

STATE OF MICHIGAN
COURT OF CLAIMS

MCM MANAGEMENT INC v STATE OF MICHIGAN DEP'T OF TREASURY

Case No. **17-000061-MT**

Hon. Michael J. Talbot

ORDER

At a session of said Court held,
Detroit, Wayne, Michigan, on
September 7, 2017.

Defendant Michigan Department of Treasury, having filed a motion for summary disposition in lieu of an answer to plaintiff's complaint;

IT IS HEREBY ORDERED that summary disposition is GRANTED IN PART and DENIED IN PART for the reasons stated in this Court's opinion. Consistent with the this Court's opinion, this matter shall be submitted to mediation pursuant to MCR 2.411 to determine a reasonable formula or method for calculating the percentage of Plaintiff's exempt use to total use of the subject equipment under the industrial processing exemption. Within 14 days of entry of this order, the parties shall provide notice to the Court identifying an agreed upon mediator. If a mediator is not agreed upon within 14 days, the Court shall select a mediator. Mediation shall be completed on or before November 15, 2017, or upon recommendation by the mediator, such deadline may be extended.

This is not a final order and does not resolve the last pending claim.



Michael J. Talbot, Judge



A true copy entered and certified by Jerome W. Zimmer Jr., Clerk, on

SEP - 7 2017

Date


Clerk

STATE OF MICHIGAN
COURT OF CLAIMS

MCM MANAGEMENT INC.,

Plaintiff,

v

Case No. 17-000061-MP

STATE OF MICHIGAN DEPARTMENT OF
TREASURY,

Hon. Michael J. Talbot

Defendant.

OPINION

This matter is before the Court on defendant State of Michigan Department of Treasury's Motion for Summary Disposition regarding plaintiff MCM Management Inc's claim for a refund of taxes paid under Michigan's Use Tax Act (UTA), MCL 205.91 *et seq.* Because the Court concludes that Plaintiff made exempt and nonexempt use of the subject equipment, Defendant's motion is GRANTED IN PART and DENIED IN PART.

I. FACTUAL BACKGROUND

Plaintiff is in the business of scrap processing and recycling, which includes certain building demolition activities. During the tax years at issue, April 1, 2007, through September 30, 2012, Plaintiff entered into contracts with property owners whereby the owners agreed to the "transfer of ownership of a building for demotion and removal while retaining the [ownership of]

the land.”¹ Pursuant to these contracts, Plaintiffs served, extracted, and systematically removed certain materials from the building before beginning demolition. While at the jobsite, Plaintiff sorted and, if necessary, further cut and processed scraps of steel, copper wiring, aluminum, tin, concrete, and other reusable materials, which were later sold to third parties. Plaintiff used long-armed and short-armed excavators to which various tools could be attached to sever, move, sort, and process these materials. At issue in this case is whether that equipment is subject to use tax.

After conducting a use tax audit for the tax years in question, Defendant determined that Plaintiff had not properly accrued or remitted use tax for purchases of the equipment used in its demolition and recycling activities. Defendant bifurcated Plaintiff’s activities, finding that the equipment was used for non-exempt purposes with respect to the disassembly and demolition of the buildings, and for exempt purposes with respect to the recycling activities that took place after materials were removed from the buildings and placed at the jobsites. Based upon a sampling of contracts and revenue statements, Defendant determined that 50% of Plaintiff’s use of the equipment was exempt. Under its dual-use formula, Defendant prorated the use tax for the tax years at issue and issued a Notice of Intent to Assess in the amount of \$164,094, exclusive of interest.

At an Informal Conference requested by Plaintiff, a hearing referee recommended cancellation of the assessment, finding that 100% of Plaintiff’s use of the equipment was for

¹ There is no documentation in the record to establish that title of the building passed to the Plaintiff independent from or prior to demolition. According to an affidavit of Plaintiff’s employee, Craig Sickmiller, Plaintiff “purchased the rights to process certain buildings into scrap, but not the land.” The Complaint makes reference to retention of ““salvage rights” to the building, as well as the “transfer of ownership of a building for demolition and removal.” However, no supporting documentation was provided by Plaintiff.

exempt purposes. Disagreeing with the hearing referee's recommendation, and after adjusting the tax for certain items it determined were 100% exempt, Defendant issued a final assessment of use tax in the amount of \$116,558, exclusive of statutory interest, from which Plaintiff now appeals.

II. ANALYSIS

Defendant brings the instant motion for summary disposition pursuant to MCR 2.116(C)(8). A motion under MCR 2.116(C)(8) "tests the legal sufficiency of the complaint on the basis of the pleadings alone to determine if the opposing party has stated a claim for which relief can be granted."² In addressing the motion, a trial court may only consider the pleadings and "[a]ll well-pleaded factual allegations are accepted as true and construed in a light most favorable to the nonmovant."³ Summary disposition is proper where the alleged claims are "so clearly unenforceable as a matter of law that no factual development could possibly justify recovery."⁴

The UTA imposes a 6% use tax for the privilege of using, storing or consuming tangible personal property in the state, subject to a number of exceptions.⁵ The industrial-processing exemption to the UTA provides, in part, as follows:

(1) The tax levied under this act does not apply to property sold to the following after March 30, 1999 . . . :

² *Zaher v Miotke*, 300 Mich App 132, 139, 832 NW2d 266 (2013) (citation omitted).

