply where there is no language in the act justifying or requiring construction*. A *fair and reasonable construction* of the statute . . . *must always be adopted*, giving the language its ordinary meaning[.]

Id., p 1416 (emphasis added). Strictly construing tax exemptions is thus a rule of last resort that has no application when a statute is unambiguous. As this Court has recognized, "[o]nly where the statutory language is ambiguous may a court properly go beyond the words of the statute to ascertain legislative intent." *Sun Valley Foods*, 460 Mich at 236. Only when all other rules of interpretation fail to resolve an ambiguity is a court permitted to strictly construe the statute one way or another.

Strictly construing tax exemptions against taxpayers also encourages lower courts to presume a Legislative intent at odds with the actual text of the statute. By placing an exemption in the statute, the Legislature quite plainly expresses an intent for the taxpayer not to be taxed under those circumstances. But by "strictly construing" the exemption against the taxpayer, a court fails to give full effect to this intent. That contradicts the first principle of statutory construction: to "give effect to the intent of the Legislature" by applying "the language of the statute itself." *Sun Valley Foods Co v Ward*, 460 Mich 230, 236; 596 NW2d 119 (1999). As

Justice Cooley put it long ago, "[b]eyond the words we are not to look, where the meaning is plain and intelligible." Cooley, *A Treatise on the Law of Taxation* (1st ed), p 198. The reason for this is simple. "[A]n enacted text is itself the law." *Reading Law*, *supra*, p 397; see also *McIntire*, 461 Mich at 153 ("[T]he statute speaks for itself[.]"). It is therefore "the text's meaning" that matters, "and not the content of anyone's expectations or intentions, that binds us as law." *Reading Law*, p 398 (quoting Tribe, "Comment," in Scalia, *A Matter of Interpretation: Federal Courts and the Law* 65, 65 (1997)) (emphasis in original). As the U.S. Supreme Court has put it:

> We have stated time and again that courts must presume that a legislature says in a statute what it means and means in a statute what it says there. When the words of a statute are unambiguous, then, this first canon is also the last: "judicial inquiry is complete."

Barnhart v Sigmon Coal Co, 534 US 438, 461-62; 122 S Ct 941, 956; 151 L Ed 2d 908 (2002).

Without identifying any ambiguity or textual basis, however, the Department urged the Court of Appeals and urges this Court to construe the industrial-processing exemption strictly against the taxpayer. The Department's rationale for this is that exemptions are disfavored because they are contrary to the principles of uniformity and equal taxation. This Court has also recognized those justifications. See, e.g., *Ladies Literary Club*, 409 Mich at 753. But neither of them have anything to do with resolving an ambiguity. And, again, ambiguity is the judiciary's only reason for applying a rule of construction. *Sun Valley Foods*, 460 Mich at 236. In effect, the Department is asking this Court to presume that the Legislature disfavored an exemption *at the same time it was enacting one*. The Court should emphatically decline this invitation.

The Michigan Constitution assigns the taxing power to the Legislature. Const 1963 art 9, § 1. It also delegates to the Legislature the power to decide when an exemption should be preferred over uniformity or equality. See Const 1963 art 9, § 3 ("The legislature shall provide

for the uniform general ad valorem taxation of real and tangible personal property not exempt by law[.]"); Const 1963 art 9, § 8 (permitting sales and use taxes on tangible personal property "not exempt by law"); Const 1963 art 9, § 4 ("Property owned and occupied by non-profit religious or educational organizations and used exclusively for religious or educational purposes, as defined by law, shall be exempt from real and personal property taxes."). "Courts," on the other hand, "cannot substitute their opinions for that of the legislative body on questions of policy." *Cady v. Detroit*, 289 Mich 499, 509; 286 NW 805 (1939). According to this Court:

> [T]raditional principles of statutory construction thus force courts to respect the constitutional role of the Legislature as a policy-making branch of government and constrain the judiciary from encroaching on this dedicated sphere of constitutional responsibility. Any other nontextual approach to statutory construction will necessarily invite judicial speculation regarding the probable, but unstated, intent of the Legislature with the likely consequence that a court will impermissibly substitute its own policy preferences.

McIntire, 461 Mich at 153.

When the Legislature enacts an exemption from a tax, it has expressed its position on whether equal or uniform taxation is desirable, leaving no room for the judiciary to presume otherwise. See *Sun Valley Foods*, 460 Mich at 236 ("The words of a statute provide 'the most reliable evidence of [the Legislature's] intent[.]'"). The judiciary gives effect to the Legislature's preferences when it applies the law as written. *Id*. Anything more—that is, applying a rule of strict construction where neither an ambiguity nor the statutory text calls for it—risks elevating the judiciary's policy preference over that of the Legislature.

