

Michigan Department of Treasury

Revenue Technical Tax Training



Sales and Use Taxes

Industrial Processing Exemption
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**STATE OF MICHIGAN
DEPARTMENT OF TREASURY
Revenue Training Manual
Sales and Use Taxes**

Industrial Processing Exemption

This manual was prepared as an instructional text to be used in conjunction with classroom training on Michigan's Sales and Use Taxes - Industrial Processing Exemption. The purpose of the manual is to explain the various provisions of the Sales and Use Tax Acts, the Department's policies and practices in administering the Acts and the applicable Revenue Administrative Bulletins, Rules and Regulations. It is not intended as a statement of law, Department policy or any official position independent of existing law and the Department's official administrative statements.

Rules and Regulations, Revenue Administrative Bulletins and Letter Rulings referenced herein are the most recent versions available as of the date of printing. Users may need to update this manual in the future when law changes, court cases or corrections affect the substance of the Acts or when policies and procedures that affect the administration of the Acts are revised.

This manual is intended only for training purposes and does not take the place of the law. This manual may not be distributed to the public without the express permission of the State Treasurer. Questions about the content of this manual may be directed to the Constituent Education Division.

Industrial Processing Exemption

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INTRODUCTION and OVERVIEW

Pre 3/31/99:

The State of Michigan allows an exemption from sales and use tax for persons engaged in the manufacturing process. This industrial processing exemption is allowed for equipment, supplies and materials used or consumed in the activity of transforming, altering or modifying tangible personal property by changing the form, composition, quality 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.

In simple terms, industrial processing begins with the first processing activity or machine and ends with the activity that produces the recognizable unit or product for retail sale or sale to another industrial processor to be further processed for ultimate sale at retail. The details of what constitutes the beginning and ending of the industrial processing exemption will be covered later.

The theory behind the exemption is that if the end product is taxed, the components used or consumed in its production are not taxed so that the product is not subject to double taxation.

Among the definitions used in the explanation of industrial processing are:

Transform = to change the form or appearance of; to change the nature, function or condition of; to convert

Alter = to change or make a difference

Modify = to change in form or character, alter

Form = The contour and structure of something as distinguished from its substance. The essence of something as distinguished from its matter.

Composition = A putting together of parts or elements to form a whole, a combining. The manner in which such parts are combined or related, constitution, make-up. The result or product of composing, mixture, compound.

Character = The combination of qualities or features that distinguishes one thing from another.

The manufacturing exemption **includes**, but is not necessarily limited to, the following activities or tangible personal property when performed by and purchased by an industrial processor:

- Production
- Patent, experimental, development, engineering, inspection by the industrial processor and not for a subsidiary or other entity
 - Quality control
- Research and development for a product the industrial processor will produce

- Planning, scheduling and production control
- Design, construction and maintenance of factory machinery
- Disposal of production scrap and waste
- Production supervision
- Production material handling
- Property which becomes an ingredient/component part of the finished product
 - Machinery, tools, dies, patterns - including repair and maintenance
- Machinery and equipment foundations - including repair and maintenance
- Property which is consumed, destroyed or loses its identity in a manufacturing or other production process
- Tangible personal property not permanently affixed and becoming a structural part of real estate used for manufacturing purposes
 - Fuel or energy used or consumed in industrial processing
- Machinery, equipment and materials used within a plant site for movement of tangible personal property in process of production
- Certain data processing equipment used directly for industrial processing
- Certain computer equipment used by servicers who perform specific industrial processing functions for industrial processors (see the “Computers Used in Industrial Processing by Servicers” section of this text)

After 3/31/95, industrial processing also includes computer equipment used in connection with the computer assisted production, storage and transmission of data if the equipment would have been exempt had the data transfer been made using tapes, disks, CD-ROMS, or similar media by a company whose business includes publishing doctoral dissertations and information archiving, and that sells the majority of the company products to nonprofit organizations exempt under MCL 205.54q.

The **industrial processing exemption does not include** the following activities or tangible personal property:

- Purchasing, receiving and storage of raw materials
- Sales, distribution, warehousing
- Shipping
- Advertising
- Administrative, accounting and personnel
- Design, construction and maintenance of real property and nonmanufacturing equipment
- Plant security, fire prevention and hospitals or first aid
- Tangible personal property permanently affixed and becoming a structural part of real estate
- Office equipment used for nonmanufacturing purposes

- Office furniture and office supplies wherever and however used
- Tangible personal property used for receiving and storage of materials
- Vehicles licensed and titled for use on public highways (except cement trucks used for manufacturing)
- Tangible personal property for preparation of food and beverage by a retailer for retail sale (See the “Retailers and the Industrial Processing Exemption” section of this text)
- Tangible personal property used or consumed for preserving or maintaining of a nonfood product in the form and condition in which it is to be sold
- Services performed on the property of others if the services do not transform, alter or modify the property to place it in a different form, composition or character

Post 3/30/99:

Public Acts 116 and 117, passed July 14, 1999, modified and expanded the industrial processing exemption.

The Sales and Use Tax Acts include a definition of industrial processing as “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”.

The definition of an industrial processor is “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”.

The exemption applies to sales to:

- 1) An industrial processor for use in industrial processing
- 2) A person, even if the person is not an industrial processor, if the tangible personal property is intended for ultimate use in and is used in industrial processing by an industrial processor
- 3) A person, even if the person is not 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
- 4) A person, even if the person is not an industrial processor, if the equipment is used in the production of canned or modified software

NOTE: Items (2-4) above were added in the new amendments.

The amendments also define the beginning and end of the industrial processing exemption. The beginning of industrial processing is the movement from raw materials storage to when industrial processing starts and ends when finished goods first come to rest in finished goods inventory storage. See the “Begin and End” section of this text.

Activities previously listed as exempt activities in Rule 40 have now been included in the Sales and Use Tax Acts. These activities either meet the definition of industrial processing or are exempt because they have specific exemption in the Acts.

The following **exempt** activities, now listed in the Acts, meet the definition of industrial processing, since the activities change the form, composition or character of the property:

- Production or assembly
- Remanufacturing
- Processing of production scrap and waste up to the point it is stored for removal from the plant of origin, if for ultimate sale at retail
- Recycling of used material for ultimate sale at retail
- Production material handling (conveyors or material handling that is part of a machine meets definition)

The following activities do not change the form, composition or character of property; however, the activities are **exempt** because they are specifically listed in the Acts as an industrial processing activity:

- Research or experimental activities
- Engineering related to industrial processing
- Inspection, quality control or testing to determine whether the materials, products or processes conform to specified parameters
- Planning, scheduling, supervision or control of production or other exempt activities
- Design, construction, or maintenance of production or other exempt machinery, equipment and tooling
- Processing of production scrap and waste up to the point it is stored for removal from the plant of origin.
- Production material handling (forklift & other movements)
- Storage of in-process materials

As in Rule 40, the Acts list the following activities that are **not exempt**:

- Purchasing, receiving or storage of raw materials
- Sales, distribution, warehousing, shipping or advertising
- Administrative, accounting or personnel services
- Design, engineering, construction or maintenance of real property and nonprocessing equipment
- Plant security, fire prevention, medical or hospital services

The Acts now list the following property that **may qualify** for an industrial processing exemption:

- Property that becomes an ingredient or component part of the finished product

- Machinery, tools, dies, patterns, machinery foundations or other equipment used in an industrial processing activity – including repair and maintenance
- Property that is consumed, destroyed or loses its identity in an industrial processing activity
- Tangible personal property, not permanently affixed and not becoming a structural part of realty, used for installation or maintenance of systems used for an industrial processing activity
- Fuel or energy used or consumed in industrial processing
- Machinery, equipment and materials used within a plant site or between plant sites of the same entity for movement of tangible personal property in the process of production
- Office equipment or data processing equipment used for industrial processing activities
- Vehicles bearing a manufacturer's plate and vehicles specifically designed, together with parts, used to mix and agitate materials at a plant or job site in the concrete manufacturing process

The Acts now list the following property that **does not qualify** for an industrial processing exemption:

- Tangible personal property permanently affixed and becoming a structural part of real estate
- Office equipment or data processing equipment not used for industrial processing purposes
- Office furniture or supplies, wherever and however used
- Inventory withdrawals that the manufacturer uses or consumes for purposes other than industrial processing
- Tangible personal property used for receiving and storage of purchased materials or natural resources extracted by the user
- Vehicles, including special bodies or attachments, licensed and titled for use on public highways
- Tangible personal property used for the preparation of food or beverages by a retailer for ultimate sale at retail through its own locations
- Tangible personal property used for the preservation or maintenance of a finished good once it first comes to rest in finished goods storage. This changes pre 3/31/99 guidelines that related only to food products.
- Returnable shipping containers or materials, except those used within a plant site or between plant sites operated by the same entity for movement of in-process materials
- Tangible personal property used in the production of custom software

The amendments also provide a definition of "product". Product includes prototype, pilot model, process, formula, invention, technique, patent, or similar

property, whether intended to be used in a business or to be sold, transferred, leased or licensed.

The industrial processing exemption involves more than a simple list of what is included and what is not. This exemption has evolved over a number of years; some of the more complicated areas will be discussed in this text.