³ *Maiden v Rozwood*, 461 Mich 109, 119; 597 NW2d 817 (1999).

⁴ *Id.* (citation omitted).

⁵ See generally, MCL 205.91 *et seq.*

- (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.^[6]

In determining whether and to what extent industrial processing applies, the Michigan Supreme Court has provided the following guidance:

[T]he overall concern of the industrial-processing exemption, MCL 205.94o, is, of course, industrial processing. It is only logical, therefore, to first determine whether “industrial processing” has occurred. Because “industrial processing” is defined by MCL 205.94o(7)(a), the analysis begins there. If “industrial processing” activity is not occurring under either MCL 205.94o(7)(a) or MCL 205.94o(3), the latter of which specifically enumerates certain 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 205.94o, including but not limited to Subsection (2), to determine the measure of the exemption.^[7]

Thus, a proper analysis in this case requires an initial inquiry into whether an industrial process has occurred “under either MCL 205.94o(7)(a) or MCL 205.94o(3).”⁸

The term “industrial processing” is defined by statute as follows:

“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 or affixed to and made a structural part of real estate located in another state. Industrial processing begins when tangible

⁶ MCL 205.94o(1).

⁷ *Detroit Edison Co v Dep't of Treasury*, 498 Mich 28, 39; 869 NW2d 810 (2015).

⁸ *Id.*

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.^[9]

Plaintiff bases its industrial processing exemption on the processing of materials removed from demolished buildings. Under the plain and unambiguous language of Subsection 7(a), this constituted an “activity of converting or conditioning tangible personal property.” In addition, at least some of Plaintiff’s activities involved “[r]ecycling of used materials for ultimate sale at retail or reuse,” which is explicitly identified as an industrial processing activity by MCL 205.94o(3)(i).

Because industrial processing has occurred under MCL 205.94o(7)(a) and MCL 205.94o(3)(i), this Court must make a second inquiry into the proper measure of the exemption. This requires the Court “to analyze the remaining provisions of MCL 205.94o, including but not limited to Subsection (2)”¹⁰ Subsection (2) provides:

The property under subsection (1) is exempt only to the extent that the property is used for the exempt purpose stated in this section. *The exemption is limited to the percentage of exempt use to total use determined by a reasonable formula or method approved by the department.*^[11]

Plaintiff contends that 100% of its activities and use made of the equipment, even *before* the buildings were demolished, involved industrial processing. Defendant’s position is that the appropriate percentage of exempt use was 50% because exempt use did not begin until *after* the materials were removed from the buildings and placed at the jobsite to begin the recycling process. Thus, the essential question presented in this case hinges on a determination of when

⁹ MCL 205.94o(7)(a).

¹⁰ *Detroit Edison Co*, 498 Mich at 39.

¹¹ MCL 205.94o(2) (emphasis added).

industrial processing of the recycled materials began or, in other words, whether use made of the equipment in severing and demolishing the building constituted exempt use.

The second sentence of MCL 205.94o(7)(a) provides, in part, that “[i]ndustrial processing begins when tangible personal property begins movement from raw materials storage to begin industrial processing” Plaintiff bases its entitlement to a complete exemption on this language, arguing that the buildings constituted tangible personal property prior to demolition under the doctrine of constructive severance and the law of fixtures. Under Michigan law, where one intends for a fixture to be permanently annexed to real estate, it generally becomes part of real property. It therefore follows, argues Plaintiff, that when a property owner’s intent changes and the owner no longer intends for the fixture to be permanently annexed to the real estate, a constructive severance occurs that changes the character of the fixtures into tangible personal property. Under Plaintiff’s theory, once it entered into contracts for the demolition and removal of building fixtures and components, the intent to have the tangible personal property permanently affixed to real estate no longer existed. As a result, the tangible personal property attached to the building was constructively severed from the land and was no longer deemed to be part of real property.¹²

Plaintiff also claims that buildings (or former buildings) are “raw materials” within the meaning of Subsection 7(a). Plaintiff points to *Webster’s New Collegiate Dictionary’s* definition

¹² There is no documentation in the record to establish that title of the building passed to the Plaintiff independent from or prior to demolition. According to an affidavit of Plaintiff’s employee, Craig Sickmiller, Plaintiff “purchased the rights to process certain buildings into scrap, but not the land.” The Complaint makes reference to retention of ““salvage rights” to the building, as well as the “transfer of ownership of a building for demolition and removal.” However, no supporting documentation such as actual contracts were provided by Plaintiff.

of “raw material” as “material whether crude or processed that can be converted by manufacture, processing, or combination into a useful product,” which would include the components of the building. Finally, Plaintiff claims that the building job site constituted “raw materials storage” from which raw materials (that is, building components) began movement at the moment of severance. Under MCL 205.92(c), “storage” means “a keeping or retention of property in this state for any purpose” According to Plaintiff, the raw materials from the former buildings were stored at the jobsites and, thus, were kept or retained by Plaintiff “for any purpose.”