At bottom, the role of the courts does not change based on the type of statute they interpret. Courts interpret tax statutes, like all statutes, according to the fair and plain meaning of their text. No less, no more. Under our constitutional system of separation of powers, courts do not favor the taxman over the taxpayer. When the taxpayer is entitled to a tax exemption under

the plain language of the statute the Legislature enacted, the courts' role is to apply that statute as written. That is the courts' role here.

II. MICHIGAN MANUFACTURERS QUALIFY FOR THE INDUSTRIAL-PROCESSING TAX EXEMPTION WHETHER THEIR INDUSTRIAL PROCESSES BEGIN WITH RAW-MATERIALS STORAGE OR NOT

With no thumb on the scale, there is no textual support for the Department's position. At issue is whether TOMRA's recycling machines engage in "industrial processing" under the tax exemption. That question is readily resolved by the unambiguous text of the statute. Indeed, the statute expressly says "Recycling" is covered. See MCL 205.54t(3)(i). On top of that, the Department does not dispute that the statute's general definition of "industrial processing" in the first sentence of MCL 205.54t(7)(a) squarely covers the activity of converting old cans and bottles into recycled materials. So TOMRA's machines are used for "industrial processing" under the plain language of the exemption, and should not be subject to tax.

The Department's only argument is that, even though TOMRA's machines perform industrial processing, they are not really engaged in "industrial processing" because "industrial processing" can only happen if the processed materials started first in "raw materials storage," under the second sentence of MCL 205.54t(7)(a). That sentence says industrial processing "begins when tangible personal property begins movement from raw materials storage[.]" *Id.* Recycling bins in the garage are not "raw materials storage"—or so says the Department—so TOMRA's recycling machines cannot be engaged in "industrial processing" under the exemption.

The Department's argument fails. As detailed below, the second sentence of MCL 205.54t(7)(a) does not mean industrial processing can *only* occur if the property starts first in raw materials storage. That reading clashes with the plain text of the exemption and with this Court's precedent. The Court of Appeals was right to reject it, and this Court should affirm.

A. The industrial-processing exemption.

The industrial-processing exemption exempts from sales tax "[t]he sale of tangible personal property" to:

> (a) An industrial processor for use or consumption in industrial processing.
>
> (b) A person, whether or not the person is an industrial processor, if the tangible personal property is intended for ultimate use in and is used in industrial processing by an industrial processor.
>
> (c) A person, whether or not the person is an industrial processor, if the tangible personal property is used by that person to perform an industrial processing activity for or on behalf of an industrial processor.

MCL 205.54t(1)(a)-(c). The statute then describes the types of property that are and are not eligible for the exemption. See MCL 205.54t(4) (identifying eligible property) and MCL 205.54t(5) (identifying ineligible property).

Subsection 7(a) provides a general definition of "industrial processing":

> "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.

MCL 205.54t(7)(a) (emphasis added). The statute then lists certain activities that are not industrial processing (including "storage of raw materials"), see MCL 205.54t(6), and several activities that are "industrial processing" whether they meet the general definition or not:

> (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 unites 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.

MCL 205.54t(3).

B. Under the plain language of the statute, industrial processing does not have to start with raw-materials storage.

The parties seem to largely agree that TOMRA's cans-and-bottles machines meet the general definition of "industrial processing" in the first sentence of MCL 205.54t(7)(a) *and* qualify as "Recycling," one of the specifically listed "industrial processing" activities in MCL 205.54t(3)(i). The Department argues, though, that the machines' activity cannot be "industrial processing" unless the process *also* began with "raw materials storage" under the second sentence of MCL 205.54t(7)(a): "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."

The Department's reading is not supported by the plain text of the statute. The exemption embraces activities in a process—the "converting and conditioning" of tangible personal property from raw materials to finished goods. MCL 205.54t(7)(1). By its plain text,

subsection (7)(a)'s second sentence does not define what industrial processing *is* (that's what the first sentence does); it just states a point when property starts being converted or conditioned and stops being converted or conditioned. The statute makes clear that property used for "[p]urchasing, receiving, or storage of raw materials" is not exempt from tax because these are not industrial-processing activities. MCL 205.54t(6)(a). So the most logical reading of the second sentence of subsection 7(a) is that it simply clarifies the point at which a process that includes a raw-materials-storage component stops using equipment for a taxable activity—storage—and starts using equipment for an exempt activity—processing.

