STATE OF MICHIGAN

COURT OF APPEALS

DUANE J. THOMAS and JUDITH A. LOBATO, Plaintiffs-Appellants,	UNPUBLISHED August 16, 2012
v	No. 303184 Washtenaw Circuit Court
DEPARTMENT OF TREASURY, Defendant-Appellee.	LC No. 10-000687-AA

Before: BECKERING, P.J., AND FITZGERALD AND STEPHENS, JJ.

PER CURIAM.

Plaintiffs, Duane J. Thomas and Judith A. Lobato, appeal as of right the trial court's order ruling on their request for a declaratory judgment regarding the validity of 1979 AC, R 206.4(2)(d), a rule promulgated by defendant, the Department of Treasury (Treasury). Plaintiffs appeal the trial court's determination that the challenged rule is valid. We affirm.

Plaintiffs argue that the trial court erred in finding that Rule 206.4(2)(d) was valid and in consequently granting the Treasury's motion for summary disposition pursuant to MCR 2.116(C)(10). We disagree. "This Court reviews de novo a trial court's grant or denial of summary disposition [pursuant to MCR 2.116(C)(10)] in a declaratory judgment action." *Michigan Ed Employees Mut Ins Co v Turow*, 242 Mich App 112, 114; 617 NW2d 725 (2000). A party may be entitled to summary disposition under MCR 2.116(C)(10) if: "Except as to the amount of damages, there is no genuine issue as to any material fact, and the moving party is entitled to judgment or partial judgment as a matter of law."

This case involves a challenge to an agency rule. "The scope of an administrative agency's statutory rulemaking authority and whether an agency has exceeded that authority are questions of law that we review de novo." *Mich Farm Bureau v Dep't of Environmental Quality*, 292 Mich App 106, 127; 807 NW2d 866 (2011). "Whether an administrative rule is arbitrary and capricious is [also] a question of law, as is the question whether a rule comports with the intent of the Legislature." *Id.* at 128. "Administrative rules are valid so long as they are not unreasonable; and, if doubt exists as to their invalidity, they must be upheld." *Id.* at 129 (quotation omitted). Of particular importance to our review, this Court has previously held that "[b] ecause the farmland preservation tax credit reduces the amount of tax imposed, we review this statute as an exemption provision." *DeKoning v Dept of Treasury*, 211 Mich App 359, 362; 536 NW2d 231, 233 (1995). Because we review this statute as an exemption provision, the

provision must be "strictly construed in favor of the taxing unit." *Id.*[1] Finally, we note that because the trial court took jurisdiction over this matter as a declaratory action, our analysis must be limited to the general validity of Rule 206.4(2)(d), as opposed to the validity of the rule as applied to a particular party.

Rule 206.4(2)(d) provides that household income does not include: "State and city income tax refunds, including homestead property tax credits. Farmland preservation tax credits [FPTCs] shall be included in federal adjusted gross income and household income." Plaintiffs contend that the agency rule is invalid because it requires that FPTCs be counted as part of household income, as defined by MCL 206.508(4). MCL 206.508(4) provides that household income includes "all income received by all persons of a household in a tax year while members of a household." MCL 206.510(1) explains, in relevant part, that income includes: "the sum of federal adjusted gross income as defined in the internal revenue code plus all income specifically excluded or exempt from the computations of the federal adjusted gross income."

This litigation is premised on plaintiffs' argument that Rule 206.4(2)(d) is invalid. "Where, as here, an agency is empowered to make rules, the validity of those rules is to be determined by a three-part test: (1) whether the rule is within the subject matter of the enabling statute; (2) whether it complies with the legislative intent underlying the enabling statute; and (3) whether it is arbitrary or capricious." *Dykstra v Dep't of Natural Resources*, 198 Mich App 482, 484; 499 NW2d 367 (1993).

