STATE OF MICHIGAN

COURT OF APPEALS

KAPPEN TREE SERVICE, LLC, Plaintiff-Appellee,	UNPUBLISHED April 26, 2016
v	No. 325984 Court of Claims
DEPARTMENT OF TREASURY, Defendant-Appellant.	LC No. 13-000141-MT

Before: SAWYER, P.J., and MURPHY and RONAYNE KRAUSE, JJ.

PER CURIAM.

Defendant Department of Treasury (Department) appeals as of right the judgment entered by the Court of Claims (trial court) that cancelled the use-tax assessment issued by the Department against plaintiff Kappen Tree Service, LLC (Kappen). The trial court granted summary disposition in favor of Kappen, concluding that all of the tangible personal property used in Kappen's mulch and woodchip business, except for trailers licensed to operate on highways, was exempt from the use tax under the industrial-processing exemption, MCL 205.94o. The trial court captured the licensed trailers under the agricultural-production exemption, MCL 205.94(1)(f), which it found equally applicable. Given the trial court's ruling, it declined to address Kappen's argument that its property was further exempt from the use tax under the extractive-operations exemption, MCL 205.94p. We affirm in part, reverse in part, and remand for further proceedings.

I. FACTUAL BACKGROUND

Kappen is primarily a tree service business, focusing on cutting, trimming, and removing trees and limbs, as well as clearing bushes and brush, for utility entities such as DTE Energy.[1] At some point, Kappen expanded its business, converting the woody remains created by its operations into woodchips, mulch, and a product called "fines," which is highly-fertile composted soil

[1] The Department's audit contained a portion of a contract between Kappen and DTE, which provided that Kappen was responsible for performing electrical line clearance services that included "tree trimming, cutting, chemical spraying, securing right of way, removing trees and brush, chipping and disposal of all brush, [and] cutting of wood to 18" lengths . . . ."

produced as a by-product of making mulch. According to Warren Kappen, who with his wife Crystal Kappen are the limited liability company's two lone members, Kappen sells the wood chips, mulch, and fines to wholesale yards, which in turn sell the products to landscape supply companies, which then sell the products at retail to consumers.

With respect to the overall process, it begins with Kappen employees, machinery, and equipment being transported into work areas on track carriers.[2] A mower called a "brush hog" is used to clear brush and other materials, so as to allow access to trees and bushes in need of trimming or removal. Trees, branches, bushes, and other woody vegetation are cut and extracted using trimmers, chain saws, buckets, an excavator, which is utilized to remove tree stumps, and various other pieces of equipment.[3] Next, the track carriers are employed to haul the severed woody materials out of the direct work areas to wood chippers, grinders, and trucks located on the general grounds of the job sites. The woody remains are promptly fed into the wood chippers and grinders, resulting in the production of woodchips, which are blown into the back of attached trucks. In his deposition, Warren Kappen explained the next step, stating:

> Then we take [the woodchips] to our small yards, pile the chips in our satellite yards, we call them. We've probably got 20 satellite yards around southeast Michigan. And then after they get big enough, we bring in a bigger truck, load them and take them to Marlette. [[4]]

Mr. Kappen indicated that sometimes woodchips sit at a satellite yard for over six months. There was uncontroverted evidence that when the woodchips are placed into piles, whether in the trucks delivering them to satellite yards or on the ground at the satellite yards or Marlette facility, decomposition intensifies, generating heat, which process is sometimes referred to as "cooking" the woodchips, and which is another step in the process of making mulch and fines.

Mr. Kappen testified that most of the woodchips are eventually transported from satellite yards to Kappen's facility in Marlette, where they are further ground and converted into mulch or fines before being dyed and sold.[5] In that process at its Marlette facility, Kappen employs various pieces of equipment, including grinders, shaker decks, screeners, loaders, conveyers, a snow pusher, a scissor lift, dyeing machinery, and a golf cart, which is used as a utility vehicle to transport tools

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[2] In interrogatory answers, Kappen stated that "[t]rack carriers are used to transport workers, machinery and equipment into the woods where cutting is to be done, and to transport wood out of the woods for chipping and/or grinding."

