# STATE OF MICHIGAN

# COURT OF APPEALS

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| ESCANABA PAPER COMPANY,<br><br>Plaintiff-Appellant, | UNPUBLISHED<br>November 19, 2009 |
| v | No. 286144<br>Court of Claims |
| DEPARTMENT OF TREASURY,<br><br>Defendant-Appellee. | LC No. 04-000227-MT |

Before: Meter, P.J., and Murphy, C.J., and Zahra, J.

PER CURIAM.

This appeal involves the question whether plaintiff, a paper mill, was entitled to a tax exemption as an "industrial processor" relative to "industrial processing" under the Michigan Use Tax Act (UTA), MCL 205.91 *et seq.*, arising out of the consumption and use of personal property needed to dispose of liquid and solid waste by way of a wastewater treatment facility and landfill. The tax dispute pertains to the years 1997 through 1999. A hearing referee recommended granting plaintiff the exemption, but the Administrator of the Office of Hearings rejected the referee's recommendation, finding the statutory exemption inapplicable and holding plaintiff liable for the assessed use taxes. The Court of Claims agreed with the administrator, granting summary disposition for defendant under MCR 2.116(C)(10). Because we conclude that plaintiff is entitled to the exemption, we reverse and remand for entry of judgment in favor of plaintiff.

Plaintiff is a Michigan corporation that engages in the production of coated paper products in Escanaba, Michigan.[1] The production of coated paper products is an industrial process that creates industrial waste in both liquid and solid forms. Plaintiff disposes of its liquid waste through a wastewater treatment facility, and it disposes of its solid waste by burying it in a landfill. Both the wastewater treatment facility and the landfill, along with the coated paper production facilities, are located within the same site in Escanaba.

[1] Our recitation of the facts and procedural history, for the most part, is based on a partial stipulation of the facts executed by the parties.

After water is used in the production of pulp and coated paper products, it is captured in a collection system installed under the papermaking facilities and flows to the wastewater treatment facility. The wastewater treatment facility consists of two primary clarifiers, a 30-acre aerated stabilization basin, a 5-acre activated sludge basin, two secondary clarifiers, a 70-acre non-aerated stabilization basin, a tertiary clarifier, and residual handling facilities. Plaintiff is required by federal and state environmental laws to properly treat and dispose of the solid and liquid waste generated by plaintiff's production of coated paper products. The wastewater treatment facility and landfill enable plaintiff to comply with these environmental laws. Plaintiff incurred expenses, and used and consumed equipment, in operating the wastewater treatment facility and landfill.

Defendant is statutorily responsible for the collection of the use tax imposed by the state in accordance with the UTA, and plaintiff is audited by defendant on an annual basis. The crux of this appeal involves use taxes to be paid on items that were used or consumed by plaintiff in connection with the operation of its wastewater treatment facility and the landfill for the time period starting January 1, 1997, and running through March 31, 1999 ("years in issue"). Defendant audited plaintiff for the years in issue and took the position that the items that were used or consumed by plaintiff in connection with operating the wastewater treatment facility and landfill were subject to use tax. The items used or consumed by plaintiff in connection with this operation upon which defendant assessed use taxes were primarily chemicals, electrical usage, and repair materials. In audits prior to the years in issue, defendant did not assess use taxes upon items that were used or consumed by plaintiff in connection with operating the wastewater treatment facility and landfill.

Plaintiff contested the audit determination for the years in issue by requesting an informal conference with defendant. Defendant's hearing referee recommended that plaintiff be entitled to the exemption for items that were used or consumed in connection with operating the landfill and the wastewater treatment facility. Defendant's Administrator of the Office of Hearings, however, rejected the referee's recommendation. As a result, defendant issued three final tax assessments on September 7, 2004, which totaled $427,987, including accrued interest. Plaintiff paid in full under protest on October 8, 2004. Under the stipulation, if plaintiff prevails in this matter, it is entitled to a refund of the use taxes and interest paid under protest in the aggregate amount of $427,987, together with additional interest pursuant to statute.