The first aspect of the test in cases challenging an agency rule involves "whether the rule is within the subject matter of the enabling statute." *Dykstra*, 198 Mich App at 484. "The scope of an administrative agency's statutory rulemaking authority and whether an agency has exceeded that authority are questions of law that we review de novo." *Mich Farm Bureau*, 292 Mich App at 127. The Treasury enforces the Income Tax Act (ITA), 206.1, *et seq.* MCL 206.471(1); see also *Kostyu v Dep't of Treasury*, 170 Mich App 123, 127-128; 427 NW2d 566 (1988). MCL 205.3(b) authorizes the Treasury to "promulgate rules . . . necessary to the enforcement of the provisions of tax and other revenue measures that are administered by the department." More specifically, MCL 206.471(1)(b), a provision of the ITA, authorizes the Treasury to promulgate rules regarding "the computation of the tax." MCL 206.471(1)(d) provides that the Treasury may promulgate rules regarding the "ascertainment, assessment, and collection of the tax."[2] "It is well settled that an administrative agency may make such rules and

[1] We acknowledge that plaintiffs dispute whether the statute should be strictly construed in defendant's favor. However, because *DeKoning* is explicit in its direction and is published, this Court is bound to follow that holding.

[2] Plaintiffs incorrectly claim that MCL 324.36109(6) is the enabling statute for the Treasury. The provision plaintiffs rely on, MCL 324.36109(6), merely directs that for purposes of the application of the credit program, the state income tax act applies. As noted above, MCL 324.36109 is the statute under which FPTCs are awarded, but it is not the enabling statute for the Treasury's rulemaking authority.

regulations as are necessary for the efficient exercise of its powers expressly granted." *Mich Farm Bureau*, 292 Mich App at 129 (quotations omitted).

Rule 206.4(2)(d), provides that household income and adjusted gross income include FPTCs. In order to enforce the ITA, defendant must discern what is properly counted as income. MCL 206.417(1)(b) and (d) expressly authorize the Treasury to create rules regarding the "computation" and "ascertainment" of income tax. In order to compute or ascertain an individual's income tax, an individual's income must be determined. Rule 206.4(2)(d) provides guidance with respect to what constitutes income and is properly within the subject matter of the enabling statute because it is a rule "necessary to the enforcement of the provisions of tax and other revenue measures that are administered by the department." MCL 205.3(b).

The next step in addressing a challenge to the validity of an agency rule is to determine "whether it complies with the legislative intent underlying the enabling statute." *Dykstra*, 198 Mich App at 484.[3] "The primary rule governing the interpretation of statutes is to discern and give effect to the Legislature's intent through reasonable construction in consideration of the purpose of the statute and the object sought to be accomplished." *Tyson Foods, Inc v Dep't of Treasury*, 276 Mich App 678, 684; 741 NW2d 579 (2007). "In construing legislative intent, a court begins by examining the statutory language and, if the statutory language is clear, it must be enforced as plainly written." *Toaz v Dep't of Treasury*, 280 Mich App 457, 461; 760 NW2d 325 (2008). Here, as described above, the enabling statute explicitly states that the department is to create rules relating to the computation of income tax. Although the enabling statute does not contain a statement of intent or purpose, the language of that statute exhibits that the legislature intended to grant the Treasury broad powers to properly ascertain the amount of tax owed by a party. There is nothing to indicate that the challenged rule, in declaring FPTCs to be income, is inconsistent with the legislative intent of the enabling statute.

Having determined that Rule 206.4(2)(d) is within the subject matter of the enabling statute and is consistent with the legislative intent of the enabling statute, we must now determine whether the rule is arbitrary and capricious. As this Court explained in *Blank v Dept't of Corrections*, 222 Mich App 385, 407; 564 NW2d 130 (citations omitted):

> A rule is arbitrary if it was fixed or arrived at through an exercise of will or by caprice, without giving consideration to principles, circumstances, or significance. A rule is capricious if it is apt to change suddenly or is freakish or whimsical. If a rule is rationally related to the purposes of the statute, it is neither arbitrary nor capricious. Further, if there is any doubt about the invalidity of a rule in this regard, the rule must be upheld.

[3] Much of plaintiffs' brief is dedicated to the notion that the challenged rule is not consistent with the legislative intent underlying the creation of FPTCs. However, the second prong of the applicable test requires an analysis of the legislative intent *of the enabling statute*, which is the statute that grants the administrative body its authority. Nonetheless, the legislative intent underlying FPTCs will be briefly discussed when addressing whether the rule is arbitrary and capricious.