[3] The documentary evidence reflected that once woody vegetation is severed from the soil, it begins to decompose, as photosynthesis can no longer take place.

[4] Kappen's main facility is in Marlette.

[5] The record reflects that, aside from the mulch and fines, Kappen also sells woodchips themselves; it is unclear to what extent, if any, those woodchips undergo further processing at the Marlette facility, although it appears that, minimally, they are dyed there.

and equipment. The sole source of the woodchips used by Kappen is the woody vegetation obtained on projects connected to its tree trimming and clearing business.

The Department performed a use-tax audit on Kappen and determined that its machinery, equipment, and motorized vehicles were subject to use tax.[6] Kappen disputed the use tax and argued that all of the property was exempt under either the industrial-processing exemption, MCL 205.94o, the extractive-operations exemption, MCL 205.94p, or the agricultural-production exemption, MCL 205.94(1)(f). After a hearing examiner agreed with the Department, and the Department adopted the hearing examiner's recommendation, ultimately issuing Kappen a final use-tax assessment in the amount of $394,089, including interest, Kappen paid the tax under protest and then brought the present action in the Court of Claims.

Both parties filed motions for summary disposition.[7] The Department argued that Kappen was not entitled to any of the claimed exemptions with respect to the equipment remaining in dispute, and that, should the trial court disagree and find that one or more of the exemptions was indeed applicable, the court would still be required to engage in apportionment between exempt and non-exempt use under MCL 205.94o(2). Kappen contended that it was entitled to all three exemptions as a matter of law and that no apportionment was necessary.

In a written opinion and order, the trial court initially noted that "[t]he parties are in agreement that Kappen is an industrial processor and that the conversion of trees, branches, bushes,

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[6] The use-tax audit, as revised, encompassed the period of February 1, 2008, through December 31, 2011. According to a list provided by Kappen in answering an interrogatory, the following capital assets were in dispute: chippers, grinders, track carriers, a golf cart, loaders, a CAT excavator, a CAT forklift, walking floor trailers, a snow pusher, sure trac trailers, a track dumper, trimmers, buckets, a scissor lift, and a brush hog.

[7] In the Department's brief in support of its motion for summary disposition, the Department made the following concession:

> There is no dispute that [Kappen] is an industrial processor as it relates to the capital assets used at its facility in Marlette to convert woodchips to mulch, and capital assets used to pick-up and transport woodchips from collection yards to its facility in Marlette. During the audit, [the Department] granted an exemption for certain capital assets that were used at the Marlette facility as part of the industrial process. During the course of discovery, additional information was presented that indicated that other capital assets were utilized as part of the industrial process, and [the Department] acknowledges that same are entitled to the industrial processing exemption.

leaves and other woody vegetation into woodchips, mulch, and fines, is an industrial process." The trial court next observed that "[t]he unified process of converting the trees, branches, bushes, leaves and other woody vegetation into woodchips, mulch and fines for ultimate retail sale began as the cutting, trimming, and grinding were conducted at Kappen's customer jobsites." Accordingly, the trial court concluded that the "property used in this process is fully exempt" under the industrial-processing exemption, except for any trailers licensed to operate on highways, which, without dispute and pursuant to MCL 205.94o(5)(g), were specifically excluded relative to the industrial-processing exemption. The trial court next determined that because the property at issue was exempt under the industrial-processing exemption, it was unnecessary to address Kappen's argument under the extractive-operations exemption, which the court concluded also excepted licensed trailers operated on highways. The trial court, however, did state that it needed to make a determination whether the licensed vehicles were exempt under the agricultural-production exemption. The trial court ruled that the agricultural-production exemption applied, because Kappen was engaged in a business enterprise that involved the harvesting of things of the soil; therefore, the licensed vehicles were not subject to the use tax. Subsequently, the trial court entered a final judgment, ordering the Department to refund to Kappen the full amount of the use-tax assessment that Kappen had paid under protest.

