STATE OF MICHIGAN

COURT OF CLAIMS

ROBERT G. MANNES, and KRISTEN MANNES,

Plaintiffs,

v

MICHIGAN DEPARTMENT OF TREASURY,

Defendants.
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OPINION AND ORDER

Case No. 18-000235-MT

Hon. Colleen A. O'Brien

Pending before the Court are the parties competing motions for summary disposition. For the reasons that follow, defendant's January 6, 2020 motion for summary disposition is GRANTED pursuant to MCR 2.116(C)(10).

I. BACKGROUND

The issue in this case involves plaintiffs' Michigan Income Tax returns for the 2015 and 2016 tax years. A person's "taxable income" under the Michigan Income Tax Act is generally based on the federally adjusted income tax. 26 USC 162 permits an individual, when computing federally adjusted gross income, to deduct expenses of carrying on a business. As a result, expenses of carrying on, for instance, an oil and gas business, are deducted from federally adjusted gross income. The problem, insofar as this state is concerned, is that the taxation of oil and gas income is done pursuant to the Severance Tax Act. The tax levied under the Severance Tax Act is levied on the gross market value of the gas or oil at the time of severance, and it is "in lieu of all

other taxes, state or local, upon the oil or gas . . . ." MCL 205.315. This provision exempts oil and gas income from other taxation in Michigan, including under the individual income tax. See *Cowen v Dep't of Treasury*, 204 Mich App 428, 433; 516 NW2d 511 (1994).

Hence, when an individual calculates his or her income for purposes of the Michigan Income Tax Act, adjustments have to be made. MCL 206.30(1)(w)(*i*)-(*ii*) effectuate two such adjustments by: (1) eliminating from federal adjusted income any income from producing oil and gas, to the extent included in adjusted gross income; and (2) eliminating expenses of producing oil and gas, to the extent deducted in arriving at adjusted gross income. Oil and gas expenses are "eliminated" by adding them back to the federally adjusted gross income figure.

In the instant case, the scope of what defendant "eliminated" or added back to plaintiffs' adjusted gross income under MCL 206.30(1)(w)(*ii*) caused a difference in the refund plaintiffs claimed in the 2015 and 2016 tax years and it is at the heart of the issues raised in this case. The primary issue in this case concerns the breadth of the phrase "Expenses of producing oil and gas[.]" The primary point of contention is whether that phrase encompasses all expenses of producing oil and gas—including those that arise prior to and after oil and gas are extracted from the ground—or whether the phrase only encompasses those expenses occurring during the extraction of oil or gas. Plaintiffs take a narrow approach to the scope of MCL 206.30(1)(w)(*ii*), and defendant takes a much broader approach to the statute.

II. ANALYSIS

The parties have filed competing motions for summary disposition pursuant to MCR 2.116(C)(10).[1] Summary disposition is appropriate under MCR 2.116(C)(10) if there is no genuine issue of material fact and the moving party is entitled to judgment as a matter of law.

A. STATUTORY INTERPRETATION

Resolution of the issues presented by the parties requires an examination of MCL 206.30(1)(w). When interpreting a statute, this Court's primary goal is giving effect to the Legislature's intent as can be determined by the plain language of the statute. *South Dearborn Environmental Improvement Ass'n, Inc v Dep't of Environmental Quality*, 502 Mich 349, 360-361; 917 NW2d 603 (2018). The Court must consider the plain meaning of the critical words or phrase(s) as well as the pertinent language's placement and purpose in the statutory scheme. *SBC Health Midwest, Inc v City of Kentwood*, 500 Mich 65, 70; 894 NW2d 535 (2017). When undertaking this task, the reviewing court "must give effect to every word, phrase, and clause and avoid an interpretation that would render any part of the statute surplusage or nugatory." *South Dearborn Environ Improve Ass'n*, 502 Mich at 361 (citation and quotation marks omitted). In general, Courts will assign significance to the Legislature's decision to use different words or a different phrase in one section of a statute than in a different section. *Bauserman v Unemployment Ins Agency*, 503 Mich 169, 184 n 10; 931 NW2d 539 (2019). Finally, if a word or phrase is not defined by the pertinent statute, the Court may consult dictionary definitions in order to ascertain a statute's plain and ordinary meaning. *South Dearborn Environ Improve Ass'n*, 502 Mich at 361.

