STATE OF MICHIGAN

COURT OF APPEALS

K & S INDUSTRIAL SERVICES, INC.,	UNPUBLISHED September 27, 2012
Petitioner-Appellee,	
v	No. 305516 Tax Tribunal
DEPARTMENT OF TREASURY,	LC No. 00-311923
Respondent-Appellant.	

Before: SHAPIRO, P.J., and GLEICHER and RONAYNE KRAUSE, JJ.

PER CURIAM.

Respondent appeals by right from the Tax Tribunal's order that, in relevant part, granted petitioner's motion for summary disposition under MCR 2.116(C)(10) and denied respondent's cross-motion for summary disposition. We affirm.

The facts in this case are undisputed by the parties. Petitioner operated a circuit board repair business for its automobile manufacturing customers. Petitioner's customers used computer assisted manufacturing ("CAM") systems to fabricate automobiles for sale. CAM systems require the use of robotics and automated machines, and these machines in turn require functional computer circuit boards. When a circuit board stopped functioning, petitioner's customers shipped the nonoperational board to petitioner. Petitioner then utilized its test beds and test stands to diagnose the problem with the board; petitioner then either made the necessary repairs if possible, or obtained a replacement board. The test beds and stands were integral to the repair and reconditioning process of the circuit boards. Petitioner contends that the repair process changes the board from a nonfunctional state into a functional state by altering the flow of electricity through them. Respondent describes the process as mere repairs.

Pursuant to contract, petitioner's customers are not entitled to return of the defective circuit board, because petitioner may elect to either order a new board or repair the existing board. Specifically, petitioner's customers transfer title over the defective boards based on petitioner's promise to return a functional circuit board, while petitioner agrees to provide a functional circuit board in exchange for the customer's promise to pay for the functional circuit board. Petitioner sold the reconditioned circuit boards at a set price, irrespective of the repair costs.

Based on the above activities, respondent assessed use taxes against petitioner for: (1) purchasing and using the test beds and stands to diagnose and repair the circuit boards; and (2)

consuming utilities while operating the above test beds and stands. Following petitioner's unsuccessful appeal to respondent before the informal conference referee, petitioner filed this petition with the Tax Tribunal, arguing that it was entitled to the "industrial processing" exemption from use taxes under MCL 205.94r.[1]

The Tribunal granted petitioner summary disposition, finding that, by reconditioning and repairing the broken circuit boards, petitioner was an "industrial processor" because it changed both the character and composition of the circuit boards by altering the flow of electricity through the boards. Further, the Tribunal found that the reconditioned circuit boards were ultimately sold for retail based on the nature of petitioner's business relationship with its clients because petitioner acquired title over the defective boards and was permitted to resell them after repair to their customers at a set price. Because petitioner charged its customers a set price for the reconditioned circuit board—rather than the costs for the repair services—the Tribunal reasoned that the circuit boards were ultimately sold to petitioner's customers at retail. Accordingly, the Tribunal held that petitioner qualified for the industrial processing exemption, and therefore petitioner was exempt from use taxes for the purchase, use, and operation (including utilities) of its test boards and stands.

Respondent argues that the Tax Tribunal erroneously found that petitioner qualified for the industrial processing exemption, arguing that petitioner's test beds and stations did not change the form, composition or character of the broken circuit boards. We agree.

In the absence of fraud, this Court reviews the Tribunal's decisions "for misapplication of the law or adoption of a wrong principle." *Briggs Tax Service, LLC v Detroit Pub Schools*, 485 Mich 69, 75; 780 NW2d 753 (2010). "We deem the Tax Tribunal's factual findings conclusive if they are supported by "competent, material, and substantial evidence on the whole record." But when statutory interpretation is involved, this Court reviews the Tax Tribunal's decision de novo. We also review de novo the grant or denial of a motion for summary disposition." *Id*. (footnotes omitted).