Defendant, on the other hand, maintains that Plaintiff has not stated a claim upon which relief can be granted for several reasons, nor can further discovery lead to the conclusion that Plaintiff made 100% of exempt use of the purchased equipment. First, a building is not tangible personal property within the meaning of subsection 7(a), and is therefore ineligible for an industrial processing exemption. Citing *Skybolt Partnership v City of Flint*,¹³ Defendant maintains that buildings are presumptively real property under Michigan law. With regard to Plaintiff’s assertion that a constructive severance occurred such that the buildings were no longer real property, Defendant notes that no documentary evidence, aside from an affidavit, was produced by Plaintiff that could establish that such severance occurred. Further, the use made of plaintiff’s equipment for the demolition of real property did not “change the form, composition, quality, combination, or character of tangible personal property” as required under Subsection 7(a), and was therefore not eligible for the exemption. Additionally, even if a building were deemed to be tangible personal property, it is not a “raw material” that was in raw materials storage prior to severance, and there was no “movement”—and therefore no processing—of the

¹³ *Skybolt Partnership v City of Flint*, 205 Mich App 597, 600; 517 NW2d 838 (1994).

materials until after severance was completed. Finally, Defendant argues that the equipment used to sever and move the materials to a place on the jobsite constituted the “receiving” of raw materials at most, which is expressly excluded from the scope of industrial processing activities under MCL 205.94o(6)(a).

Resolution of this matter involves interpretation of the UTA. When construing a statute, a reviewing court’s primary concern “is to discern and give effect to the intent of the Legislature.”¹⁴ “The first step in that process is to examine the language in the statute itself. If the language of the statute is unambiguous, the Legislature must have intended the meaning clearly expressed, and the statute must be enforced as written.”¹⁵ Because tax exemptions are generally disfavored, they are strictly construed against the taxpayer and the taxpayer has the burden of proving its entitlement to the exemption.¹⁶

This Court is unpersuaded by Plaintiff’s constructive severance argument. Even if the buildings were construed as tangible personal property based on constructive severance principles, there can be no converting or conditioning of such property until it is physically severed from the real estate.¹⁷ The deficiencies in plaintiffs’ constructive severance argument are also apparent in the statutory provision mandating that “[i]ndustrial processing beings when tangible personal property begins movement from raw materials storage to begin industrial

¹⁴ *Midamerican Energy Co v Dep’t of Treasury*, 308 Mich App 362, 369; 863 NW2d 387 (2014).

¹⁵ *Id.* (citation and quotation marks omitted).

¹⁶ *Elias Bros Restaurants, Inc v Treasury Dept*, 452 Mich 144, 150; 549 NW2d 837 (1996).

¹⁷ See MCL 205.94o(7)(a) (defining industrial processing as “the activity of converting or conditioning tangible personal property by changing the form, composition, quality, combination, or character of the property . . .”).

processing”¹⁸ As a practical matter, materials cannot be moved when they are physically attached to real estate. Thus, accepting that Plaintiffs’ job sites are considered raw materials storage, there can be no “movement of raw materials,” i.e., the building components, until after the materials are physically severed and capable of movement from the job site location where the materials were “kept or retained” by Plaintiff “for any purpose” within the meaning of MCL 205.94o(7)(a). In other words, Plaintiffs’ exempt use of the subject equipment did not begin until the moment that the physically severed building components began moving for industrial processing purposes, and plaintiffs’ exempt use ended when the finished goods.

Having found that Plaintiffs made exempt and nonexempt uses of the subject equipment, the Court must now address the issue of apportionment. The industrial-processing exemption statute provides,

The property under subsection (1) is exempt only to the extent that the property is used for the exempt purpose stated in this section. The exemption is limited to the percentage of exempt use total use determined by a reasonable formula or method approved by the department.^[19]

Construing a nearly identical provision regarding the extractive-operations exemption,²⁰ the Supreme Court explained that “it is necessary to determine the ‘percentage of exempt use to total use’ by identifying and comparing the use of the property for exempt activity with the use of the property for all activities, both exempt and nonexempt.”²¹ To assist this Court in the efficient resolution of this matter, the parties are directed to submit this matter to mediation to determine a

¹⁸ MCL 205.394o(7)(a).

¹⁹ MCL 205.94o(2).

²⁰ MCL 205.94p(2).

²¹ *Detroit Edison Co*, 498 Mich at 55.

reasonable formula or method for calculating the percentage of Plaintiff's exempt use to total use of the subject equipment under the industrial processing exemption.

Dated: September 7, 2017



Michael J. Talbot, Judge