Following defendant's rejection of plaintiff's argument that it was entitled to an "industrial processing" exemption from use taxes for the years in issue, plaintiff pursued an action in the Court of Claims, asserting that the use taxes were erroneously assessed and that equal protection guarantees were violated where similarly situated taxpayers were granted exemptions. The Court of Claims, relying on *Beckman Production Services, Inc v Dep't of Treasury*, 202 Mich App 342; 508 NW2d 178 (1993), ruled:

> As in *Beckman*, it is not pertinent that plaintiff can prove that its treatment of waste water is necessary, essential, vital and integral to its industrial processes. Even if Plaintiff could make such a showing, it is of no consequence. Plaintiff must now establish that its water treatment and disposal practices transform, alter or modify its tangible personal property by imparting to it "a different form, composition, or character . . . for ultimate sale at retail or sale to another industrial

> processor to be further processed for ultimate sale at retail." This is what section 4(g) required, and this Plaintiff has not done. Indeed, Plaintiff makes no claim whatsoever that its treatment and disposal function produced such effects. Rather, it has shown only that its property was used to clean water, thereby permitting its lawful discharge into the river. That in itself did not transform the composition or character of Plaintiff's property.
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> The Court therefore agrees with Defendant when it says, "Treatment of the wastewater after it has been used in industrial processing is not exempt. The wastewater is not being altered for the purpose of being sold. It is being changed so that it can be legally discharged back into the Escanaba River. Property used for treatment of waste after it has been carried away from the industrial process is not used for an exempt purpose and is subject to use tax." Thus Plaintiff has not borne its burden of establishing a claim to the exemption under 4(g).

The Court of Claims also rejected plaintiff's equal protection claim, finding that there was no evidence of deliberate discrimination and that the pertinent language in the UTA was not unconstitutional as written nor as applied by defendant to plaintiff. Plaintiff appeals as of right.

This Court reviews de novo a ruling by the Court of Claims on a motion for summary disposition in a case entailing the UTA. *Guardian Industries Corp v Dep't of Treasury*, 243 Mich App 244, 248; 621 NW2d 450 (2000). Issues relating to the construction of the UTA are also reviewed de novo. *Id.* Constitutional issues are likewise reviewed de novo by this Court. *In re Hawley*, 238 Mich App 509, 511; 606 NW2d 50 (1999).

Our primary task in construing a statute is to discern and give effect to the intent of the Legislature. *Shinholster v Annapolis Hosp*, 471 Mich 540, 548-549; 685 NW2d 275 (2004). The words contained in a statute provide us with the most reliable evidence of the Legislature's intent. *Id.* at 549. In ascertaining legislative intent, this Court gives effect to every word, phrase, and clause in the statute. *Id.* We must consider both the plain meaning of the critical words or phrases as well as their placement and purpose in the statutory scheme. *Id.* This Court must avoid a construction that would render any part of a statute surplusage or nugatory. *Bageris v Brandon Twp*, 264 Mich App 156, 162; 691 NW2d 459 (2004). "The statutory language must be read and understood in its grammatical context, unless it is clear that something different was intended." *Shinholster*, *supra* at 549 (citation omitted). If the wording or language of a statute is unambiguous, the Legislature is deemed to have intended the meaning clearly expressed, and we must enforce the statute as written. *Id.* "A necessary corollary of these principles is that a court may read nothing into an unambiguous statute that is not within the manifest intent of the Legislature as derived from the words of the statute itself." *Roberts v Mecosta Co Gen Hosp*, 466 Mich 57, 63; 642 NW2d 663 (2002).

The use tax complements the sales tax and was designed to govern transactions that are not covered by the General Sales Tax Act, MCL 205.51 *et seq*. *Guardian Industries*, *supra* at 249. The UTA applies to every person in this state for the privilege of consuming, storing, or using tangible personal property in Michigan. *Id.*, quoting MCL 205.93(1). The tax laws generally will not be extended in scope by implication or forced construction, and when there is doubt with respect to interpretation, the tax laws are to be construed in favor of the taxpayer. *Brunswick Bowling & Billiards Corp v Dep't of Treasury*, 267 Mich App 682, 685; 706 NW2d