We will generally afford deference and respectful consideration to an agency's interpretation of a statute that the agency is charged with administering, but the agency's interpretation is not binding on the courts and cannot override the intent of the Legislature. *In re Rovas Complaint*, 482 Mich 90, 103, 111-112, 117-118; 754 NW2d 259 (2008). The goal of statutory interpretation is to determine and give effect to the intent of the Legislature, with the presumption that unambiguous language should be enforced as written. *Gladych v New Family Homes, Inc*, 468 Mich 594, 597; 664 NW2d 705.

[1] MCL 205.94r has been repealed by 2004 PA 172. The parties make interchangeable reference to MCL 205.94r's predecessor statute, MCL 205.94(g), which it replaced pursuant to 1999 PA 117. Because the substantive language was identical between the two statutes, we refer only to MCL 205.94r. Respondent concedes that MCL 205.94*o* entitles petitioner to the exemption after March 30, 1999.

Ambiguity exists when statutory language reasonably "admits of more than one meaning," but a statute is not ambiguous merely because a term is undefined or has multiple definitions in a dictionary. *People v Jackson*, 262 Mich App 669, 673-674; 686 NW2d 810 (2004); *Marcelle v Taubman*, 224 Mich App 215, 219; 568 NW2d 393 (1997). In ascertaining the clear meaning of a statute, the Court must consider the context of the passages by reading them "in relation to the statute as a whole and [read to] work in mutual agreement [with each other]." *US Fidelity Ins & Guaranty Co v Michigan Catastrophic Claims Ass'n*, 484 Mich 1, 13; 795 NW2d 101 (2009). If an ambiguity is found in a tax statute, it will be construed in favor of the taxpayer. *Signature Villas, LLC v Ann Arbor*, 269 Mich App 694, 702; 714 NW2d 392 (2006). However, tax exemptions are strictly construed against the taxpayer and in favor of the taxing unit. *Liberty Hill Housing Corp v City of Livonia*, 480 Mich 44, 64; 746 NW2d 282 (2008). However, if the language is unambiguous, "the proper role of a court is simply to apply the terms of the statute to the circumstances in a particular case." *Veenstra v Washtenaw Country Club*, 466 Mich 155, 159-160; 645 NW2d 643 (2002).

MCL 205.94r(1)—which was enacted in 1999 PA 117 and was effective between March 30, 1995, and March 30 1999—established in relevant part that the use tax does not apply to property sold to the following:

> (a) An industrial processor for use or consumption in industrial processing . . . "[I]ndustrial 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 subdivision (b). [MCL 205.94r(1).]

Likewise, MCL 205.94r(2) only permits the exemption if the property is actually used for the aforementioned exempt purposes, based on a reasonable proportion of conforming to nonconforming use as approved by respondent. The purpose of this exemption is to avoid double taxation, or "pyramiding," from both the use and sales taxes being imposed on the end product. *Elias Bros Restaurants, Inc v Dep't of Treasury*, 452 Mich 144, 152; 549 NW2d 837 (1996).

Respondent claims that petitioner was not entitled to the exemption because it was not an "industrial processor." "[T]o determine whether the industrial processing exemption applies, it is necessary to consider the activity in which the [property] is engaged and not the character of the equipment-owner's business," or "the nature or existence of a transaction between the processor and the retailer." *Elias Bros Restaurants, Inc*, 452 Mich at 156, 157. A taxpayer qualifies as an industrial processor if: (1) it alters the form, composition, or character of tangible personal

property[2]; and (2) the property is ultimately sold at retail or sold to another industrial processor for processing for ultimate sale at retail. MCL 205.94r(1)(a).

A taxpayer may also qualify for the exemption by providing services to property owned by others, as long as the taxpayer acts as an industrial processor by changing the form, composition, or character of the property. *Beckman Production Services, Inc v Dep't of Treasury*, 202 Mich App 342, 345; 508 NW2d 178 (1993) (holding that cleaning and unclogging oil wells does not "transform, alter, or modify the property so as to place it in a different form, composition, or character."). Testing or diagnostic services that do not change the form, composition, or character of property are insufficient to qualify for the exemption, even if the fruit of the testing results in the alteration of the property. *Michigan Automotive Research Corp v Dep't of Treasury (on remand)*, 222 Mich App 227, 229-230; 564 NW2d 503 (1997). (finding that services "essential" to industrial processing—such as testing vehicle parts from automobile manufacturers—are not independently sufficient to qualify for the exemption).