In other words, *if* an industrial processor receives and stores raw materials, its equipment is taxable up to the point the raw materials begin to leave raw-material storage. After that point, the equipment is exempt. And the statute then tells the Department to come up with a formula to apportion the exempt and non-exempt uses: "The exemption is limited to the percentage of exempt use to total use determined by a reasonable formula or method approved by the department." MCL 205.54t(2). *That* is the purpose of the second sentence of subsection 7(a): to draw the line between taxable storage activity and tax-free processing activity. What the statute does *not* say is that a manufacturer cannot engage in exempt industrial processing unless it has raw-materials storage, or that processing must happen after raw materials storage to be exempt.

The Court of Appeals got this exactly right. "Our Legislature thus articulated exactly which activities related to the storage of raw materials are and are not included in industrial processing, thereby providing guidance for determining exactly when in the continuum tangible personal property makes the transition from storage (not exempt) to activities of industrial processing (exempt)." (COA Slip Op at 7.) But the second sentence of MCL 205.54t(7)(a) "does not attempt to foreclose the possibility that industrial processing could occur without the

initial step of moving raw materials from storage, or when tangible items are never in raw-materials storage[.]" (*Id.*) The Court of Appeals was right to "decline to so expand the provision." (*Id.*)

Indeed, the Department's theory would gut the statute. There are several *specifically listed* examples of "industrial processing" that *must* occur before "raw materials storage." The statute lists as an included "industrial processing" activity, for example, "[d]esign [and] construction . . . of production or other exempt machinery, equipment and tooling." MCL 205.54t(3)(f). Designing and constructing machinery must occur before that machinery is put to an exempt use. The same is true for "[p]lanning [and] scheduling . . . of production or other exempt activities." MCL 205.54t(3)(e). An exempt activity cannot be planned or scheduled after the activity has already begun. Likewise, certain "[r]esearch or experimental activities," MCL 205.54t(3)(b), cannot occur after tangible personal property leaves raw materials storage. The statute defines "research or experimental activity" as "activity incident to the development [or] discovery . . . of a product or a product related process." MCL 205.54t(7)(e). A product or process can only be developed or discovered before materials are used to make that product or are consumed in the process. Under the Department's reading, none of these activities could qualify as industrial processing even though the Legislature specifically said they do.

In fact, the Department's position here clashes with its *own guidance* issued in the wake of the Legislature's 1999 amendment to the industrial-processing exemption. The Department there gave the following example of exempt "research and development activity":

> The research division of an automobile manufacturer designs a new prototype of an engine. The equipment and supplies consumed in the development of the prototype would qualify under research and development. The manufacturer qualifies for an industrial processing exemption because "the tangible personal property is used by that person to perform an industrial processing activity."

Revenue Admin Bull 2004, *Sales and Use Tax – Industrial Processing*, June 13, 2000, Example 3. It similarly elaborated on the exempt activity of "[i]nspection, quality control or testing":

> An industrial processor performs tests on its raw materials. The equipment and supplies used or consumed by an industrial processor in this testing and quality control function are exempt.

Id., Example 5. In neither case did the Department say that these activities must occur after tangible personal property begins to leave raw materials storage. In fact, the Department's training materials suggest that property used for raw materials testing is exempt no matter when the testing occurs. See Michigan Department of Treasury, *Revenue Technical Tax Training Sales and Use Taxes: The Industrial Processing Exemption* (July 2002) (explaining that radiation monitors used for testing raw materials were formerly not exempt property used in receiving materials, i.e., before they're even stored, but after the 1999 amendment would now be exempt as property used in raw-materials testing). This goes to show that an activity need not happen after raw materials have left storage to be industrial processing under subsection (3).

The Department's position also clashes with this Court's decision in *Detroit Edison Co v Dep't of Treasury*, 498 Mich 28; 869 NW2d 810 (2015). The case involved whether Detroit Edison's transmission equipment located outside its generating plants qualified for the industrial-processing exemption in the UTA. This Court started by "determin[ing] whether 'industrial processing' ha[d] occurred." *Id*. at 39. The Court then explained that industrial processing occurs when either MCL 205.94*o*(7)(a) or MCL 205.94*o*(3) is satisfied:

> Because "industrial processing" is defined by MCL 205.94*o*(7)(a), the analysis begins there. If "industrial processing" is not occurring under *either* MCL 205.94*o*(7)(a) *or* MCL 205.94*o*(3), the latter of which specifically enumerates activities that constitute "industrial processing," the analysis is complete and the taxpayer is entitled to no exemption. On the other hand, if "industrial processing" activity is occurring, it is then necessary to analyze the remaining provisions of MCL 205.94*o*[.]