References: MCL 205.54t and y
MCL 205.94o and r
RAB 2000-4

R 205.90

ACTIVITIES OF PROCESSORS THAT MAY NOT QUALIFY FOR EXEMPTION

A manufacturer may be engaged in nonprocessing operations in addition to its industrial processing activities.

Pre-3/31/99:

If a manufacturer works on the property of others and does not change the form, composition or character of the property, the manufacturer is performing a service and those activities are taxable.

NOTE: Subprocessors may appear to be servicers working on the property of others. However, subprocessors qualify for the exemption when they are changing the form, composition, or character of tangible personal property for sales at retail or for sale to another processor. Examples of subprocessors are plating companies and heat-treating companies.

Post-3/30/99:

If a manufacturer is performing a service, the service activity qualifies for the industrial processing exemption if the tangible personal property is used to perform an industrial processing activity for or on the behalf on an industrial processor.

See the "Servicer" section of this text.

During the preliminary discussions with the taxpayer's representative, determine all aspects of the taxpayer's activities to determine possible tax issues. Tools, supplies, and equipment may be used for both exempt processing purposes and for taxable activities. Analysis should be made to determine the materiality of any possible adjustments before extensive review is conducted.

ITEM	ACTIVITY	PRE- 3/31/9 9	POST- 3/30/9 9
1.	A MANUFACTURER OF AIRPLANE ENGINE PARTS HAS A SERVICE DEPARTMENT THAT REPAIRS AND OVERHAULS ENGINE PARTS (NOT ORIGINAL WARRANTY REPAIRS) ON PROPERTY OWNED BY AIRLINE COMPANIES. (EXCEPTION: INTERSTATE COMMERCE CARRIER AIRCRAFT, MCL 205.54x AND 205.94k)	T	T
2.	A PRINTER PRINTS ON STOCK FURNISHED BY THE CUSTOMER. SEE THE "PRINTERS" SECTION OF THIS TEXT FOR EXCEPTIONS.	T	T
3.	A PRINTER BINDS BOOKS FURNISHED BY ANOTHER PRINTER.	E	E

ITEM	ACTIVITY	PRE-3/31/99	POST-3/30/99
	SEE THE "PRINTERS" SECTION OF THIS TEXT FOR EXCEPTIONS.		
4.	A PRINTER BINDS BOOKS FURNISHED BY A NONPROCESSOR. SEE THE "PRINTERS" SECTION OF THIS TEXT FOR EXCEPTIONS.	T	T
5.	PHOTOGRAPHS ARE RETURNED TO A PHOTOGRAPHER TO COLOR OR TINT THE PHOTOGRAPHS. THE PHOTOGRAPHER IS PERFORMING A SERVICE. R 205.109	T	T
6.	A SIGN MANUFACTURER PAINTS SIGNS OWNED BY AN ADVERTISING AGENCY. R 205.119	T	T
7.	A SIGN MANUFACTURER PERFORMS A SERVICE BY PAINTING A SIGN ON A PRESS.	T	E
8.	A TIRE COMPANY PURCHASES OLD TIRES AND RETREADS THEM FOR SALE TO OTHERS. SEE THE "RECONDITIONING/REMANUFACTURING" SECTION OF THIS TEXT. R 205.130	E	E
9.	A TIRE COMPANY RETREADS OR VULCANIZES TIRES SUPPLIED BY A TRUCKING COMPANY. R 250.130 (EXCEPTION: TIRES FOR "ROLLING STOCK", MCL 205.54r AND MCL 205.94k)	T	T
10.	A PALLET MANUFACTURER REPAIRS PALLETS OWNED BY A SOAP MANUFACTURER THAT USED THE PALLETS IN THEIR IN-PROCESS STORAGE AREA.	T	E
11.	A HEAT-TREAT COMPANY HARDENS STEEL TO BE USED BY AN AUTOMOBILE MANUFACTURER AS PARTS FOR AN AUTOMOBILE.	E	E
12.	A HEAT-TREAT COMPANY HEAT-TREATS DIES OWNED BY AN AUTOMOBILE MANUFACTURER.	T	E
13.	A GRAVEL MINING AND CRUSHING OPERATION HAS PORTABLE EQUIPMENT THAT CRUSHES AND REFINES PRODUCT UNDER FOUR SCENARIOS: <ul style="list-style-type: none"> • FOR OTHER MINING OPERATIONS • AT ITS OWN PITS • FOR CONTRACTORS • FOR COUNTY ROAD COMMISSIONS 	E E T T	E E T T
14.	A COMPANY MANUFACTURES SPIRAL STAIRWAYS AND HANDRAILS. THE STAIRWAYS, ETC. ARE CUSTOM MADE TO SPECIFIC CUSTOMER REQUIREMENTS AND AFFIXED TO	T	T

ITEM	ACTIVITY	PRE- 3/31/99	POST- 3/30/99
15.	<p>REALTY. THE COMPANY DOES NOT MAINTAIN AN INVENTORY OR PRICE LIST. SEE THE "MANUFACTURER/CONTRACTOR" SECTION OF THIS TEXT.</p> <p>A COMPANY MANUFACTURES SPIRAL STAIRWAYS AND HANDRAILS. THE STAIRWAYS, ETC. ARE CUSTOM MADE TO SPECIFIC CUSTOMER REQUIREMENTS AND SOLD AT RETAIL.</p>	E	E
16.	A CONVEYOR MANUFACTURER HAS EMPLOYEES FABRICATE, ASSEMBLE AND INSTALL THE CONVEYOR PARTS AT THE CUSTOMER'S PLANT	E	E
17.	IF THE SAME TOOLS USED IN # 16 ABOVE ARE USED TO INSTALL A CONVEYOR USED FOR AN EXEMPT ACTIVITY, THE PERCENTAGE OF USE TO INSTALL IS TAXABLE PRIOR TO 3/31/99 AND EXEMPT AFTER 3/30/99. NOTE: IF ASSEMBLY AND INSTALLATION USAGE IS INSEPARABLE, CONSIDER THE ASSEMBLY AND INSTALLATION USAGE TAXABLE PRIOR TO 3/31/99 AND EXEMPT AFTER 3/30/99	T on %	E
18.	A WINDOW MANUFACTURER MAINTAINS A PRICE LIST. THE MANUFACTURER INSTALLS THE WINDOWS. THE TOOLS USED AT THE JOB SITE TO INSTALL THE WINDOWS ARE TAXABLE.	T	T
19.	A SOFT DRINK BOTTLER SELLS 5% OF ITS PRODUCED PRODUCT THROUGH ITS OWN VENDING MACHINES. ALL NORMALLY EXEMPT EQUIPMENT WOULD BE TAXABLE AT 5%. THE IP EXEMPTION DOES NOT EXTEND TO THE PREPARATION OF FOOD SOLD AT RETAIL. SEE THE "RETAIL PREPARATION OF FOOD" AND "STORAGE TANK" SECTIONS OF THIS TEXT.	T	T

INDUSTRIAL PROCESSING BEGIN AND END

Post 3/30/99:

For determining where the industrial processing exemption begins and ends we need to look at the statute, supporting rules and binding litigation.

The statutory language in the Sales Tax Act at 205.54(o)(7)(a) and in the Use Tax Act at 205.94(s)(7)(a) is identical. “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.”

The movement of raw material from raw materials inventory is exempt whether it goes directly to the production machinery or to a staging area near the production process. The movement of the material is exempt if the production process drives the movement of the material from raw materials storage.

The exemption ends when the manufactured goods come to rest in finished goods inventory. The movement to or from boxing, bagging, shrink-wrapping or other packaging operations is exempt if it is done before the finished goods come to rest in finished goods inventory.

References: MCL 205.54
MCL 205.94
R 205.90

CEMENT TRUCKS

A specially designed vehicle used to mix and agitate materials, which are added at a plant or job site in the concrete manufacturing business is exempt. The truck and any repair parts are exempt. Tires and repair parts attached to the truck or to the mixer are exempt. This exemption is available only for a concrete manufacturer. Consumable supplies such as gasoline, oil, antifreeze, windshield washer solvent, transmission fluid, brake fluid, etc. would be subject to tax.

If a cement manufacturer does not make retail sales but consumes all of the product on their own jobs, they would not be entitled to the exemption on the cement trucks. They would not be entitled to an industrial processing exemption on any of their equipment or supplies. See the "Manufacturer/Contractor" section of this manual.

If the manufacturer of cement is not able to deliver a load of cement immediately, a separate charge is made for "wait time". Wait time at the plant or job site for the manufacturer/contractor of cement is considered part of the tax base for sales tax.

References: MCL 205.94r(1)(a)
MCL 205.54t

COMPUTER SOFTWARE MANUFACTURING

Definitions:

- Canned Software – offered to the general public on an “as is” basis with or without modification.
- Custom Software – software designed for the exclusive use and special needs of a customer.

Pre-3/31/99 and Post-3/30/99:

Equipment, supplies, utilities, etc. used to produce canned software are exempt for industrial processing. Equipment, supplies, utilities, etc. used to develop custom software are taxable as a service activity. Equipment supplies, utilities, etc. used to modify canned software, whether separately itemized for sales tax purposes or not, are exempt for industrial processing.