II. STANDARD OF REVIEW

This Court reviews de novo a trial court's ruling on a motion for summary disposition. *Detroit Edison Co v Dep't of Treasury*, 498 Mich 28, 35; 869 NW2d 810 (2015). Questions concerning the construction of the Use Tax Act (UTA), MCL 205.91 *et seq.*, as with any statute, are also subject to de novo review. *Id.*

III. CONSTRUCTION PRINCIPLES – TAX LAWS AND EXEMPTIONS

The foremost rule of statutory construction is to discern and give effect to the intent of the Legislature, and we do so by examining the most reliable evidence of legislative intent, which is the language of the statute itself. *Whitman v City of Burton*, 493 Mich 303, 311; 831 NW2d 223 (2013). "If the language of a statute is clear and unambiguous, the statute must be enforced as written and no further judicial construction is permitted." *Id.* (citation omitted). Generally speaking, tax laws will not be extended in scope by implication or forced construction, and when there is doubt with respect to interpretation, the tax laws must be construed in favor of taxpayers and against the government. *Brunswick Bowling & Billiards Corp v Dep't of Treasury*, 267 Mich App 682, 685; 706 NW2d 30 (2005); *DeKoning v Dep't of Treasury*, 211 Mich App 359, 361; 536 NW2d 231 (1995). Tax exemptions under the UTA and in general, however, are disfavored and will not be inferred, and the burden of proving entitlement to an exemption is on the party claiming the exemption, with exemptions being strictly construed against the taxpayer. *Menard, Inc v Dep't of Treasury*, 302 Mich App 467, 474; 838 NW2d 736 (2013); *Guardian Indus Corp v Dep't of Treasury*, 243 Mich App 244, 249; 621 NW2d 450 (2000).

IV. ANALYSIS

In *Detroit Edison Co v Dep't of Treasury*, 303 Mich App 612, 622; 844 NW2d 198 (2014), aff'd in part, rev'd in part on other grounds, this Court explained the broad nature of the UTA:

> The use tax is an excise tax that is levied on every person in this state for the privilege of consuming, storing, or using tangible personal property in Michigan. 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.* The use tax exempts from taxation property on which a sales tax is paid. The legal incidence of the use tax falls upon the consumer or purchaser. Here, the "tangible personal property" alleged by the Department to be subject to use tax without exemption is [certain] . . . machinery and equipment . . . . The tax rate under the UTA is 6% of the price of the property subject to taxation. [Citations, quotation marks, and alteration brackets omitted.]

At issue in this appeal are the industrial-processing exemption to the use tax, MCL 205.94o, the extractive-operations exemption, MCL 205.94p, and the agricultural-production exemption, MCL 205.94(1)(f). We shall begin with the agricultural-production exemption.

A. THE AGRICULTURAL-PRODUCTION EXEMPTION

We find it unnecessary to spend any significant amount of time regarding the agricultural-production exemption, as it plainly does not apply to Kappen's mulch-woodchip-fines business operations. MCL 205.94(1)(f) provides an exemption to the use tax for "[p]roperty sold to a person engaged in a business enterprise and using and consuming the property in the tilling, planting, caring for, or *harvesting of the things of the soil* or in the breeding, raising, or caring for livestock, poultry, or horticultural products, including transfers of livestock, poultry, or horticultural products for further growth[.]" (Emphasis added.). The trial court relied on, and Kappen points to, the emphasized language, reflecting their conclusion that Kappen harvests trees, limbs, bushes, and other woody vegetation.