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[1] Defendant's briefing cites MCR 2.116(C)(8) in addition to MCR 2.116(C)(10). However, given that defendant's arguments rely extensively on documentary evidence outside the scope of the pleadings, the Court will construe the motion only under MCR 2.116(C)(10).

Before turning to the statutory interpretation task at hand, the Court notes that defendant, by way of a Revenue Administrative Bulletin (RAB 2018-08), has already interpreted the pertinent statutory provisions in a way that is contrary to plaintiffs' position in this case. Revenue Administrative Bulletins are not legally binding. *KMart Mich Prop Servs, LLC v Dep't of Treasury*, 283 Mich App 647, 654; 770 NW2d 647 (2009). However, an RAB "reflects the Department's interpretation of a statute it is charged with enforcing, entitling it to respectful consideration." *Id*. at 654-655. See also *Clam Lake Twp v Dep't of Licensing & Regulatory Affairs*, 500 Mich 362, 372; 902 NW2d 293 (2017) (explaining that an agency's interpretation of a statute it is charged with implementing is entitled to "respectful consideration."). If an agency's interpretation is persuasive, it "should not be overruled without cogent reasons." *Younkin v Zimmer*, 497 Mich 7, 10; 857 NW2d 244 (2014). Nonetheless, "courts may not abdicate their judicial responsibility to interpret statutes by giving unfettered deference to an agency's interpretation." *In re Complaint of Rovas Against SBC Mich*, 482 Mich 90, 93; 754 NW2d 259 (2008). An agency's interpretation "cannot control in the face of contradictory statutory text." *SBC Midwest*, 500 Mich at 71.

B. THE COURT ADOPTS A BROAD INTERPRETATION OF THE PERTINENT STATUTORY LANGUAGE

As noted above and as summarized succinctly by plaintiffs' brief filed in support of summary disposition, because income from producing oil and gas is subject to taxation under a different statute (the Severance Tax Act), the Michigan Income Tax statute provides that the "income from producing oil and gas" is not to be included as income for Michigan Income Tax purposes. MCL 206.30(1)(w)(*i*). At the same time, the "expenses of producing oil and gas" are not to be deducted from income for purposes of determining income subject to the Michigan Income Tax Act. See MCL 206.30(1)(w)(*ii*). The dispositive statute in this case, MCL

206.30(1)(w), provides that the following items are to be "eliminated" from income under the Michigan Income Tax Act:

> (i) Income from producing oil and gas to the extent included in adjusted gross income.
>
> (ii) Expenses of producing oil and gas to the extent deducted in arriving at adjusted gross income.

The question before the Court concerns the meaning of the phrase "Expenses of producing oil and gas," and whether that phrase encompasses a narrow set of expenses in a limited timeframe (i.e., the time of extraction), or whether it encompasses a broad set of expenses incurred at a variety of times. To begin the analysis, the Court notes that the statute does not define any of the pertinent terms, so resort to a dictionary definition is appropriate. See *South Dearborn Environ Improve Ass'n*, 502 Mich at 361. As it concerns the word "of," in the phrase "expenses *of*" producing oil and gas, there are numerous definitions and uses of the term from which the Court could choose. For instance, the word "of" can be "used as a function word to indicate cause, motive, or reason." Merriam-Webster Online Dictionary, <https://www.merriam-webster.com/dictionary/of> (accessed March 18, 2020). It can also be "used as a function word to indicate belonging or a possessive relationship." *Id.* In addition, the word can suggest connection, or "relating to" another thing. *Id.* Finally, the same online dictionary defines the word to mean "belonging to, relating to, or connected with (someone or something)." *Id.* Caselaw has recognized a similar meaning of the term "of" as well. See *In re McCarrick/Lamoreaux*, 307 Mich App 436, 455; 861 NW2d 303 (2014) (noting that the word "of" "typically indicates possession or *association*") (emphasis added).