An industrial processor could not claim exemption for equipment used to modify a canned accounting software package for their own use. The software will not be used in industrial processing and there is no ultimate sale at retail.

See RAB 99-5 for the sales tax treatment of computer software.

References: MCL 205.51(1)(e)
MCL 205.54t(d)(vi)
MCL 205.94o(d)(vi)
RAB 99-5
RAB 2000-4 VII (6)

COMPUTER STUDIES

MCL 205.54t states:

- (5) Property that is not eligible for an industrial processing exemption includes the following:
 - (b) Office equipment, including data processing equipment, used for nonindustrial processing purposes.

Computers used for industrial processing purposes, including those purchased for use in the first four areas described in MCL 205.54t(1)(d) and MCL 205.94o(1)(d) (See the “Computers Used in Industrial Processing by Servicers” section of this text) can be used in both taxable and exempt functions. If this is the case, a study should be made determining the amount of computer time spent on taxable functions compared to the total computer usage time. This can be based on a week, a month, or any reasonable amount of time that reflects normal usage. These figures are normally available from the Information Systems Department as the hours are usually billed back to the department utilizing the computer service. If no time usage analysis is available, a breakdown based on functional usage should be made. The actual functions by department should be analyzed, because both taxable and exempt usage can be found in almost every department. We cannot assume by the names of departments the tax status of the functions that are actually performed there.

Computers and equipment used in CAD/CAM may not be used only to design or develop products and parts. Care should be taken when reviewing both servicers and industrial processors to determine if the equipment is used in a taxable function. For example:

- 1) To provide a service to their customers (e.g., designing real property floor plans)
 - **Pre-3/31/99:** Equipment used by a servicer to design a floor plan for an industrial processor's exempt machinery would have been taxable.
 - **Post-3/30/99:** Equipment used by a servicer to design a floor plan for an industrial processor's exempt machinery is exempt.
- 2) In a post production function
 - **Pre-3/31/99:** Post production was defined as any function performed after the product is complete and the first movement away from the production line has been made.

- **Post-3/30/99:** Post production functions are now defined as any function performed after the product first comes to rest in finished goods inventory storage.

Computer software may be taxable at a different percentage than the computer equipment it is used on. If the usage of the software can be specifically identified, tax should be applied on that basis, otherwise use a study as described above.

Computers or computer main frames located in Michigan that perform industrial processing functions for both in-state and out-of-state manufacturing divisions are exempt to the extent used in performing industrial processing functions.

Computer cables (personal property), CRT's, modems, printers and monitors used in inter- or intra-plant transmissions are taxed on the determined computer equipment percentages, not as communication devices. Routers, servers, network hookups, etc. are not just communications devices and thus would not always be 100% taxable. A separate study for servers and routers should be performed if the amounts are material.

Laptop computers are considered taxable unless the processor or servicer has definite proof of the percentage of time the laptop was used in exempt activities.

In general, the following functions would be considered taxable:

- Billing
- Order entry
- Payroll
- Accounting
- Sales/Marketing
- Shipping
- Raw material receiving and inventory control

The following computer activities would generally be considered exempt:

- Order summary by product (for production scheduling)
- Production control forecasting
- In-process product testing
- Product design
- Production machinery operation

References: See the "Computers Used in Industrial Processing by Processors" and the "Computers Used in Industrial Processing by Servicers" sections of this text.

**TAXABILITY OF COMPUTER FUNCTIONS
FOR INDUSTRIAL PROCESSORS**

	DESCRIPTION OF FUNCTION	TAX STATUS	REASON
1)	ACCOUNTS PAYABLE	T	ACCOUNTING
2)	CAPITAL ASSET SYSTEM	T	ACCOUNTING
3)	COMPUTERS USED TO OPERATE EXEMPT MACHINES	E	MACHINERY USED IN IP
4)	COMPUTERS USED TO OPERATE TAXABLE MACHINES	T	OPERATES TAXABLE EQUIPMENT
5)	DAILY PRODUCTION REPORT FOR PRODUCTION SCHEDULING	E	PRODUCTION SCHEDULING
6)	DAILY PRODUCTION REPORT FOR RAW MATERIAL ORDERING	T	PURCHASING
7)	DAILY PRODUCTION REPORT USED FOR COST ACCOUNTING	T	ACCOUNTING
8)	DEFECTIVE WORK-IN-PROCESS INVENTORY EXCEPTION REPORT USED TO IMPROVE PROCESS	E	QUALITY CONTROL
9)	DESIGN OF MANUFACTURING MACHINE LAYOUT	E	PRODUCTION CONTROL
10)	DESIGN OF REAL PROPERTY FLOOR PLAN	T	ADMINISTRATIVE
11)	DIRECT COMPUTER ORDERING FROM MFG. TO SUPPLIER (EDI ORDERING)	T	PURCHASING
12)	DIRECT LABOR VARIANCE REPORT	T	ACCOUNTING
13)	EDAP AUDITING	T	ACCOUNTING
14)	FINANCIAL ANALYSIS & FORECASTING	T	ACCOUNTING
15)	GENERAL LEDGER	T	ACCOUNTING
16)	INSTATE PRODUCTION SCHEDULING FOR OUTSTATE DIVISION	E	PRODUCTION SCHEDULING
17)	INVENTORY EXCEPTION REPORT FOR DEFECTIVE RAW MATERIAL USED TO ADJUST PAYMENT TO VENDOR (IF NECESSARY)	T	ADMINISTRATIVE

	DESCRIPTION OF FUNCTION	TAX STATUS	REASON
18)	INVENTORY MANAGEMENT FOR FINISHED GOODS	T	ACCOUNTING/ADMIN.
19)	INVENTORY MANAGEMENT FOR RAW MATERIAL	T	RECEIVING
20)	INVENTORY MANAGEMENT FOR WORK IN PROCESS FOR COST ACCOUNTING	T	ACCOUNTING
21)	INVENTORY MANAGEMENT FOR WORK IN PROCESS FOR PRODUCTION SCHEDULING	E	PRODUCTION SCHEDULING
22)	ORDER REPORT PRINTED BY PRODUCT AND CUSTOMER FOR PRODUCTION SCHEDULING	E	PRODUCTION SCHEDULING
23)	PERSONNEL/ADMIN/PAYROLL	T	ACCOUNTING/ADMIN.
24)	PRINT FORECAST OF ORDERS BY PRODUCT FOR PRODUCTION SCHEDULING	E	PRODUCTION SCHEDULING
25)	PRINT FORECAST OF POTENTIAL SALES BY PRODUCT	T	SALES
26)	PRODUCTION PERSONNEL SCHEDULING-OVERTIME	T	ADMINISTRATIVE
27)	PRODUCTION PERSONNEL SCHEDULING-OVERTIME--FOR FAIR ROTATION OF UNION EMPLOYEES	T	ADMINISTRATIVE
28)	PRODUCTION PERSONNEL SCHEDULING-OVERTIME--TO DETERMINE MANPOWER REQUIREMENTS FOR CONTINUED PRODUCTION	E	PRODUCTION SCHEDULING
29)	PRODUCTION PERSONNEL SCHEDULING-VACATION	T	ADMINISTRATIVE
30)	PRODUCTION PERSONNEL SCHEDULING-VACATION--TO DETERMINE MANPOWER REQUIREMENTS FOR CONTINUED PRODUCTION	E	PRODUCTION SCHEDULING
31)	PRODUCTION REPORT DETAILING CAUSES OF WORK STOPPAGES USED TO IMPROVE THE PRODUCTION PROCESS	E	PRODUCTION SCHEDULING
32)	PRODUCTION REPORT DETAILING FREQUENCY OF DEFECTIVE IN-PROCESS MATERIAL USED TO IMPROVE PRODUCTION PROCESS	E	PRODUCTION SCHEDULING/QUALITY CONTROL
33)	PRODUCTION SCHEDULING	E	PROD. SCHEDULING

	DESCRIPTION OF FUNCTION	TAX STATUS	REASON
34)	PURCHASE ORDER ENTRY	T	PURCHASING
35)	PURCHASING	T	PURCHASING
36)	QUALITY CONTROL INSPECTION REPORT OF RAW MATERIALS	T	ADMINISTRATIVE
37)	QUALITY CONTROL OF IN-PROCESS MATERIAL	E	INSPECTION/QUALITY CONTROL
38)	RAW MATERIAL USAGE REPORT	T	PURCHASING
39)	RAW MATERIALS PROPERTIES REPORT USED TO: A) DETERMINE AMOUNT TO PAY VENDOR OR TO DECIDE TO KEEP OR REPLACE VENDOR	T	ACCOUNTING
	B) DETERMINE QUALITY OF RAW MATERIALS TO DECIDE WHETHER PRODUCT WILL BE GENERIC OR NAME BRAND	E	PRODUCTION
40)	RESCHEDULING ONGOING PRODUCTION TO ACCOMMODATE INSTALLATION OF PRODUCTION EQUIPMENT	E	PRODUCTION SCHEDULING
41)	SALES ANALYSIS	T	SALES
42)	SALES HISTORY REPORT	T	SALES
43)	SALES INVOICE GENERATION	T	ACCOUNTING
44)	SALES ORDER ENTRY	T	SALES
45)	SALES REPORT PRINTED BY PRODUCT & CUSTOMER	T	ACCOUNTING/SALES
46)	SCHEDULING OF EMPLOYEES INVOLVED IN INSTALLATION OF PRODUCTION EQUIPMENT	T	ADMINISTRATIVE
47)	SCHEDULING OF PRODUCTION MACHINE MAINTENANCE OR REPAIR	E	PROCESSING MACHINE MAINTENCE
48)	SCHEDULING REMOVAL OF EXISTING PRODUCTION EQUIPMENT	T	PRODUCTION CEASED
49)	SCRAP REPORT	T	COST ACCOUNTING