For the agricultural-production exemption to apply, "the property must be used . . . for agricultural or horticultural production." *Mich Milk Producers, Ass'n v Dep't of Treasury*, 242 Mich App 486, 493; 618 NW2d 917 (2000); see also *William Mueller & Sons, Inc v Dep't of Treasury*, 189 Mich App 570, 573; 473 NW2d 783 (1991) (exempt property is that which "is used for agricultural or horticultural growth"). Kappen's machinery and equipment were simply not used for agricultural or horticultural production or growth. Kappen was not involved in the planting, growing, cultivation, and care of trees and bushes; rather, DTE or other contracting parties would identify areas that required clearing and Kappen would use its equipment to trim or remove trees, branches, bushes, or other woody vegetation in order to provide the necessary clearance. With respect to the phrase "harvesting of the things of the soil," as read in the context of MCL 205.94(1)(f), the Legislature plainly envisioned the planned growing of a crop or comparable thing, its cultivation, and then its extraction, e.g., the operation of a Christmas-tree farm. In sum, the agricultural-production exemption is inapplicable in this case, and the trial court erred by invoking it.

B. THE INDUSTRIAL-PROCESSING EXEMPTION

With respect to the industrial-processing exemption under the UTA, MCL 205.94o 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 . . . :
>
> (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.

The Legislature defined the term "industrial processing" in MCL 205.94o(7)(a), which provides:

> "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 use 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 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. [Emphasis added.[8]]

[8] An "industrial processor" is defined as "a person who performs the activity of converting or conditioning tangible personal property for ultimate sale at retail or 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." MCL 205.94o(7)(b). The Department agrees that Kappen qualified as an industrial processor, given that the Department does not dispute that at least part of Kappen's business entails industrial processing. In general, property eligible for the industrial-processing exemption includes "[m]achinery, equipment, tools, dies, patterns, foundations for machinery or equipment, or other processing equipment used in an industrial processing activity[.]" MCL 205.94o(4)(b). And it also encompasses "[m]achinery, equipment, or materials used within a plant site or between plant sites operated by the same person for movement of tangible personal property in the process of production[,]" including "front end loaders, forklifts, pettibone lifts, skidsters, multipurpose loaders, knuckle-boom log loaders, [and] tractors[.]" MCL 205.94o(4)(f).

The Department's appellate argument relies on that part of the statutory definition of industrial processing which provides that such processing commences "when tangible personal property begins movement from raw materials storage . . .," MCL 205.94o(7)(a), with a particular focus on the "raw materials storage" language.[9] The Department maintains that "[i]n this case *storage* occurs in trucks, in storage yards around Kappen's service area, and at its facility in Marlette, because that i[s] when it is clear that the woodchips will be used as part of the industrial process of converting the woodchips into mulch." (Emphasis added.)[10] The Department argues, "Kappen is not entitled to the industrial processing exemption for the capital assets and expenses (referred to as equipment) used to clear utility right-of-ways." We note that the Department's argument apparently also encompasses track trailers used to transport woody materials from points of extraction to the worksite wood chippers and grinders, along with the chippers and grinders themselves, considering the Department's contention that "raw materials storage" included woodchip placement in Kappen trucks. Thus, as best we can glean the Department's position, Kappen's equipment that was used in removing or cutting trees, branches, and bushes, clearing brush and woody vegetation, creating the woodchips (chippers and grinders), and moving them *into storage* in trucks was not exempt from use tax under the industrial-processing exemption.[11] Effectively, the Department is of the view that industrial processing did not begin until Kappen began moving, converting, or conditioning truck-stored woodchips.

Again, MCL 205.94o(7)(a) provides, in relevant part, "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." Under the plain and unambiguous language of this provision, industrial processing cannot commence until there is movement of tangible personal property from raw materials storage. The Department implicitly accepts that the woody materials or remains immediately generated by Kappen's cutting, trimming, and removal operations constituted "tangible personal property," and the Department makes no argument that the woody materials or remains did not constitute "raw

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[9] The Department does not argue that Kappen's activities did not generally entail the converting or conditioning of tangible personal property by way of changing the form, composition, quality, combination, or character of the property for ultimate sale at retail, which matter comprises the first sentence of the statutory definition of industrial processing, MCL 205.94o(7)(a).

[10] The Department later similarly reiterated that "raw materials storage occurred at Kappen's facility in Marlette, at storage yards around Kappen's service area, or even in the back of Kappen's truck, when there was some affirmative act to collect the woodchips for future use."