As discussed above, the enabling statutes task the Treasury with computing taxable income. MCL 206.508(4) provides that household income includes "all income received by all persons of a household in a tax year while members of a household." MCL 206.510(1) explains, in relevant part, that income includes: "the sum of federal adjusted gross income as defined in the internal revenue code plus all income specifically excluded or exempt from the computations of the federal adjusted gross income." Consequently, calculating tax liability in Michigan involves interpreting both the state's ITA and the Internal Revenue Code. Therefore, in determining whether the rule in question is valid, we must look to both federal and state law to ascertain whether the rule is so clearly inconsistent with our concept of income that it can be declared arbitrary or capricious.

Turning to the Internal Revenue Code, 26 USC 62(a) provides that "adjusted gross income" means "gross income," as defined by26 USC 61, minus certain exceptions which are not applicable to the present case. "Gross income" is given a broad definition of "all income from whatever source derived." 26 USC 61(a). 26 USC 61(a)(3) also specifically provides that gross income includes "gains derived from dealings in property." As the Treasury argues, the Internal Revenue Service has taken the position that payments received from participating in similar programs, such as the Conservation Reserve Program, must be counted as income. While there may not be a program that is entirely analogous to the FPTCs at issue in the present case, the broad definition of gross income utilized by the Internal Revenue Code, as well as the Internal Revenue Service's position regarding similar programs, prevents us from concluding that Rule 206.4(2)(d) is arbitrary or capricious. Therefore, unless the ITA or another state provision provides otherwise, FPTCs must be included as part of federal adjusted gross income calculations and household income.

FPTCs are granted in exchange for the execution of a "development rights agreement or easement on behalf of the state." MCL 324.36102(1). While MCL 324.36109(1) makes the payment to an individual by way of a credit against income tax liability, where an individual has no income tax liability the individual is entitled to a direct "payment," MCL 324.36109(5). This plainly appears to be "income from whatever source derived." 26 USC 61. MCL 206.2(3) states that, "[i]t is the intention of this part [the ITA] that the income subject to tax be the same as taxable income as defined and applicable to the subject taxpayer in the internal revenue code, except as otherwise provided in this act." See also *Sturrus v Dep't of Treasury*, 292Mich App 639, 650; 809 NW2d 208 (2011) ("Taxable income in Michigan is to be calculated using the definitions in the IRC [Internal Revenue Code]. Indeed, this is precisely what the plain language of MCL 206.2(3) mandates."). The parties each recognize that MCL 206.510(1)(e) provides that "payments or credits under" the ITA are not included in income. Plaintiff asserts that FPTCs are tax credits *under* the ITA, thus invalidating Rule 206.4(2)(d). However, FPTCs are plainly established by MCL 324.36109, a portion of the Natural Resources and Environmental Protection Act (NREPA), MCL 324.101 *et seq*. MCL 324.36109(7) expressly directs the Treasury to "account separately for payments *under this part* and not combine them with other credit programs." (Emphasis added.) Likewise, the ITA at MCL 206.522(9), notes that FPTCs are "claimed under part 361 of the" NREPA.

Absent a provision that expressly states that FPTCs are tax credits that arise under the ITA (and are thus excludable from income) *or* a provision that states that credits arising under provisions outside the ITA are not includable in income, we are unable to say that the rule in

question is arbitrary or capricious. Plaintiffs' arguments, although thoughtful and well-developed, do not demonstrate that the Treasury's rule is invalid beyond all doubt. *Blank*, 222 Mich App at 407. While we recognize that the inclusion of FPTCs in income potentially diminishes the incentive to participate in the program, that assumption, by itself, does not indicate that the rule is so contrary to the view of the legislature so as to be invalid.

Because Rule 206.4(2)(d) is within the subject matter of the enabling statute, is consistent with the legislative intent underlying the enabling statute and is neither arbitrary nor capricious, the trial court did not err in granting the Treasury's motion for summary disposition pursuant to MCR 2.116(C)(10).

Affirmed.

/s/ Jane M. Beckering
/s/ E. Thomas Fitzgerald
/s/ Cynthia Diane Stephens