	DESCRIPTION OF FUNCTION	TAX STATUS	REASON
50)	SHIPPING DOCUMENTS	T	SHIPPING
51)	SUMMARY OF COMPLETED ORDERS BY PRODUCT	T	SALES
52)	SUMMARY OF PENDING ORDERS FOR PRODUCTION SCHEDULING	E	PRODUCTION SCHEDULING
53)	WARRANTY INFORMATION & ADMINISTRATION	T	ADMINISTRATIVE

COMPUTERS USED IN INDUSTRIAL PROCESSING BY SERVICERS

MCL 205.54t(1)(d) and MCL 205.94o(1)(d) grant exemption to servicers who purchase or lease:

- 1) computers used in operating industrial processing equipment;
- 2) equipment used in a computer assisted manufacturing system;
- 3) equipment used in a computer assisted design or engineering system integral to an industrial process;
- 4) a subunit or electronic assembly comprising a component in a computer integrated industrial processing system.

The above exemptions are based on the use of the equipment rather than the nature of the purchaser's business.

Computers or computer main frames owned by servicers and located in Michigan that perform any of the above activities for an out-of-state company are exempt or partially exempt from tax, based on the amount of time used in the above activities.

Examples of the above exemptions are:

- Computers programmed to operate robotics on an assembly line
- Robotics on the assembly line owned by the servicer operating the equipment
- Computers that design the final product and/or any component part of the final manufactured product
- Servicer owned circuit boards in computers used to operate paint application systems

Examples of taxable usage of computers:

- CAD computers used by engineering firms to design buildings
- Lumber yards or specialized kitchen designers to design the layout of a home or kitchen
- Lumber wholesalers or lumber yards to determine the stress loads for floor joists on load bearing walls
- Computers programmed to operate a finished goods inventory retrieval system or stores account
- CAD equipment used for engineering design and development not directly related to the manufacturing design process

Pre-3/31/99: This would include any post production activities.

Post-3/30/99: This would include any post-finished goods inventory storage activities.

- Experimental research (R & D) performed for an industrial processor

Post-3/30/99: this activity is exempt.

- Computers and equipment used to test products for defects for an industrial processor

Post-3/30/99: this activity is exempt if performed prior to the product coming to rest in finished goods inventory storage.

Pre-3/31/99:

Research and development are not exempt activities for servicers as there is no transforming, altering or modifying of a product for ultimate sale at retail. This exemption is available only to industrial processors.

Post-3/30/99:

Research and development are exempt if performed by a servicer for or on behalf of an industrial processor.

Pre-3/31/99:

Paper, supplies, electricity and other items consumed in the CAD/CAM process while performing a service for a manufacturer are taxable. CAD/CAM equipment for servicers includes canned software only if it is capitalized and either depreciated or amortized. If it is expensed, it is not considered to be equipment. Custom software is always exempt.

Post-3/30/99:

Any items used or consumed in the CAD/CAM process that would be exempt for the industrial processor are now exempt for servicers performing the same function for or on behalf of the industrial processor.

References: MCL 205.54t(1)(d)
MCL 205.94o(1)(d)
R 205.90
RAB 99-5
RAB 00-4

DELIVERY - JUST IN TIME

Pre 3/31/99:

The just in time delivery system is a highly interactive system of delivering products to the customer based on the customer's production requirements. The system usually involves the exchange of electronic data between the purchaser and the supplier.

No matter how coordinated the activities of the supplier's production and the purchaser's manufacturing schedule, the industrial processing activities of the supplier and the customer stand on their own separate merits.

From the delivery standpoint, there is a completed product that needs to be shipped to the customer. There may not be a finished goods inventory. There is still a point where the product is complete prior to the shipping activity. The accumulation point or short term holding area would be considered finished goods inventory. The shipping functions are still taxable.

From the receiving standpoint, there is still a receiving function even though the product may go to a production staging area or directly into the production area to start the production process. The receiving functions are taxable when the items are received from an outside supplier. The movement of the purchased products to a raw material inventory location is a taxable use of equipment. The exempt uses of automated equipment begin with the move immediately before production.

Automated equipment used for shipping or receiving is often the same equipment used to take the products to, from or through the production areas.

Several uses for the same automated equipment will create the need to compute taxable or nontaxable percentages for the equipment. This can be accomplished by measuring the time spent on each activity or by counting the taxable and nontaxable movements or using some other method of generating a reasonable taxable percentage.

Post 3/30/99:

The tax status of the purchaser and supplier still remains dependent on their own facts and activity. What has changed is the Sales and Use Tax Acts now allow the industrial processing exemption for material handling movement of purchased materials removed from raw materials inventory. This is easily identified when there is clear and identifiable raw material storage and becomes more difficult to identify receiving from exempt material handling activities when the purchaser's operations are highly automated.

The taxable and nontaxable areas of just in time inventory scheduling can be demonstrated with examples. The following examples assume the purchaser uses just in time delivery scheduling with its suppliers. The examples start with a low degree of automation and progress to a higher level of automation.

Example 1:

The purchased parts are received at the receiving dock via truck. A forklift unloads the parts and puts them in a raw material inventory to be taken to the production area later. All equipment used to unload and handle raw material is taxable.

Example 2:

The purchased parts are received at the receiving dock via truck. A forklift unloads the parts and puts them in an open area in the receiving department. After the truck is unloaded, the parts are taken to the production area. The equipment used to unload the truck is taxable. The equipment used to move the parts to the production area is exempt.

Example 3:

The purchased parts are received at the receiving dock via truck. A visual inspection and manual inventory count are performed on the truck. The receiving area uses a conveyor to unload the truck. The parts are put in an open area in the receiving department. As the truck is being unloaded, the parts are taken to the production area by a different conveyor. The equipment used to unload the truck is taxable. The equipment used to move the parts to the production area is exempt.

Example 4:

The purchased parts are received at the receiving dock via truck. On the truck a visual inspection and manual inventory count is performed. The trucks are designed with a track that allows the parts to roll out of the truck. The truck receiving area is designed with a slope toward the building. The parts are unloaded directly onto a conveyor via use of the track and gravity. After leaving the truck, the parts are moved by conveyor to the production area. In this example, there is no taxable material handling activity as the movement of the purchased parts is to the production area, being driven by the production process. There is a receiving activity, but no equipment is used for that purpose.

Example 5:

The purchased parts are received at the receiving dock via truck. The trucks are designed with a track that allows the parts to roll out of the truck. The truck

receiving area is designed with a slope toward the building. The parts are unloaded directly onto a conveyor via use of the track and gravity. At the midpoint of this conveyor a visual inspection and manual inventory count is performed. The conveyor then moves the parts to the production area. In this example, the conveyor is 50% taxable as a receiving function occurs at the mid point of the conveyor system.

Example 6:

The purchased parts are received at the receiving dock via truck. The trucks are designed with a track that allows the parts to roll out of the truck. The truck receiving area is designed with a slope toward the building. The parts are unloaded directly onto a conveyor via use of the track and gravity. As parts move on a conveyor through the receiving area, electronic equipment reads UPC bar codes to record the type and amount of items received. The parts continue to move via conveyor to an auxiliary feed line to the production area. The parts will be used in production in 12 hours. In this example, the conveyor is taxable up to the point of the bar code equipment as this is a taxable receiving function. The fact that the parts will not be used in production for 12 hours does not impact the decision. The electronic equipment used to read the bar codes is taxable, since it is for accounting and inventory control purposes.

The above examples demonstrate that the first event that takes place is receipt of the purchased material. The next event may be to raw material storage, even though this phase may be brief. The examples also show the material may move directly to the production area. Review the receiving area carefully in your plant tour to determine if there is a break between the receipt of the purchased material and the movement to the production area.

DIRECT PAY

Direct pay is a process whereby the Michigan Department of Treasury authorizes a taxpayer to report their sales and use tax liability directly to the Department. After June 1999 direct pay provisions are provided by statutory provisions in the Sales Tax Act, MCL 205.54a(l)(o), and the Use Tax Act, MCL 205.98.

The direct pay authorization does not include the following transactions:

- Materials furnished by, or supplied to, construction contractors in the performance of a contract to construct, alter, repair or improve real estate.
- Vehicles purchased, leased or rented for highway use and requiring a license and title.
- Aircraft
- Watercraft
- Services subject to use tax including communication services and motel rentals.
- Petty cash purchases made by company employees on behalf of the company.
- Prepayment of sales tax on gasoline.
- Tangible personal property consumed by a person performing any service activity for your company.