[11] We note that MCL 205.94o(6)(a) provides that "industrial processing" does not include "[p]urchasing, receiving, or storage of raw materials."

materials."[12] Essentially, the Department's argument comes down to a construction of the term "storage."

The Department maintains that "[t]he industrial processing statute does not define storage[,]" and it proceeds to examine the definition of "storage" in *Black's Law Dictionary* (10th ed). Although the industrial-processing statute itself, MCL 205.94o, does not define "storage," MCL 205.92, which is part of the UTA and contains definitions for terms "as used in this act[,]" provides a definition of "storage" in subsection (c). MCL 205.92(c) states that the term "storage" "means a *keeping or retention of property* in this state for any purpose after the property loses its interstate character." (Emphasis added); see *Podmajersky v Dep't of Treasury*, 302 Mich App 153, 165; 838 NW2d 195 (2013) (examining the "for any purpose" language in the statutory definition of "storage" under the UTA and construing it to mean that storage can "be for all purposes without limitation"). Here, keeping in mind the statutory definition of "storage," the question becomes identifying the point at which the raw materials were *kept or retained* by Kappen for any purpose. We agree with the Department that the trees, limbs, bushes, and other woody vegetation were not being kept or retained by Kappen prior to severance, removal, or extraction; therefore, Kappen was not entitled to an exemption under the industrial-processing exemption for equipment and machinery used to sever, extract, or remove those woody materials. However, we disagree with the Department that the woody materials were not in "raw materials storage" until, at its earliest, when the woodchips were in Kappen's trucks. Rather, we conclude that once Kappen finished severing, removing, and extracting the woody materials and was holding them for chipping and grinding at jobsites, the woody or raw materials were being kept or retained by Kappen for any purpose, i.e., they were in "raw materials storage" for purposes of MCL 205.94o(7)(a). Accordingly, equipment used thereafter to move, convert, and condition the woody materials, including the chippers and grinders, was generally covered by the industrial-processing exemption. Therefore, on the issue of the industrial-processing exemption, the trial court erred in part and ruled properly in part. We shall discuss apportionment below.

We take a moment to briefly explain why our Supreme Court's opinion in *Detroit Edision*, 498 Mich 28, does not provide any guidance on the issue of defining "raw materials storage." In *Detroit Edison,* the Court addressed the issue regarding whether electricity was continuing to be

[12] "Tangible personal property" is statutorily defined as "personal property that can be seen, weighed, measured, felt, or touched or that is in any other manner perceptible to the senses and includes electricity, water, gas, steam, and prewritten computer software." MCL 205.92(k). We do question whether the trees, bushes, and woody vegetation, when in their natural state and before being severed or extracted, were "personal" property. See *In re Morris' Estate*, 210 Mich 36, 43; 177 NW 266 (1920) (an interest in growing trees is "an interest in real estate and not personal property"); *Case v Ranney*, 174 Mich 673, 683; 140 NW 943 (1913) ("trees standing upon the land and a part of the realty become personal property when cut and severed from it"). If they did not qualify as tangible personal property, industrial processing could only have started, at its earliest point, after severance or extraction. Given our ultimate holding, it is unnecessary for us to tackle and resolve this particular question.

industrially processed outside the walls of the electric utility's generation plants. As part of its analysis of the definition of "industrial processing" found in MCL 205.94o(7)(a), the Supreme Court stated:

> The next inquiry required under MCL 205.94o(7)(a) is whether the industrial processing of the electricity outside the generation plant satisfies the second sentence, which provides that "[i]ndustrial processing begins when tangible personal property begins movement from raw materials storage to begin industrial processing and ends when finished goods first come to rest in finished goods inventory storage." Defendant does not dispute that industrial processing begins before the electricity has been transmitted from the generation plant. And defendant has identified no point at which the electricity comes to rest in inventory storage. And nowhere does the record otherwise suggest that electricity ever comes to rest in inventory storage. Moreover, electricity is never a "finished good" until the voltage has been reduced to a level approximating 120/240 volts for the typical residential consumer and 480 volts for the typical industrial consumer. We conclude as a result that industrial processing of electricity does not become complete until final distribution to the *consumer* because there is simply no point within the electric system at which "finished goods first come to rest in finished goods inventory storage" before that point. [*Detroit Edison*, 498 Mich at 41-42.]