In light of these definitions, the Court concludes that the plain language of the statute lends itself to a broad construction and that MCL 206.30(1)(w)(*ii*) encompasses a wide range of

expenses. Notably, while there are admittedly numerous definitions that can apply to the word "of," there are several pertinent dictionary definitions and examples that, as defendant points out, suggest a broad definition of the term, wherein it suggests relation to, connection to, or belonging to something. This is, as caselaw has recognized, supportive of the notion that the term "of" suggests a mere association with something. See *In re McCarrick/Lamoreaux*, 307 Mich App at 455. Furthermore, while plaintiffs urge the Court to find a temporal limit in the statute, i.e., limiting the phrase to applying only to expenses occurring at the moment of production, no such limit is found within the plain language of the statute. Where no limit exists, this Court will not read a temporal limit into MCL 206.30(1)(w)(*ii*). See *SBC Health Midwest*, 500 Mich at 72 ("We do not read requirements into a statute where none appear in the plain language and the statute is unambiguous.")

The above conclusion is reinforced by considering the meaning of the term "expenses,"—which precedes the term "of"—in MCL 206.30(1)(w)(*ii*). The term generally is defined in a broad fashion, to refer to "a financial burden or outlay," or "something expended to secure a benefit *or bring about a result*." Merriam-Webster's Online Dictionary, https://www.merriam-webster.com/dictionary/expenses (accessed March 18, 2020) (emphasis added). As discussed in the parties' briefing, bringing about a result in the oil and gas business, i.e., producing oil and gas, involves several stages and several different types of costs and expenses. In light of the Legislature's employment of the term "expenses" in MCL 206.30(1)(w)(*ii*), the Court concludes that a wide range of efforts or monies spent to "bring about a result" of producing oil and gas fall within the ambit of MCL 206.30(1)(w)(*ii*), whether direct or indirect, and regardless of the time they are incurred.

In support of their position to the contrary, plaintiffs point to different dictionary definitions of the word "of" and argue that the more common understanding of the term "of" comports with their proposed interpretation. The Court rejects plaintiffs' position. Plaintiffs look only to the definition of "of," and ignore that the pertinent statutory language uses the phrase "expenses of." When construing a statute, the Court must consider the statute as a contextual whole. See *McCahan v Brennan*, 492 Mich 730, 739; 822 NW2d 747 (2012). Stated otherwise, the word "of" should not be construed in isolation; it should be construed in context. And as stated above, construing it in context, i.e., in the phrase "expenses of," it is apparent that the Legislature intended to refer to a broad range of "expenses," without temporal limitation. Hence, while selecting a different dictionary definition could support plaintiffs' proposed interpretation, a reading of the statute as a contextual whole does not support plaintiffs' position.

In further support of their proposed, restrictive reading of the phrase "expenses of producing oil and gas," plaintiffs rely on a somewhat complicated argument that starts in RAB 2018-08's discussion of the phrase "income from producing oil and gas" in MCL 206.30(1)(w)(*i*), and works back to MCL 206.30(1)(w)(*ii*). Plaintiffs note that RAB 2018-08 takes a narrow approach to income that must be eliminated under MCL 206.30(1)(w)(*i*). In particular, the RAB examines the term "produce," which it defines to mean "to bring [oil, etc.] to the surface of the earth." RAB 2018-08, p. 4, quoting *Black's Law Dictionary* (10th ed). Next, the RAB notes that the term "from" is typically used "as a function word to indicate the source, cause, agent, or basis." *Id*. at 5 (citation and quotation marks omitted). Thus, the RAB concludes that "income from" producing oil and gas refers only to the activity of extracting oil and gas from the earth, and not from any pre- or post-production activities. Plaintiffs argue that, because the RAB has adopted

such a narrow construction of the scope of MCL 206.30(1)(w)(*i*), the same narrow construction should apply to the scope of MCL 206.30(1)(w)(*ii*).