A few contractors also have a limited direct pay account. These usually cover construction projects. The limited permits pertain only to materials and equipment directly incorporated into the project. They do not include consumable materials and equipment used by the contractor (tools, torches, gases, cleaning solvents, etc.).

For an industrial processor, the direct pay permit or the limited direct pay permit covers the purchases of tangible personal property only, not materials attached to real estate by a contractor.

Corporate purchasing cards, procurement cards, or credit cards are covered under the direct pay permit.

Attached is a copy of a standard direct pay permit.

Refer to RAB 2000-3 for the requirements to receive direct pay authorization and obligations of a taxpayer receiving direct pay status.

References: MCL 205.54a(l)(o)
MCL 205.94
RAB 2000-3



**STATE OF MICHIGAN
DEPARTMENT OF TREASURY**

**TREASURY BUILDING
LANSING, MICHIGAN 48922**

Dear: Taxpayer

In response to your correspondence of _____, the Revenue Division of the Michigan Department of Treasury hereby authorizes _____ to operate under a direct pay permit for Michigan sales and use taxes. This becomes effective _____.

This letter is your "direct pay" permit. This represents your authority to report sales and use tax liabilities directly to the Department of Treasury, and is limited to purchases of tangible personal property. In addition, the following are excluded from your direct pay authorization.

- Materials furnished by, or supplied to, construction contractors in the performance of a contract to construct, alter, repair or improve real estate.
- Vehicles purchased, leased or rented for highway use and requiring license and title.
- Aircraft.
- Watercraft.
- Services subject to use tax including communication services and motel rentals.
- Petty cash purchases made by company employees on behalf of the company.
- Prepayment of sales tax on gasoline.
- Tangible personal property consumed by a person performing any service activity for your company.

The purchase of power, steam, gas, etc. and capital appropriation items may be included under your direct pay procedure.

When claiming exemption from sales and use taxes on purchases of tangible personal property, other than those transactions stated above, you should state on your purchase orders to vendors this notation: "Authorized to pay sales or use taxes on purchases of tangible personal property directly to the State of Michigan under Account Number _____".

You may furnish a copy of this letter to any vendor who questions your direct pay authority.

If you have any questions, please write or call this office at (517) 636-4230.

Sincerely,

Dale P. Vettel, Administrator
Technical Services Division

EXTRACTIVE OPERATIONS

Prior to Public Acts 116 and 117 of 1999, the extractive operation exemption was only addressed in the promulgated rules. The 1999 amendments explained later in this section are effective retroactively to March 31, 1995.

The extractive operator included a person who, from his own land or from the land of another, either directly or by contract, took or extracted for resale:

- Ore
- Oil
- Gas
- Coal
- Timber
- Stone
- Gravel
- Clay
 - Minerals
 - Sand
 - Gypsum
 - Salt
 - Other natural resource material

The exemption began for the extractive operator when contact was made with the actual type of natural raw material being recovered. No exemption was allowed prior to the contact with the natural raw material.

The following are examples of taxable use of equipment:

- Removal of top soil before contact with gravel
- Removal of trees before contact with gravel
- Snow removal
- Road grading

If the same equipment were used for both the removal of the topsoil and the removal of gravel, a percentage exemption would be allowed. However, if the topsoil was also sold, all equipment used to extract the topsoil and gravel would be exempt for processing.

Another example of dual usage would be a land stripper that may also be used in the “mixing” of various sizes of gravel which qualifies for the industrial processing exemption on a percentage basis.

Processing included all necessary processing operations before shipment from the place of extraction.

The processing exemption did not include tangible personal property consumed or used in the transportation of the material or the construction, alteration, improvement or repair of buildings, storage tanks or storage and housing facilities.

OIL AND GAS

The drilling or prospecting for oil and gas did not constitute industrial processing. The exemption only began when contact was made with the natural resource.

To determine the taxability of a well we should visualize it in three stages:

- 1) **DRILLING**-including through the cementing of production casing:
TAXABLE
- 2) **COMPLETION**-starts with the perforation and tubing installation:
EXEMPT
- 3) **PRODUCTION**-actual extraction and production: **EXEMPT**

Post-3/31/95:

Extractive operations are no longer associated with the industrial processing exemption. The current exemption covers a sale of tangible personal property to an extractive operator for use or consumption in an extractive operation.

The description of “extractive operations” has not changed. Its definition was merely put into the statute. It is defined as “the activity of taking or extracting for resale ore, oil, gas, coal, timber, stone, gravel, clay, minerals, or other natural resource material”.

The extractive exemption begins when contact is made with the desired product being recovered. It continues through all necessary operations and movements and ends when the natural raw product first comes to rest in finished goods inventory storage at the extraction site.

The extractive exemption is available if a servicer is performing an extractive operation. The natural resource still has to be sold but it does not have to be sold by the servicer.

The Acts specifically exempt tangible personal property used in depositing tailings from hard rock mining and in extracting lithologic units necessary to produce iron ore. The Department has interpreted this to include movement of tailings to the final resting point.

Casing pipe or drive pipe without specific measurements is also specifically mentioned in the statute as eligible for the extractive exemption. Rule 49 exempted case and drive pipe commonly known as 8-inch or under if used in production. Casing pipe or drive pipe used in production was and still is exempt. Pipe, even if 8-inch or under, was and is taxable if not used in production such as being abandoned in a dry hole. The use of this pipe rather than its dimensions determines the exemption.

The following examples reinforce or expand on the exemption given to an extractive operator.

Example 1: S S G Corporation extracted gravel from a site or pit that it owned. The gravel was ideal for use in building roads. The gravel was loaded into non-highway trucks, moved over a company owned road to locations about one half mile from the pit and stored in piles until it was removed for sale. The pit and the finished goods inventory storage location were both located on one parcel of land. Would the equipment used to move the gravel to the storage area be taxable, partially taxable, or exempt?

Post 3/31/95 Answer: Extractive operations are exempt. An extractive operation includes the movement of the natural resource material to the point at which the natural raw product being recovered first comes to rest in finished goods inventory storage at the extraction site. In this example, the first resting place of the gravel in a finished goods inventory state is in the pile located one half mile from the pit. We would consider the pit and the surrounding area as the extraction site and exempt all of the transportation equipment.

Example 2: We have the same facts as in example one but the pile of raw material/finished goods inventory is located five miles down the highway and the vehicles transporting the gravel are licensed for highway use. Would the transportation equipment and fuel in this example be exempt from tax, partially exempt or taxable.

Post 3/31/95 Answer: In this example it is not necessary to decide whether the five mile journey down the highway is a taxable or exempt movement. Since the trucks are licensed to operate on the public highways, by statute they are subject to tax. We would not, however, consider the inventory location as part of the extraction site.

Example 3: We have the same facts as in example number one but the extractor crushes some of the gravel so that it can be used in the manufacture of cement for ultimate sale at retail. The crushing operation is done next to the pile of raw material/finished goods inventory storage. Is this crushing operation a necessary extractive operation?

Post 3/31/95 Answer: The crushing operation is not an extracting operation. The extracting operations ended when the gravel was placed in the pile of raw material/finished goods inventory. The crushing operation would qualify as an industrial processing operation.

Example 4: XYZ Corporation extracted sand from a site or dune that it owned. The sand was stored at the extraction site. Half of the sand was sold at retail and the other half was consumed in their road building contracts. What portion of the sand extraction equipment is exempt from tax and what would be the tax base for the consumed sand?

Post 3/31/95 Answer: The corporation is an extractive operator who consumes part of its product. Its tax base on consumed goods is wholesale fair market value. Since the extracted product is available for sale, 100% exemption applies to the extractive equipment even if the extractive operator consumes the product by attaching it to the real estate of others.

Example 5: XYZ Corporation extracted sand from a site or dune that it owned. The sand was stored at the extraction site. All of the sand was consumed in their road building contracts. What portion of the extraction equipment is exempt from tax and what would be the tax base for the consumed sand?

Post 3/31/95 Answer: The extraction equipment is taxable and the tax base for the sand is zero. The corporation is not defined as an extractive operator because the requirement that the product be sold was not met.

The extracting or assembly costs do not meet the definitions of manufacture or fabricate when determining the price of materials attached to real estate by a construction contractor.

Example 6: Oil is extracted and stored near the well. It is later moved through pipes several miles to be refined. Is the compressor used to move the oil to the refinery taxable or exempt?

Post 3/31/95 Answer: The compressor is taxable. The extractive operation exemption does not include property used in transporting the product from the place of extraction after it has come to rest in finished goods inventory storage. In this example, the first finished goods inventory storage was located near the well.

Example 7: Three producing oil wells are located on one tract of land owned by the extractor. The wells are one mile apart. The production from the wells is moved through pipes and first comes to rest in central storage tanks located between the wells. Are the piping and pumps used to move the oil from the wells to the central storage tanks exempt?

Post 3/31/95 Answer: The piping and pumps are exempt. Equipment used before transport of the natural resource from the production area is eligible for the extractive operation exemption. The wells and the storage tanks are all located at the extraction site.

Example 8: Three producing oil wells are located on three separate tracts of land owned by the extractor. The wells are four miles apart. The oil from each well is transported through pipes to the same central storage tank located four miles from each well. The central storage tank is the place where the oil first comes to rest in finished goods inventory storage. Most of the piping runs through land owned by others. Are the piping and pumps used to move the oil from the wells to the central storage tanks exempt?