30 (2005). However, tax exemptions under the UTA and in general are disfavored, and the burden of proving an entitlement to an exemption is on the party claiming the right to the exemption. *Guardian Industries, supra* at 249. Tax exemptions are strictly construed against the taxpayer because exemptions represent the antithesis of tax equality. *Id.*

The UTA was first enacted in 1937 and has been extensively amended over the years, which can create some confusion in analyzing the interpretive caselaw for purposes of current application, remembering also that the statutory language for the years in issue must be considered. 1937 PA 94; Historical and Statutory Notes to the UTA. Relevant here is the time period starting January 1, 1997, and running through March 31, 1999, i.e., the years in issue. During the years in issue, MCL 205.94(g)(*i*) provided:

> The tax levied does not apply to the following:
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> (g) Property sold to the following:
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> (*i*) An *industrial processor* for use or consumption in *industrial processing*. Property used or consumed in industrial processing does not include tangible personal property permanently affixed and becoming a structural part of real estate; office furniture, office supplies, and administrative office equipment; or vehicles licensed and titled for use on public highways other than a specially designed vehicle, together with parts, used to mix and agitate materials added at a plant or jobsite in the concrete manufacturing process. Industrial processing does not include receipt and storage of raw materials purchased or extracted by the user or consumer, or the preparation of food and beverages by a retailer for retail sale. As used in this subdivision, "industrial processor" means a person who transforms, alters, or modifies tangible personal property by changing the form, composition, or character of the property for ultimate sale at retail or sale to another industrial processor to be further processed for ultimate sale at retail. Sales to a person performing a service who does not act as an industrial processor while performing the service may not be excluded under this subdivision, except as provided in subparagraph (*ii*). [1987 PA 141 and 1993 PA 326 (emphasis added).][2]

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[2] Subsection (g)(*ii*) addressed computer related property and is not pertinent to our discussion. Also, MCL 205.94(g) was amended pursuant to 1998 PA 491, which became effective on January 4, 1999 (within our timeframe), but this amendment only added language to address advancements in computer technology for purposes of subsection (g)(*ii*). Accordingly, we need not concern ourselves with this particular amendment. MCL 205.94 in general has been amended numerous times since 1999, but none of those amendments are relevant to the instant case. 2000 PA 200; 2001 PA 39; 2002 PA 456; 2002 PA 669; 2004 PA 172; 2007 PA 103; 2008 PA 314.

There is no dispute that plaintiff was and is an "industrial processor." The debate entails the question whether plaintiff was engaged in "industrial processing" during the years in issue relative to treatment and disposal of the liquid and solid waste.

Pursuant to 1999 PA 117, made effective July 14, 1999, the Legislature deleted the language contained in MCL 205.94(g) regarding the "industrial processing" exemption and created MCL 205.94o and 94r, moving the "industrial processing" exemption to these two new statutes. MCL 205.94o pertained to an "industrial processing" exemption for property sold after March 30, 1999, and is thus not relevant to our analysis. We do note that MCL 205.94o(7)(a) did expressly define the term "industrial processing," and the statute also provided that industrial processing included the "[p]rocessing of production scrap and waste up to the point it is stored for removal from the plant of origin," MCL 205.94o(3)(h).[3]

MCL 205.94r, as added by 1999 PA 117, also addressed the "industrial processing" exemption, but it limited itself to exemptions for "property sold . . . after March 30, 1995 but before March 31, 1999," which fits the pertinent timeframe in the case at bar. The language in MCL 205.94r concerning the "industrial processing" exemption mimicked, for the most part, the language in the former MCL 205.94(g) as it existed in the second half of the 1990s.[4] 1993 PA 326; 1998 PA 491; 1999 PA 117. However, MCL 205.94r itself was repealed by the Legislature pursuant to 2004 PA 172, effective September 1, 2004.[5] To the extent that MCL 205.94r remains applicable because proceedings before defendant's referee and administrator occurred before September 1, 2004,[6] there are no relevant differences between former MCL 205.94r and former MCL 205.94(g) for purposes of our analysis.[7]

While MCL 205.94(g) and 205.94r defined "industrial processor," they did not specifically define "industrial processing." Rather, those statutes simply spoke of instances or goods that would not be encompassed by the "industrial processing" exemption, e.g., "industrial processing does not include tangible personal property permanently affixed and becoming a structural part of real estate[.]" MCL 205.94(g)(*i*) and 205.94r(1)(a). Defendant takes the

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[3] MCL 205.94o was later amended pursuant to 2004 PA 172, but it retained the language defining "industrial processing" as including the processing of scrap and waste.