Neither MCL 205.94r nor its predecessor defined "industrial processing," but rather only defined what constitutes an "industrial processor." Pursuant to its rulemaking powers under MCL 205.3(b), defendant promulgated 1979 AC, R 205.90, otherwise known as "Rule 40." In relevant part, Rule 40 provides that:

> (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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> (d) Design, construction and maintenance of factory machinery, equipment and tooling.

"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). Administrative agencies' rules cannot conflict with statutes. *Michigan Sportservice, Inc v Dep't of Revenue Comm'r*, 319 Mich 561, 566; 30 NW2d 281 (1948). But at least as applied here, Rule 40 clearly does not conflict with any statute in effect during the relevant time periods: it simply fills in a

[2] Although the statute also requires a taxpayer to transform, alter, or modify property, our Courts have not treated this as a separate element, apparently because the statute explicitly states that these activities are accomplish "by" changing the "form, composition, or character" of property. Because the former activities are established through satisfying the latter activities, they do not constitute an independent element of the exemption.

gap that was later filled by MCL 205.94*o*.[3] Significantly, MCL 205.94*o* now provides that "industrial processing" includes "[d]esign, construction, or maintenance of production or other exempt machinery, equipment, and tooling." MCL 205.94*o*(3)(f). Because MCL 205.94*o* was itself clearly intended to fill in a gap, we conclude that Rule 40 was, at all relevant times, not in conflict with MCL 205.94r.

We observe that, if taken *strictly* literally, almost anything could be arguably construed as changing the form, composition, or character of tangible personal property. We think it unlikely that the Legislature intended such a result. Although legislative staff analyses are of minimal probative value, *In re Certified Question from the United States Court of Appeals for the Sixth Circuit*, 468 Mich 109, 115 n 5; 659 NW2d 597, 600 (2003), we nevertheless take note that a House analysis anticipated that "maintenance of real property and nonprocessing equipment" was *not* expected to be considered "industrial processing." House Legislative Analysis, HB 4744 and 4745, July 16, 1999. This is consistent with this Court's conclusion in *Beckman* that clogged and unclogged pipes were not of a "different form, composition, or character" within the meaning of the statute.

The intent of the exemption was to avoid "double-dipping" taxation on both an end product and the transformation of raw (or relatively raw) materials into that end product. See *Elias Bros*, 452 Mich at 152-153. The change of form, composition, or character must be in the nature of something recognizably transformative. This might be a mere subtle refinement or enhancement (for example, purifying or flavoring water), or it might be a fundamental conversion (for example, taking various raw minerals and producing a tool). We think it unlikely that merely fixing something that was already in its final form; changing it from a broken to a non-broken state; is the kind of change to form, composition, or character intended by the Legislature to trigger the exemption. There is no evidence that petitioner, for example, altered the nature of the boards in a manner that would change their function when the boards were re-installed in to their customer's machines.

However, we interpret statutes as they are actually written, not as we guess they were intended to have been written. It is unambiguous that, pursuant to a literal reading of the relevant statutes, petitioner did technically change the form, composition, or character of the boards. Significantly, defendant explicitly conceded that petitioner is entitled to the exemption pursuant to MCL 205.94*o*(3)(f). Because MCL 205.94*o*(3)(f) is essentially identical to Rule 40, 1979 AC, R 205.90(5)(d), which we find had the "force and effect of law" at all relevant times,

[3] We do not express any opinion as to whether any other provision of Rule 40 conflicts with any other statute beyond the respective provisions we explicitly discuss herein, nor do we in any way address the effect, if any, MCL 205.94*o* has on Rule 40.

we deem that effectively to be a concession that, whatever the nature of respondent's activities, they fit the factual prerequisites for an exemption under Rule 40. With those two points in mind, we are unable to conclude that the tribunal committed any legal or factual errors.

Affirmed.

/s/ Douglas B. Shapiro
/s/ Elizabeth L. Gleicher
/s/ Amy Ronayne Krause