Post 3/31/95 Answer: The piping and pumps are exempt. Extractive operations includes all necessary movement of the natural resource material until it comes to rest in finished goods inventory storage at the extraction site. The wells and the storage tanks are all located at the extraction site.

Example 9: A paper manufacturer owns 160 acres of trees. It contracts for certain trees to be harvested for pulp. The trees are cut at the base, delimbed, cut to length, put into an iron mule and dragged to a staging area. Trucks equipped with loading arms load the attached flat bed trailers and trailing pups. The trucks pull the logs five miles over the access road to the public highway and on to the paper mill. Is the travel on the access road a taxable or exempt movement of extracted materials?

Post 3/31/95 Answer: Extractive operations include movement of natural resource material until it first comes to rest in finished goods inventory at the extraction site. In this example, finished goods inventory first comes to rest at the staging site. Subsequent movement from the place of extraction is a taxable operation.

Example 10: A paper manufacturer owns 160 acres of trees. It contracts for certain trees to be harvested for pulp. The paper manufacturer maintains the logging roads or two ruts by installing culverts, adding stone, and grading with its bulldozer. The logging road is entirely within the extracting site. Does the extractive operation exemption include the maintenance of the logging road?

Post 3/31/95 Answer: The paper company is repairing or improving real estate when it repairs the roads. The extractive operations exemption does not include this activity.

Example 11: Mike's Equipment Repair maintains and repairs the equipment used by an iron mining company in their extractive operation.. The mining company sells the iron. Do the tools used by Mike's Equipment Company qualify for exemption?

Post 3/31/95 Answer: Servicers qualify for the exemption given to the extractive operator when they perform an extractive operation. Repair of equipment used in the extractive operation qualifies as an extractive operation and their tools would be exempt from tax.

Example 12: An iron mining company removes tailings from its ore at its processing plant near the mine. The tailings are transported one mile by huge earthmoving trucks to a tailings basin on the company's property. The road is owned and maintained by the mining company. Are the trucks used to transport the tailings taxable? Is the equipment used to maintain the road taxable?

Post 3/31/95 Answer: Property eligible for the extractive operation exemption includes personal property used in depositing tailings from hard rock mining processing. The Department has interpreted this to include movement of the tailings to their final resting place. In this example, movement does not require the use of licensed vehicles so the transportation equipment is exempt.

The road is real property. Equipment and supplies used to maintain real property are subject to tax no matter where it is located.

MANUFACTURER/CONTRACTORS (EXTRACTORS/CONTRACTORS) RAB 93-5:

An extractor is also subject to the manufacturer/contractor rules as defined in RAB 93-5 when the natural raw product being recovered is further processed after first coming to rest in finished goods inventory storage at the extraction site.

NOTE: A contractor who only extracts natural resources for its own use is not an extractive operator as defined in the Act. To qualify for this exemption, the extractor has to sell part of the resources being extracted. (See example 5 above to calculate the tax base of extracted materials used by contractors who only extract for their own use.)

There are two types of manufacturer/contractors as defined in RAB 93-5. See the “Manufacturer/Contractor” section of this text for a detailed discussion.

Type 1:

- Maintains inventory for sale to others
- or
- Makes tangible personal property available for sale to others through a publication or a price list

Type 2:

- No inventory maintained for sale to others
- No publication or price list available

The first example below is a Type 2 manufacturer/contractor. The second example is a Type 1 manufacturer/contractor.

Example 1: ABC company extracts gravel from its own pit. It is crushed so it can be used in road bases. The contractor uses half of the gravel to construct a road and half is sold. What is the tax base of the crushed gravel used in the road contract?

Post 3/31/95 Answer: The tax base of the consumed gravel is the material cost of the raw gravel (fair market value) plus the labor costs to manufacture or crush. The statute states that the consumed or used portion of an extractive operator’s product, other than the manufacturing a product for ultimate sale, is taxed at its fair market value.

Example 2: XYZ Asphalt Company extracts gravel and sand from parcels that it owns. Both resources are maintained in an inventory for sale to others. The company also manufactures asphalt that is available for sale to others through a price list. Sand and gravel is consumed by the company through its asphalt contracts. It is used in making the asphalt and in the preparation of the real estate to receive the asphalt. What is the tax base of the consumed sand and gravel?

Post 3/31/95 Answer: The tax base for the sand and gravel used to prepare the real estate to receive the asphalt is fair market value of the extracted resources per statute. The tax base of the consumed asphalt, which includes the sand and

gravel, is its finished goods inventory value. It makes no difference whether the sand and gravel was extracted from the taxpayer's dune or pit or from the property of another.

There is a difference between a manufacturer/contractor and an extractor/contractor. For the extractor/contractor, the tax base for self use materials will always be "fair market value" regardless if an inventory or price list is maintained.

References: MCL 205.54u

MCL 205.94p

R 205.90

R 205.99

RAB 89-56

RAB 93-5

LR 77-4

LR 80-5

LR 81-1

LR 86-2

LR 88-26

“FARMING OUT” OF INDUSTRIAL PROCESSING FUNCTIONS

Will the IP exemption apply for an entity that purchases equipment, tools, and supplies to be used in industrial processing, but who is not an industrial processor?

PRE-3/31/99: The IP exemption would not be available if the entity did not transform, alter, or modify 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. However, if the entity did qualify as an industrial processor, even if in an unrelated activity, the exemption would be available.

POST-3/30/99: An entity can get the IP exemption if the property is intended for and actually used by an industrial processor in industrial processing. This effectively gives an exemption for those who purchase tooling and other similar property that is subsequently given to another entity for actual use in industrial processing activities.

The following examples illustrate this concept:

Example 1: ABC Manufacturing Corporation is a California based distributor of automobiles. They do no actual manufacturing themselves as all production is farmed out to DEF Corporation, a wholly owned subsidiary located in Detroit, Michigan. ABC Corp. has purchased dies for \$10,000,000 that will be used by DEF Corp. in the actual manufacturing of automobiles. Is ABC Corp. liable for sales or use tax on the purchase of the dies if delivered to them in Michigan?

Pre-3/31/99 Answer: Yes, ABC Manufacturing Corp. would owe sales or use tax on the dies, as they are not an industrial processor.

Post-3/30/99 Answer: The dies would be exempt, as they are used by an industrial processor in an industrial processing activity.

Example 2: Same situation as in example # 1 above, except that ABC Manufacturing Corp. also manufactures paper clips at a small plant in Davenport, Iowa. Is ABC Corp. liable for sales or use tax on the purchase of the dies delivered to them in Michigan?

Pre-3/31/99 and Post-3/30/99 Answer: No, the dies would be exempt for IP. ABC Manufacturing Corp. does qualify as an industrial processor in the unrelated activity of manufacturing paper clips. Also, the dies are used by an industrial processor in an industrial processing activity.

Example 3: GHI Corporation is a book publisher located in Flint, Michigan. They perform composition work, artwork, and graphics in conjunction with the books they sell. However, all the actual printing of the books is done by a printer located in Toledo, Ohio. Is GHI Corp. liable for sales or use tax on equipment or supplies used in performing the artwork, graphics, and composition?

Pre-3/31/99 and Post-3/30/99 Answer: No, these items would be exempt for IP. GHI Corp. is an industrial processor as their activities are part of transforming, altering or modifying the form, composition, or character of property that will ultimately be sold at retail.