[4] There was one exception. The language in MCL 205.94r(2) was not found in MCL 205.94(g). MCL 205.94r(2) provided that property is "exempt only to the extent that the property is used for the exempt purposes 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." Ultimately, this difference does not impact our holding. Contrary to defendant's assertion, MCL 205.94r was not in effect during the years in issue, where it was not added to the UTA until enacted in 1999. 1999 PA 117. Rather, MCL 205.94r reflected an effort by the Legislature to reach back and retroactively apply its language to earlier tax years.

[5] Defendant does not acknowledge this repeal.

[6] The complaint in the Court of Claims was filed in December 2004.

[7] For the remainder of this opinion, we shall not preface each reference to MCL 205.94(g) and MCL 205.94r with the term "former."

language that defined "industrial processor," MCL 205.94(g)(*i*); MCL 205.94r(1)(a), and extrapolates a definition of "industrial processing." An "industrial processor" was defined as "a person who transforms, alters, or modifies tangible personal property by changing the form, composition, or character of the property for ultimate sale at retail or sale to another industrial processor to be further processed for ultimate sale at retail." *Id.* Thus, defendant maintains that "industrial processing" encompasses acts of transforming, altering, or modifying tangible personal property by changing the form, composition, or character of the property for ultimate sale at retail or sale to another industrial processor. According to defendant, the act of treating and disposing of liquid and solid waste does not fit within this definition, especially given that the waste was not placed for ultimate sale; therefore, the "industrial processing" exemption is inapplicable.

Although there arguably may be some logic in extrapolating a definition of "industrial processing" from the statutory provision identifying who constitutes an industrial processor, it is not so evident such that we are prepared to conclude that the statutory language renders null and void or is in conflict with an agency rule issued by defendant that squarely addresses the question posed in this case.

Under the authority granted to defendant to promulgate rules, found in MCL 205.3(b), defendant issued Rule 40, 1999 AC, R 205.90 (hereinafter "Rule 40"), as part of the general sales and use tax rules promulgated by defendant. Rule 40 provides, in pertinent part:

> (2) "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 use in manufacturing of a product to be ultimately sold at retail.
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> (5) Industrial processing includes the following activities:
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> (e) *Disposal of production scrap and waste*. [Emphasis added.]

Rule 40 has been in effect in one form or another since first promulgated in 1962, and the language quoted above was in effect during the years in issue. "Rules adopted by an agency in accordance with the APA have the force and effect of law." *Clonlara, Inc v State Bd of Educ*, 442 Mich 230, 239; 501 NW2d 88 (1993).[8]

[8] Contrary to defendant's argument, Rule 40 is not simply an "interpretive" rule. "'An interpretive rule is any rule an agency issues without exercising delegated legislative power to make law through rules.'" *Clonlara, supra* at 239 (citation omitted). Here, defendant has been empowered to promulgate rules through the exercise of delegated legislative power. *Id.*

Of course, rules promulgated by an agency cannot conflict with statutory provisions. *Michigan Sportservice, Inc v Dep't of Revenue Comm'r*, 319 Mich 561, 566; 30 NW2d 281 (1948). In *Michigan Sportservice, id.*, our Supreme Court stated:

> Plaintiffs contend that the sales on which the assessments in controversy were based were exempt from taxation on the ground that the subject matter thereof was commercial advertising within the meaning of the provisions of the statute and of the rule, above quoted. The provisions of the rule must, of course, be construed in connection with the statute itself. In case of conflict, the latter governs. It is not within the power of the department of revenue to extend the scope of the act. For equally cogent reasons the rules and regulations of the department may not grant exemptions not authorized by the legislature.