The Court is unmoved by plaintiffs' contentions. As noted above, the plain language of MCL 206.30(1)(w)(*ii*) supports a broad approach. That defendant has interpreted *different* statutory language in MCL 206.30(1)(w)(*i*) to have a narrower scope is of little moment. Plaintiffs' argument largely brushes aside the notion that MCL 206.30(1)(w)(*i*)—which refers to "income from" oil and gas production—and MCL 206.30(1)(w)(*ii*)—which refers to "expenses of" oil and gas production—employ different language. This Court must assign significance to the different language employed in the statute, and is not to take lightly that the Legislature employed two distinct phrases in the statute. See *Bauserman*, 503 Mich at 184 n 10. Plaintiffs have not presented a convincing argument why the Court should cast aside the different words employed by the Legislature.

As a result of the above, the Court agrees with RAB 2018-08's conclusion that the interpretation of MCL 206.30(1)(w)(*ii*) honors the Legislature's intent, as expressed in the plain language of the statute. The Court finds this reasoning to be persuasive, and it is without cogent reasons to overrule it. See *Younkin*, 497 Mich at 10.

C. PLAINTIFFS' CHALLENGES TO ADJUSTMENTS ARE MERITLESS

Having concluded that MCL 206.30(1)(w)(*ii*) was intended to apply to a broad set of expenses, without regard to the time when the expenses were incurred during the process of producing oil and gas, the next set of issues involves the five discrete categories challenged by plaintiffs' amended complaint and briefing. By and large, the conclusion that MCL 206.30(1)(w)(*ii*) must be construed to have broad application is sufficient to resolve the bulk of

plaintiffs' challenges. Indeed, plaintiffs largely do not even dispute that the challenged expenses are, generally, related to the production of oil and gas. As a result, plaintiffs' challenges are meritless and do not warrant granting the requested relief. Nevertheless, the Court will briefly touch on the specific categories of expenses challenged by plaintiffs.

1. GEOLOGICAL AND GEOPHYSICAL EXPENSES

Plaintiffs first take issue with the several thousands of dollars in expenses added back to their tax returns as income and that pertain to amortization of geological and geophysical expenses associated with seismic surveys. However, their contentions about these expenses are without merit. To begin with, while plaintiffs support their position with the affidavit of plaintiff Robert Mannes, the legal conclusions asserted in the affidavit about whether the expenses fall within MCL 206.30(1)(w)(*ii*) do not bind the Court. See *Carson Fisher Potts & Hyman v Hyman*, 220 Mich App 116, 123; 559 NW2d 54 (1996) (explaining that it is the responsibility of the trial court to find and interpret the applicable law). Moreover, plaintiffs' position rests entirely on the underlying premise, rejected by this Court, that the reach of MCL 206.30(1)(w)(*ii*) is narrow and that pre-production activities are outside of the statutory exemption. All that is required under MCL 206.30(1)(w)(*ii*) is that the expenses relate to, or are connected with, the production of oil and gas. And here, plaintiffs have presented no evidence indicating that the geological and geophysical costs do not relate to the production of oil and gas. In fact, plaintiffs' documentary evidence demonstrates the opposite, because the purpose of the expenses, according to plaintiff Robert Mannes's affidavit, is to determine whether the land being surveyed is worth drilling for oil and gas production. Thus, these expenses lead to, and relate to, the production of oil and gas.