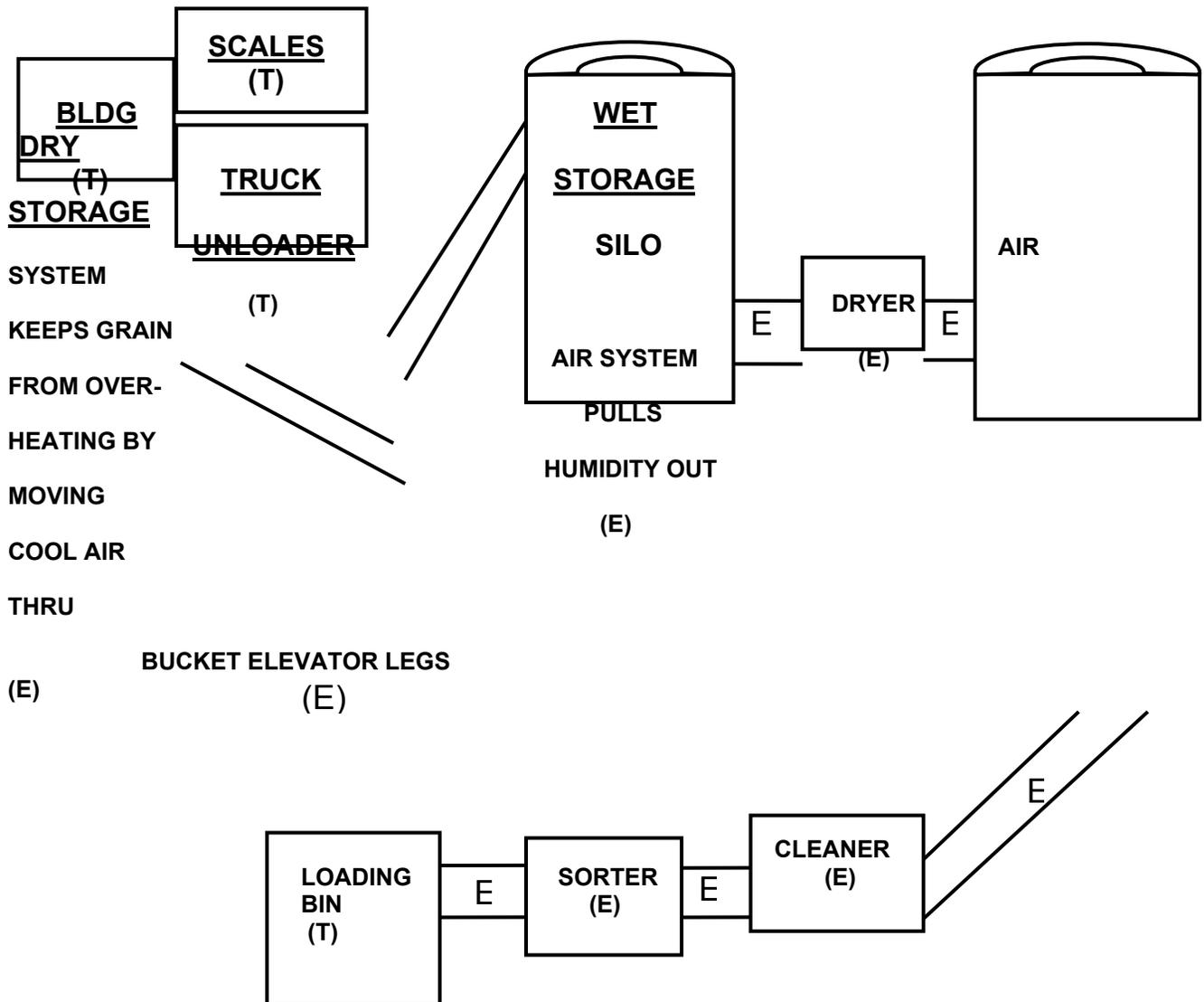
Example 4: JKL Corporation is a distributor of kitchen cabinets located in Ann Arbor, Michigan. They do no actual manufacturing themselves as all production is farmed out to a separate controlled group member, MNO Corporation, located in Grand Rapids, Michigan. JKL Corp. has employees (engineers) permanently on site at MNO Corporation performing quality control functions and product inspection. Is JKL Corp. liable for sales and use tax on the tools and supplies purchased for their engineers?

Pre-3/31/99 Answer: Yes, JKL Corp. would owe sales or use tax on these tools and supplies, as the activities of the engineers would not make them an industrial processor.

Post-3/30/99 Answer: The tools and supplies purchased for this engineering function would be exempt. Any entity is entitled to the industrial processing exemption if the property is used to perform an industrial processing activity for or on behalf of an industrial processor.

GRAIN ELEVATORS

The following drawing shows a typical grain elevator and the areas that would normally be considered taxable (T) or exempt (E).



NOTES:

- 1) The electrical wiring of equipment is personal property and is taxable or exempt depending on where used.
- 2) The actual silo is real property and is taxable.
- 3) IP would not be allowed when drying is performed for farmers, as farmers are not manufacturers. Per statutory changes as of December 17, 1998, the above service would qualify for the Agricultural Production exemption as well as the utilities used in this activity.

- 4) Cleaning equipment used to remove clay from grain would be exempt for industrial processing. This is also true if this equipment is located at a secondary location (not in close proximity to the primary elevator site).

References: LR 86-10

INVENTORY WITHDRAWALS/CONSUMED GOODS

The use tax base of self-produced or purchased products placed into an inventory to be withdrawn for **internal use** or to be **given away at no cost** to an outside party is **material cost**. See the “Samples” and “Inventory Withdrawals/Demonstration” sections of this text.

MICHIGAN WITHDRAWALS:

The above items withdrawn from a Michigan inventory are taxable on material cost regardless of where the item is shipped (see exceptions below). The items are considered to be “used or consumed” in Michigan. If the taxpayer erroneously remits tax to another state, a refund must be requested from the other state.

Items consumed in the performance of optional maintenance contracts or service agreements are considered to be used internally and subject to tax on material cost.

If an item is given away with a minimal charge that is designated as a shipping charge, tax is due on material cost. A shipping charge on a giveaway is not considered to be a sale at retail.

If an item is sold to a customer for a nominal charge that may be less than cost and does not represent a shipping charge, no use tax is due. The nominal charge is considered to be gross proceeds of a sale at retail with sales tax due.

Example:

A company purchases a catalog and charges \$5.00 to its customers for the catalog. The \$5.00 charge is less than the cost of a catalog. Any catalogs shipped out-of-state would be exempt for interstate commerce. Sales tax would be due on the \$5.00 charge for any catalogs shipped to Michigan customers.

If a company sells 1,000 items of its product to a customer and gives the customer an additional 10 items of the product free, the additional 10 items are not considered taxable giveaway items. There is one gross selling price on the 1,010 items. The gross proceeds would be the amount charged for the 1,000 items.

A “tie-in” sale requires someone to first buy tangible personal property in order to receive a different item free. There is an advertisement that an item will be received free at the time of purchase. The advertised item given away with the

“tie-in” sale is not subject to use tax. A portion of the gross proceeds received from the sale is attributed to the free item.

Example:

A gas station advertises in the newspaper or at the pump island that a customer receives a free glass if they purchase 8 gallons of gas. The glass would not be subject to use tax by the gas station owner, since this is an exempt “tie-in” sale.

If a customer purchases a product and receives a free item without expecting to receive a free item, the person giving away the free item must pay use tax on the material cost of the free item. This is not considered a “tie-in” sale.

Example:

A furniture manufacturer with a retail outlet sells a coffee table. The customer is given a can of furniture polish when they buy the coffee table. There was no advertisement that the furniture polish would be given to the customer. The customer was not expecting to receive anything when purchasing the coffee table. The furniture polish given away is taxable on cost.

EXCEPTIONS:

- Inventory withdrawals for the fulfillment of a contract affixing to realty by a manufacturer/contractor are taxable on finished goods inventory value (see the “Manufacturer/Contractor” section of this text).
- Items donated by a manufacturer, wholesaler or retailer to a qualified exempt entity are not taxable. A qualified exempt entity is a nonprofit school, nonprofit hospital, nonprofit home for the care of the aged or children (operated by certain types of organizations), parent cooperative preschool, or church.
- Food items given away are not taxable. This includes prepared food, except for employee meals. Employee meals were considered retail sales subject to sales tax until September 30, 2001. Effective October 1, 2001 employee meals provided during work hours are no longer taxable whether given away or sold to the employee.
- Promotional or packaging material transferred for use in fulfilling a redemption offer (box tops, labels, rebates) **to a person located outside this state are exempt** for resale even if a servicer fulfills the redemption.
- Rebate checks issued to promotional program recipients are taxable at cost. The checks do not meet the definition of promotional materials. The envelope used to mail the check would be exempt if mailed to a person out-of-state, since the envelope meets the packaging material definition.

- Prescription drug samples given away by a manufacturer of prescription drugs to health professionals are exempt. All packaging materials are taxable at material cost and any packaging or material handling equipment may need to be prorated, depending on any other uses of the equipment. See the “**Other Deductions**” manual.
- Prescription drug samples given away by a wholesale distributor to health professionals are exempt.

NOTE: Since the tax base of inventory withdrawals is material cost, the percentage of equipment (with materiality considered) used to produce inventory items that are withdrawn would also be taxable.

NON-MICHIGAN WITHDRAWALS:

Items withdrawn from an inventory **not** located in Michigan and shipped into Michigan may be taxable on material cost with an appropriate credit for any sales or use tax, including local taxes, which had been legally due and paid in another state. If the tax paid was less than the tax imposed by Michigan, the difference in the tax is due.

EXCEPTION: The Michigan Court of Appeals *Sharper Image* case involved catalog mailings from out-of-state sources. The court ruled that the Michigan use tax statute lacks specific language to tax the activity of “distribution”. The court also ruled that Sharper Image did not exercise sufficient control over the catalogs inside Michigan to meet the definition of “use”.

Based on the *Sharper Image* court case, the following conditions must be met for the inventory withdrawal outside of Michigan to be exempt from tax:

- The distribution is made by mail or common carrier.
- The distribution originated from out-of-state.
- The taxpayer has no control in Michigan over the distributed items. Control can be actual physical possession or other control as noted in examples 2-4 below.

This exemption would extend beyond catalogs to include promotional literature, samples, giveaways, etc.

See the “Inventory Withdrawals” flow chart in this text for assistance in determining the use tax base of tangible personal property withdrawn from inventory.

Example 1:

ABC Company gives away brochures to its customers in Michigan. An out-of-state company prints the brochures. The out-of-state printer ships the brochures by mail to ABC Company's customers in Michigan. ABC Company never received physical possession of or title to the brochures nor did it have any control over the brochures in Michigan. The brochures are not subject to tax.