We conclude that Rule 40 does not conflict with MCL 205.94(g) and MCL 205.94r. The scope of the UTA's "industrial processing" exemption is not being extended by giving weight to Rule 40 and finding it applicable. An exemption for industrial processing was granted by the Legislature, but the Legislature did not expressly define "industrial processing," let alone set the parameters of what encompassed "industrial processing." Defining an "industrial processor" does not equate to defining "industrial processing," and Rule 40 filled the void for the missing definition, which now has been addressed by subsequent amendment, MCL 205.94o. Evidently, defendant is of the position that, had the definition of "industrial processor" been expanded to state that the person also needed to treat and dispose of the waste generated by transforming, altering, or modifying tangible personal property in order to qualify as a processor, an exemption would be forthcoming. It would have been, however, a bit nonsensical for the Legislature to add such language, given that the generation of waste would be a necessary component of the process. It strains reason to conclude that the Legislature meant to limit "industrial processing" in a manner consistent with defendant's argument when the Legislature was simply defining and identifying an "industrial processor." This becomes all the more clear where the Legislature specifically set forth circumstances that did not encompass "industrial processing," without including the necessary waste-disposal process or component associated with the manufacturing. MCL 205.94(g) and 205.94r.

Defendant argues that Rule 40 was enacted before the applicable statutory definition was enacted; therefore, the statute takes precedence over the rule as the rule cannot extend the subsequently-enacted statute. The applicable statutory definition that defendant refers to is the definition of "industrial processor," which was first defined by the Legislature in 1987 PA 141. The relevant language in Rule 40 does indeed predate the 1987 amendment. See 1979 AC, R 205.90. However, this argument, once again, equates the definition of "industrial processor" to "industrial processing," which argument we reject. Thus, the pertinent language in Rule 40 did not predate a statutory definition of "industrial processing" for purposes of this case. There was no definition of "industrial processing" and Rule 40 filled the void. And Rule 40 did not constitute an improper expansion of the legislatively-granted exemption.[9]

[9] For the reasons stated above, we reject defendant's reliance on an opinion issued by the Tax

We reject defendant's alternative argument that Rule 40, even if implicated, does not control where *treatment* of waste is at issue and not the "*[d]isposal* of production scrap and waste." 1999 AC, R 205.90(5)(e) (emphasis added). This argument lacks merit. Solid waste or scrap are clearly *disposed* of in the landfill, and, while the water is treated in order to return clean water to the environment, the process effectively *disposes* of waste contained within the water. Additionally, the parties specifically stipulated that "[p]laintiff *disposes* of its liquid waste through a wastewater treatment facility and *disposes* of its solid waste by burying it in a landfill." (Emphasis added.)

Although not entirely on point because the statutory definition of "industrial processor" did not exist at the time it was decided, we do lend some weight to our Supreme Court's ruling in *Minnaert v Dep't of Treasury*, 366 Mich 117; 113 NW2d 868 (1962), because "industrial processing" was a term used in the UTA at the time and it lacked a statutory definition. See 1949 PA 273. At issue was the disposal of waste tailings generated by the plaintiff's mining of copper ore and manufacturing of copper ingots for sale in the copper market. *Minnaert, supra* at 118-119. The dispute, arising under the UTA, was whether the "[p]laintiff ha[d] sustained the burden of persuasion that his equipment was acquired for exempted use or consumption in 'industrial processing' and ha[d] been so used or consumed." *Id.* at 121. The Court held:

> The work accomplished by means of plaintiff's equipment permits a more economical manufacturing operation in that a substantial part of such waste tailings – the decante – may be used again and again in avoidance of the extra expense of pumping additional quantities of water from the lake and then disposing of additional quantities of tailings by means of more and more compensatorily required dams and ponds. From all this the conclusion cannot be avoided that plaintiff's equipment was acquired for and is being used in the industrial processing of copper ore into copper ingots, "for the market." [*Id.* at 122-123.]

Here, we are also addressing the use and consumption of materials in connection with the disposal of waste, in liquid and solid form, and we likewise conclude that the materials were used for purposes of industrial processing. Moreover, we also have Rule 40, implemented after *Minnaert*, which compels us to grant plaintiff the requested exemption. Plaintiff has sustained its burden to show entitlement to the "industrial processing" exemption.