2. INTANGIBLE DRILLING COSTS

Plaintiffs next argue that intangible drilling costs, or IDC, were improperly eliminated or added back to their tax returns. They describe intangible drilling costs, by way of citing 26 CFR 1.612-4(a) as expenses such as wages, fuel, repairs, supplies that are "incident to and necessary for the drilling of wells and the preparation of wells for the production of oil or gas." Contrary to plaintiffs' position, the description plaintiffs provide undermines, rather than supports, their position. As noted above, all that is necessary for an expense to fall within the reach of MCL 206.30(1)(w)(*ii*) is that the expense be related to, or connected with, oil and gas production. Here, plaintiffs' own description of these expenses admits that they are incident to, and *necessary* for, drilling wells for the production of gas and oil. This description falls within the broad category of expenses that must be eliminated or added back under MCL 206.30(1)(w)(*ii*).

3. DEPRECIATION EXPENSES

Plaintiffs assert that certain depreciation expenses were improperly added back. However, the only documentary evidence regarding these expenses demonstrates that they are related to, or connected with, oil and gas production. This is true even of the wells that did not produce oil or gas in certain years, but did produce in subsequent years. At their core, these expenses are, under the broad interpretation of MCL 206.30(1)(w)(*ii*), related to, or connected with, producing oil and gas. Further, MCL 206.30(1)(w)(*ii*) makes no mention of the timing with which the expense is incurred, and this Court is not free to insert such a provision into the statute. See *Mich Ed Ass'n v*

Secretary of State (*On Rehearing*), 489 Mich 194, 218; 801 NW2d 35 (2011) (discussing statutory interpretation, generally).[2]

4. GUARANTEED PAYMENT EXPENSE

The next category at issue concerns a 2015 "guaranteed payment" made by Giant Chester 2 & 5, LLC to its members; this expense was passed through to the LLC's members, including M&M Exploration Partners, LLC. Plaintiff Robert Mannes is a 50% owner of M&M Exploration partners, such that he claimed as an expense $46,476 of this guaranteed payment. In his affidavit, plaintiff Robert Mannes asserts that the payment was for "management and advisory services." The affidavit also asserts, without analysis, that "None of this expense was for services involved in bringing oil and gas to the surface of the earth nor was the amount of the payment tied to how much if any oil and gas production might occur."

Plaintiffs' primary contention as for why this payment for management and advisory services at an oil and gas company should not be eliminated is premised on their narrow interpretation of MCL 206.30(1)(w)(*ii*). They do not argue that such a fee is not related to, or connected with, producing oil and gas, generally. Furthermore, a review of a federal schedule K-1 for Giant Chester 2 & 5 reveals that this payment was for "consulting fees." Stated otherwise, these were consulting fees paid by an oil and gas company with respect to its business operations. Revenue Administrative Bulletin 2018-08 concludes that items such as wages are expenses that

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[2] The Court notes that plaintiff Robert Mannes's affidavit mentions expenses associated with properties that never produced or, in the case of one property, was located outside of this state. Defendant's briefing asserts that expenses associated with these properties were properly eliminated, and plaintiffs' reply briefing has not challenged that assertion. Thus, to the extent plaintiffs even raised an issue with these properties, it appears to have been waived.

must be eliminated pursuant to MCL 206.30(1)(w)(*ii*). On the record before the Court, there is no reason to treat the consulting fee pertaining to the management of an oil and gas business any differently.

5. TRANSPORTATION, PROCESSING, AND COMPRESSION EXPENSES

The final category identified by plaintiffs are expenses incurred in processing oil and gas, compressing natural gas for transportation, and for transportation. Plaintiffs' sole argument as for why these expenses should not be eliminated is that they are post-production expenses; plaintiffs rely solely on their narrow interpretation of MCL 206.30(1)(w)(*ii*) in making this assertion. For the reasons articulated above and which need not be restated here at length, the Court rejects plaintiffs' position. Plaintiffs do not generally contest that the fees are related to, or connected with, producing oil and gas. That is all that is required to bring the fees within the reach of MCL 206.30(1)(w)(*ii*).

III. CONCLUSION

IT IS HEREBY ORDERED that defendant's motion for summary disposition is GRANTED pursuant to MCR 2.116(C)(10).

This order resolves the last pending claim and closes the case.

Dated: March 23, 2020

Colleen A. O'Brien, Judge
Court of Claims