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Michigan Supreme Court Denies Exemptions for Car Manufacturers' Pollution Testing Equipment

GRAND RAPIDS, MI – Monday, August 4, 2008 – In what I believe to be a very surprising decision, the Michigan Supreme Court has overturned and reversed the Court of Appeals and reinstated the State Tax Commission's decision denying the taxpayers' request for tax exemptions for their test cells. The Supreme Court also affirmed the appellate court's holding that the engine production line was not entitled to a tax exemption.

The Michigan Supreme Court ruled that certain pollution testing equipment used by the automobile manufacturers did not qualify for sales tax, use tax or property tax exemptions for pollution control equipment. Further, an engine manufacturer was not entitled to the exemption for a new engine production line. (*DaimlerChrysler Corp., et al. v. State Tax Commission, et al., Mich. S. Ct., Dkt. Nos. 133394; 133396; 133400-133406, 07/30/2008 , rev'g in part and aff'g in part Mich. Ct. App. (2007) 274 Mich App 108, 732 NW2d 591.*)

Pollution Testing Equipment

Before issuing a certificate allowing for sales of new vehicles, the federal Environmental Protection Agency (EPA) must test or require to be tested new motor vehicles or new motor vehicle engines to ensure compliance with emission standards that the EPA promulgates. The EPA has created a testing regime, requiring vehicle manufacturers to submit an application with substantial supporting data. The taxpayers in this case, three automobile manufacturers and an engine manufacturer, installed test cells. The test cells are large buildings that can replicate many temperature conditions. They also house equipment that allows for

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up to 40 different types of tests and data collection. The test cells are used in the manufacturing process to ensure compliance with the EPA's regulations. In addition to its test cell, the engine manufacturer installed a new engine production line to meet federal emissions regulations.

Tax Exemptions

All the taxpayers sought tax exemptions from the State Tax Commission (STC) under the Michigan Natural Resources and Environmental Protection Act (NREPA) for their test cells and the engine manufacturer also petitioned for an exemption for its engine line. NREPA provides real and personal property tax exemptions, as well as sales and use tax exemptions for certain air pollution control facilities. The law requires that the STC refer applications to the Michigan Department of Environmental Quality (DEQ).

The DEQ concluded that none of the taxpayers' equipment qualified for an exemption under NREPA because their primary purpose was not to reduce pollution, but to test products for compliance with federal emissions standards and to manufacture engines that comply with those standards. The DEQ also found that all the equipment actually generated some pollution during the testing or manufacturing process, instead of physically disposing of air pollution or controlling it as the law requires.

The Court of Appeals held that the tax exemptions must be issued for all the taxpayers' test cells. The court concluded that the primary purpose of the test cells is to reduce pollution and that they need not physically or directly reduce pollution in order to qualify as tax exempt. However, the Appeals Court affirmed the denial of an exemption for the engine manufacturing line on the ground that its primary purpose was engine manufacturing and not pollution reduction.

Test Cells Are Subject To Tax

The Michigan Supreme Court held that under the plain language of the statute, neither the test cells nor the engine line qualify for the exemption. The statute [MCL 324.5903] which provides an exemption for a particular "facility" requires a determination by the DEQ that the facility is designed and operated primarily for the control, capture, and removal of pollutants from the air and is suitable, reasonably adequate, and meets the intent and purposes of NREPA. The equipment must therefore meet the requirements

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of both section 5901 [MCL 324.5901] and section 5903 [MCL 324.5903] to qualify for the tax exemption. Section 5901's definition of "facility" expressly requires that the equipment be installed or acquired for the primary purpose of controlling or disposing of air pollution.

The Court found that the primary purpose of the equipment at issue was to build engines or test engines (the test cells). The ancillary effect of the equipment is the control of pollution emitted by the engines. While the test cells help the taxpayers ensure that they are producing less polluting engines, the primary purpose of this equipment is not to regulate, curb the spread of, or destroy air pollution, and certainly not "pollution that if released would render the air harmful ... to the public health or to property within this state." Instead, the Court said that the primary purpose of the equipment is to *test* engines to ensure that the taxpayers have properly designed their engines to meet federal regulations so that they can sell them to consumers. Further, the equipment does not get rid of or curb air pollution. Therefore, the test cells are not "facilities" as defined by section 5901 [MCL 324.5901].

The Supreme Court went on to say that even assuming that the taxpayers' federally required pollution equipment and the engine line qualify as "facilities," the taxpayers are still not entitled to an exemption because none of the equipment qualifies under section 5903 [MCL 324.5903]. Under that section, the DEQ must find that the facility is designed and operated primarily for the control, capture, and removal of pollutants from the air. The language of the statute suggests that the facility must actually and physically limit pollution. The language does not stand for the proposition that the facility itself may contribute to the creation of a product that pollutes less than a similar product, which is what the equipment in this case does. Because the statutory language requires the *facility* to do the removing, controlling, and capturing of pollution, this equipment does not qualify.

The Court also said that the fact that the federal government may require such pollution control testing equipment has nothing to do with its eligibility for a tax exemption under Michigan law. None of the pollution control created by redesigned engines tested by the taxpayers is intended to improve the quality of the air. Finally, the NREPA serves to regulate air pollution from stationary sources, while air pollution from mobile sources is covered by other parts of the NREPA. Nothing about the test cells affects air pollution from a stationary source. In fact, a test cell itself adds contaminants to the

air in its location.

Stay tuned for more news and follow the [MichiganStateAndLocalTaxBlog](#) for information as it becomes available. If you have any questions, please go ahead and contact me. I will be happy to be of assistance.

Sincerely,

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