Id. (emphasis added). Thus, both subsection 7(a) and subsection (3) can independently identify if industrial processing has occurred, a point that the *Detroit Edison* Court made explicit later in its decision:

> "Industrial processing" activity is generally defined by MCL 205.94*o*(7)(a). However, the statute *also* provides that certain specific activities *that do not satisfy the general MCL 205.94o(7)(a) definition* nonetheless constitute "industrial processing" activity for purposes of the statute.

Id. at 49 n13 (emphasis added). The court ultimately held that Detroit Edison's equipment was performing industrial processing under subsection (7)(a) and did not expressly hold that subsections (7)(a) and (3) operate independently to state when industrial processing is occurring. But this case gives the Court the opportunity to make that clarification.

The Department next misses the mark when it argues that reading the activities in subsection (3) separate from subsection (7)(a) would not serve the purpose of the industrial-processing exemption. (Appellant's Br at 32). The Department overlooks that the industrial-processing exemption serves more than one purpose.[3] Yes, one purpose of an industrial-processing exemption is to avoid pyramiding or double taxation. But the 1999 amendment, which greatly expanded the industrial-processing exemption, was included in a larger package of bills aimed at lowering the cost of doing business in Michigan and thereby drawing businesses to the State. This purpose is served when the exemption is applied to activities that either satisfy

[3] In the same respect, the Department is wrong to suggest that the exemption does not apply here because TOMRA's customers use the reverse vending machines to satisfy obligations under the Bottle Bill, MCL 445.571, *et seq*. This creates a false all-or-nothing approach that is inconsistent with MCL 205.54t(2) and this Court's observation in *Detroit Edison* that property may be used for taxable and non-taxable purposes, even simultaneously. *See Detroit Edison*, 498 Mich at 47-52; see also *id*. at 37 (reaffirming that "it is necessary to consider the *activity* in which the equipment is engaged and not the *character* of the equipment-owner's business"). So to say that the reverse vending machines are not eligible for the exemption just because one of their many uses is taxable is a non sequitur.

subsection (7)(a)'s general definition of industrial processing or are listed in (3), whereas construing subsection (7)(a) to neuter subsection (3) defeats it.

This would not, as the Department fears, open the floodgates to exemption claims. That is because subsection (7)(a) isn't the only limit on the exemption's availability. Take the Department's examples involving office shredders or consumers' use of recycling bins. (See Appellant's Br at 34-36). The Department need not worry about subsection (7)(a)'s temporal requirements because those uses of property can't get past subsection (1)'s requirement that the ultimate user either be an industrial processor or use the property "for or on behalf of" an industrial processor. MCL 205.54t(1)(a)-(c). The phrase "for or on behalf of" implies some sort of relationship with or act in the interest of another. *See, e.g.*, Garner, *Modern American Usage* (Oxford: Oxford University Press 2d ed 2003), p 92. A law office that buys a shredder to shred confidential material, even when the shredded paper is picked up by a recycling service, is not performing an industrial-processing activity "for or on behalf of" an industrial processor.[4] The same is true of the consumer who stores bottles in a bin at home. Only by ignoring other textual requirements can the Department argue that subsection (7)(a)'s second sentence is the only thing standing between appropriate exemptions and chaos.

In sum, the Department's arguments require a strained interpretation of unambiguous statutory text. The Court should not accept them and should instead affirm the Court of Appeals' correct reading of the plain statutory text.

[4] Then again, the Department offers no reason why the shredder would not qualify for the exemption to the extent that it *is* used for or on behalf of the industrial processor. See MCL 205.54t(2).

C. The Department's reading of the industrial-processing exemption would strip the exemption from countless manufacturers across the state.

The Department's construction of MCL 205.54t is also flawed because it essentially restricts "industrial processing" to a single, rigid, step-by-step method of manufacturing. The Department describes these steps as a "journey," where a manufacturer first acquires raw materials, stores them, moves them from storage, processes them into a product, and then puts the product into finished-goods inventory storage. (Appellant's Br at 23; see also *id*. at 22: "[T]he Legislature established a discrete timeline within which activities must occur to qualify for the exemption.") But to find this journey in MCL 205.54t the Department had to cherry-pick various subsections and ignore others. (See *id*. at 23). The Department also had to assume that "industrial processing" does not cover processes other than traditional, lockstep mass production. The statute's text is not so inflexible.