Accordingly, given the lack of a dispute on the matter, the *Detroit Edison* Court did not need to concern itself with the meaning of "raw materials storage." Further, although the Court examined the language "finished goods *inventory storage*" (emphasis added), the Court ultimately did not need to engage in any construction of the term "storage" itself, given the nature of the circumstances and arguments presented.

C. THE EXTRACTIVE-OPERATIONS EXEMPTION

The extractive-operations exemption is found in MCL 205.94p, and subsection (5)(a) of the statute defines "extractive operations" as follows:

> [T]he activity of taking or extracting for resale ore, oil, gas, coal, timber, stone, gravel, clay, minerals, or other natural resource material. An extractive operation begins when contact is made with the actual type of natural raw product being recovered. Extractive operation includes all necessary processing operations before shipment from the place of extraction. . . . .

Given our ruling that the agricultural-production exemption does not apply, that the industrial-processing exemption is limited in scope as explained above, and that the trial court did not reach Kappen's argument concerning the extractive-operations exemption, the proper course in our view is to remand the case to the trial court, so as to allow it to address in the first instance the applicability of the extractive-operations exemption. We find this especially appropriate because, as discussed below, the issue of apportionment between exempt and nonexempt use must be addressed by the trial court as mandated by our Supreme Court in *Detroit Edison.*

D. APPORTIONMENT

The trial court, relying on this Court's opinion in *Detroit Edison*, 303 Mich App 612, did not entertain the issue of apportionment under MCL 205.94o(2), which provides as follows in the context of the industrial-processing exemption:

> The property under subsection (1) is exempt only to the extent that the property is used for the 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.

In our Supreme Court's decision in *Detroit Edison*, which was issued after the trial court had ruled, the Court observed:

> Because exempt and nonexempt activities are simultaneously occurring, 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. MCL 205.94o(2).
>
> This percentage must be determined on the basis of a "reasonable formula or method approved by the department [of Treasury]." *Id.* The record has not been sufficiently developed in this regard. Therefore, a remand to the trial court is necessary for defendant to approve a "reasonable formula or method" to determine the percentage of plaintiff's exempt use to total use of the electric system and, thus, the industrial-processing exemption to which plaintiff is entitled. The trial court must review this formula or method in light of the statute and enter an order consistent with the reasonable formula or method. [*Detroit Edison*, 498 Mich at 55-56.[13]]

We similarly remand the case to the trial court for proceedings consistent with the directives in *Detroit Edison*, 498 Mich 28, as to the industrial-processing exemption and, if found applicable, the extractive-operations exemption. To be clear, we are not determining one way or the other whether exempt and nonexempt use or activities were occurring simultaneously.

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[13] We note that to the extent the trial court determines that the extractive-operations exemption is applicable, that exemption has its own apportionment provision, MCL 205.94p(2), which is nearly identical to MCL 205.94o(2), and which provides:

> The property under subsection (1) 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.

V. CONCLUSION

We reverse the trial court's ruling with respect to the agricultural-production exemption, which is inapplicable. We affirm in part and reverse in part the trial court's ruling concerning the industrial-processing exemption, as it did not exempt Kappen's equipment and machinery employed in removing, severing, or extracting trees, limbs, bushes, and other woody vegetation. Further, we direct the trial court to examine and determine the applicability of the extractive-operations exemption. Finally, after resolving the issue regarding the extractive-operations exemption, the trial court is to entertain the matter of apportionment consistently with our Supreme Court's opinion in *Detroit Edison*.

Affirmed in part, reversed in part, and remanded for further proceedings consistent with this opinion. We do not retain jurisdiction. Neither party having fully prevailed, we decline to award taxable costs under MCR 7.219.

/s/ David H. Sawyer
/s/ William B. Murphy
/s/ Amy Ronayne Krause