Finally, the Court of Claims' reliance on *Beckman* was entirely misplaced. In *Beckman*, the plaintiff provided oil and gas extraction services to owners and operators of oil and gas wells. One of the services provided by the plaintiff was the removal of sediment that inhibited the flow of oil or gas in well tubing and piping. The plaintiff was assessed use taxes on equipment and

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Tribunal that is contrary to our ruling and consistent with defendant's arguments. Although we accord deference to the Tax Tribunal's construction of a statute that it enforces, we are not bound by that interpretation. *Ford Motor Co v Bruce Twp*, 264 Mich App 1, 7; 689 NW2d 764 (2004), rev'd on other grounds *sub nom* in *Ford Motor Co v City of Woodhaven*, 475 Mich 425 (2006). We also note that a challenge under the UTA can proceed either to the Court of Claims or the Tax Tribunal, MCL 205.22(1), so the Tribunal does not solely enforce the UTA.

vehicles that the plaintiff purchased in connection with performing the sediment-removal services. The plaintiff paid the taxes under protest, claiming that the UTA's "industrial processing" exemption under MCL 205.94(g) applied. The defendant denied the plaintiff's request for a refund, and the Court of Claims dismissed the plaintiff's action. *Id*. at 343.

This Court affirmed, ruling in pertinent part:

> The amendment of [MCL 205.94(g)] by 1970 PA 15 more narrowly defined the term [industrial processing] . . . to explicitly exclude "*services performed upon property owned by others where the services do not transform, alter, or modify the property so as to place it in a different form, composition or character*." The amendment did not make an exception for those services that are "absolutely essential" to the industrial process of a manufacturer or producer.
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> [W]hen amending the statutory language of section 4(g), the Legislature had the opportunity to follow the courts' previous definition of "industrial processing" and did not do so, choosing instead to more narrowly define the term. We can only conclude that this was a conscious choice by the Legislature. Therefore, as the Court of Claims reasoned in its opinion, it is no longer pertinent that plaintiff can prove that its services are essential to the industrial process of its customers. Rather plaintiff must prove that it services transform, alter, or modify the property so as to place it in a different form, composition, or character.
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> [I]n this case, plaintiff failed to prove that the use of its equipment to clean and unclog oil wells is a service that transforms, alters, or modifies the property so as to place it in a different form, composition, or character. [*Beckman, supra* at 344-345 (emphasis added).]

First, the statutory language relied on by the *Beckman* panel was language added to MCL 205.94(g) by amendment under 1970 PA 15, and the Court of Claims here relied on the same amendatory language and this Court's discussion of the amendment in *Beckman*. However, while the language relied on in *Beckman* survived a later amendment under 1978 PA 262, a subsequent amendment, 1987 PA 141, resulted in deletion of that language. Therefore, during the years in issue, there was no provision stating that industrial processing excluded "services performed upon property owned by others where the services do not transform, alter, or modify the property so as to place it in a different form, composition or character." 1970 PA 15. Moreover, contrary to the situation in *Beckman*, which involved services performed by a party on the property of others, our plaintiff itself was engaged in disposing of the waste, not an outside party. Thus, even if the language at issue found in 1970 PA 15 still existed, it would not be applicable. We also note that the Court of Claims improperly melded together a definition of industrial processing in its opinion by quoting part of 1970 PA 15 as cited in *Beckman* and continuing the quote, after use of an ellipsis, with language from the "industrial processor" definition. *Beckman* simply has no bearing on addressing the issue presented in the case at bar.

In sum, plaintiff is entitled to an "industrial processing" exemption under the UTA, and the Court of Claims erred in granting summary disposition in favor of defendant. In light of our ruling, it is unnecessary to address plaintiff's constitutional challenge.

We reverse and remand for entry of judgment in favor of plaintiff consistent with this opinion and the parties' stipulation. We do not retain jurisdiction.

/s/ Patrick M. Meter
/s/ William B. Murphy
/s/ Brian K. Zahra