Nothing in the text of the industrial-processing exemption suggests that the Legislature intended to shackle modern (and future) manufacturers to antiquated manufacturing methods. The Legislature was well-aware of advances in manufacturing techniques when it amended the exemption in 1987. See SB 323 (June 2, 1987) (expanding the exemption to, among other things, "computers used in operating industrial processing equipment; equipment used in an industrial processing related computer assisted design, manufacturing, or engineering system"). The Legislature's 1999 expansion of the exemption further accommodated all manufacturing processes, not just those in existence at a given time or in which materials first come to rest in "raw materials storage." So the Court should not "read therein a mandate that the legislature has not seen fit to incorporate." *Jones v Grand Ledge Pub Schs*, 349 Mich 1, 11; 84 NW2d 327 (1957).

Even the Department seemed at one point to agree. The Department's own *Industrial Processing Manual* provides this illuminating example:

> The purchased parts are received at the receiving dock via truck. On the truck a visual inspection and manual inventory count is performed. The trucks are designed with a track that allows the parts to roll out of the truck. The truck receiving area is designed with a slope toward the building. The parts are unloaded directly onto a conveyor via use of the track and gravity. After leaving the truck, the parts are moved by conveyor to the production area. In this example, there is **no taxable** material handling **activity** as the movement of the purchased parts is to the production area, being driven by the production process. There is a receiving activity, but no equipment is used for that purpose.

Michigan Department of Treasury, *Industrial Processing Manual* (June 2015), ch 9, p 27 (emphasis in original). In the Department's example, there is no discernable raw-materials storage as traditionally understood. Yet the Department readily acknowledges that industrial processing is occurring. This is possible because the statute's reference to raw-materials storage doesn't add "raw materials storage" to industrial processing's essential definition; it is meant to clarify that when materials are in fact in storage they cease being stored (taxable activity) and start being processed (exempt activity) when they begin movement toward the production process. The activity of "converting or conditioning tangible personal property" doesn't become something else just because the activity was not preceded by raw materials storage.

The Department's newly conceived and uncompromising interpretation would deny the exemption to scores of manufacturers that have either moved on from or never used traditional mass-production techniques. That is antithetical to the Legislative purpose of expanding the exemption. The Legislature recognized in 1987 that becoming more efficient and productive may involve more automation at all phases of production. As automation increases, the prevalence of old-fashioned "raw material storage" decreases. If the Department's position were correct, industrial processors that become efficient enough to eliminate raw-materials storage

could never begin industrial processing. This subverts the Legislative goal in 1999 of expanding the industrial-processing exemption and paradoxically makes the exemption *less* available as manufacturers become more innovative, efficient, and productive.

If the Department is concerned that only a bright-line rule could work, that concern is unwarranted. The Department's example above shows that the exemption can be readily applied when materials do not move station-to-station 1950s-style. See *Industrial Processing Manual*, *supra*, ch 9, p 27. More significant, the Legislature recognized that bright-line distinctions would not be possible in every case, which is why it added subsection (2) to "authorize apportionment." See SB 544 (July 19, 1999). That subsection acknowledges that property may be used for exempt and non-exempt purposes and eliminated an all-or-nothing approach to applying the exemption. See MCL 205.54t(2). Instead, when property is used for exempt and non-exempt purposes, the Department is to come up with a "reasonable formula or method" to determine "the percentage of exempt use to total use[.]" *Id*. Thus, it is not the Court's job to transform the industrial-processing exemption into an all-or-nothing provision when the Legislature did not see fit to do so itself.

The Court should therefore reject the Department's dubious position and apply the statutory text according to its ordinary meaning.

CONCLUSION

The industrial-processing exemption's scope and application are of significant importance to Michigan's manufacturers. Tax laws in general impact businesses' bottom lines, affect business planning, and influence employment and capital investment. The industrial-processing exemption does so even more acutely. For all of these reasons, the MMA respectfully requests that the Court affirm the decision of the Court of Appeals.

Respectfully submitted,

MILLER, CANFIELD, PADDOCK AND STONE, PLC

Dated: August 30, 2019

By: s/ Paul D. Hudson

Clifford W. Taylor (P21293)
Paul D. Hudson (P69844)
Michael C. Simoni (P70042)
One Michigan Avenue, Suite 900
Lansing, MI 48933
Attorneys for Amicus Curiae
Michigan Manufacturers Association

34313412.2\154952-00011