Example 2:

ABC Company gives away brochures to its customers in Michigan. An out-of-state company prints the brochures. The out-of-state printer ships the brochures by mail to ABC Company's customers in Michigan. The mailing package is marked "return to sender". ABC Company never received physical possession of or title to the brochures. Specific mailing instructions, e.g. "return to sender" or "address correction requested", do not constitute control over the brochures in Michigan. The brochures are not subject to tax.

Example 3:

ABC Company hires an out-of-state printer to print advertising supplements. The out-of-state printer ships the supplements to a distributor located in Michigan for further distribution based on guidelines or instructions provided by ABC Company (number of inserts to be distributed at any given time, date of distribution, etc.). ABC Company has sufficient control over the supplements in Michigan; therefore, the supplements are taxable on material cost.

Example 4:

National Corporation, an out-of-state corporation, has nexus in Michigan through various distributors. The distributors give away products of National Corporation as promotional material. National Corporation gives specific instructions to the distributor as to where the product is to be located and what records to maintain relative to the distribution. The distributor has to sign a distribution agreement with National Corporation. National Corporation is subject to use tax on the material cost of the items given away in Michigan, since it has sufficient control over the distributed product (this example assumes there is no sale of products between National Corporation and the distributors).

References: MCL 205.94c, e, and t

R 205.90

R 205.112

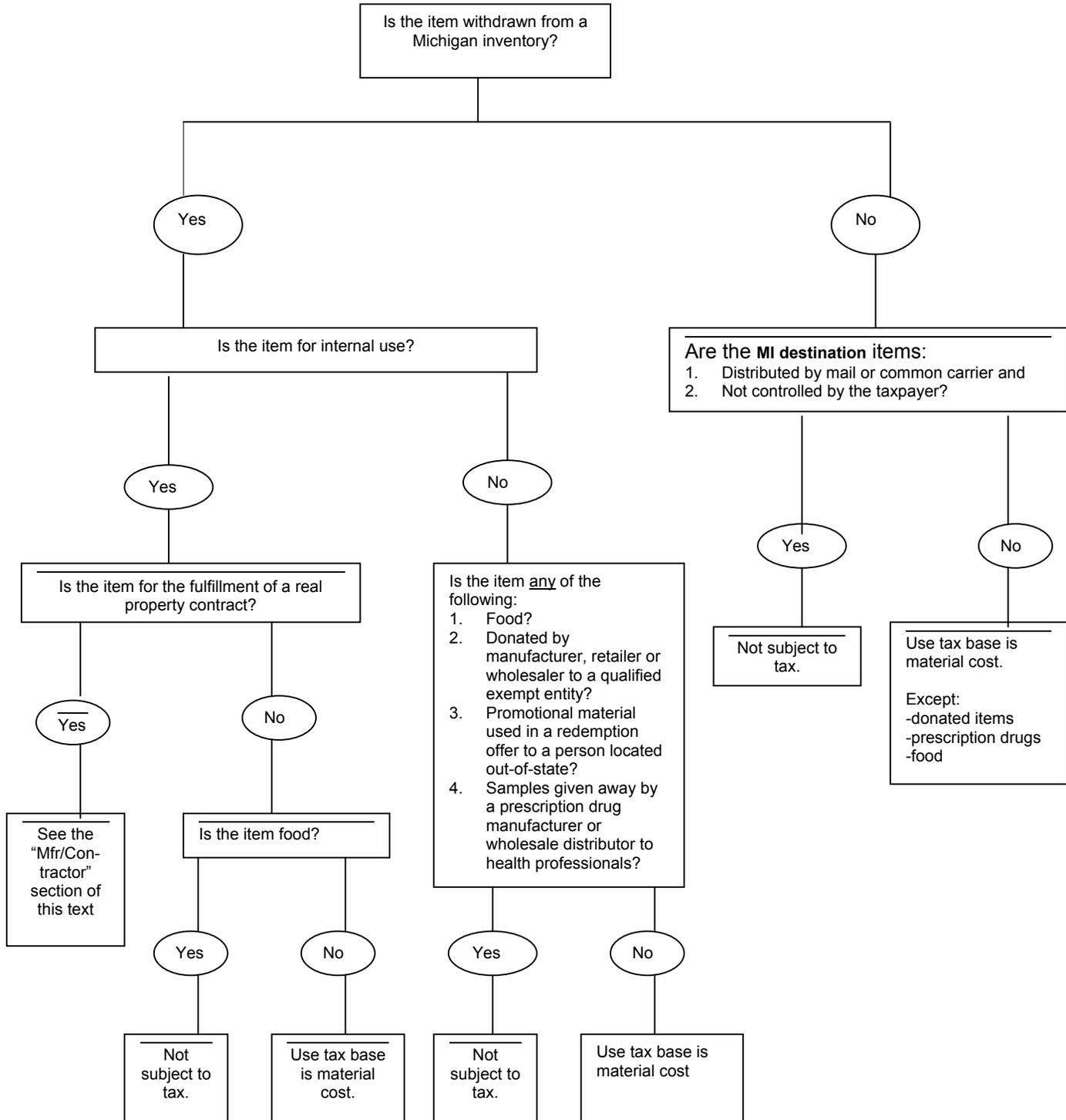
RAB 93-5

LR 73-7

IBM vs. Michigan Department of Treasury

Sharper Image vs. Michigan Department of Treasury
Wilson Sporting Goods vs. Michigan Department of Treasury

**USE TAX BASE OF TANGIBLE PERSONAL PROPERTY
WITHDRAWN FROM INVENTORY**



INVENTORY WITHDRAWALS/DEMONSTRATION

The following discussion applies to manufacturers who self-produce or purchase items exempt for demonstration purposes. This also applies to retailers who purchase inventory type items for demonstration.

Demonstration is the display or operation of a product in order to entice a customer to buy the product.

ALL of the following guidelines must be met to qualify for demonstration purposes:

- 1) The product is being used for bona fide demonstration purposes.
- 2) The sole use of the product is for demonstration.
- 3) The item is not a sample. Title and possession is transferred when samples are given away. (See the "Samples" section of this text).
- 4) The taxpayer is in the business of selling the demo type property.
- 5) **Title is retained by the company using the product for demonstration.**

Some demonstration activities consist of:

- Product display.
- Salesman using the product to show the use or features of the product.
- Customer using the product in the store to see how the product operates.

Some activities that do not constitute demonstration are:

- Advertising of the product.
- Company personnel using the product for their own personal use.

If **all** of the above guidelines are not met, see the "Inventory Withdrawals/Consumed Goods" and "Samples" sections of this text for further guidance.

If a company retains title to the property and the above criteria are met, the item can qualify as demo type property even if independent representatives make the demonstration.

Any shelving, equipment, software, electricity, etc. used in displaying or demonstrating the demo type property is taxable, since those items are not sold in the ordinary course of business.

Any subsequent sale of the item used for demonstration is subject to sales tax on the retail selling price. If the items used for demonstration are eventually given

away, tax is due on material cost unless qualifying for exemption (e.g., a qualified exempt entity).

Examples:

EXEMPT:

- A furniture manufacturer withdraws furniture from inventory. The furniture is used in company showrooms in Michigan and throughout the country. The furniture is used for display purposes only and not used for the manufacturer's own general use at any time. The furniture is eventually sold.
- A chain saw manufacturer has its own salespersons demonstrate chain saws to prospective customers.

TAXABLE:

- A manufacturer and retailer of computers uses inventory items for display and "after market" training purposes.
- A manufacturer of snowmobiles uses the same snowmobile for display and racing purposes.
- Swatch books used by furniture salespersons to display colors and types and grades of fabrics that can be used on a chair (the salespersons are not in the business of selling fabric).
- Carpet samples used by carpet retailers to display color choices, styles and grades.

References: MCL 205.51(b)
MCL 205.94(c)

MANUFACTURER / CONTRACTOR

A **MANUFACTURER/CONTRACTOR** manufactures tangible personal property that they affix to realty or may sell to others. There are two types of manufacturer/contractors as defined in RAB 93-5.

Type 1

- 1) Maintains inventory for sale to others, **OR**
- 2) Makes tangible personal property available for sale to others through a publication or a price list.

Tax Status:

- 1) *Retail sales are subject to sales tax on full selling price.*
- 2) *Use tax base for material withdrawn from inventory and affixed to realty on construction projects is “**FINISHED GOODS INVENTORY VALUE**”.*
- 3) *Equipment and supplies qualify for manufacturing exemption if used in the manufacturing process. Tools used at the construction site do not qualify for exemption unless used to mix, blend, etc.*

“Finished Goods Inventory Value” is given the same interpretation as that given inventory valuation in U.S. Treasury Regulation 1.471-11. (Full absorption method of inventory valuation for manufacturers.)

Type 2

- 1) Inventory not maintained for sale to others, **AND**
- 2) No publication or price list.

Tax Status:

- 1) *Retail sales are subject to sales tax on full selling price.*
- 2) *Use tax base for material affixed to realty is **the direct cost of material and direct cost of labor** to fabricate and assemble property.*
- 3) *The cost of a subprocessing activity by an outside party would be a part of the cost of material for determining the base subject to tax. It does not matter if the subprocess occurs before or after the transfer of ownership to or possession by the manufacturer/contractor.*
- 4) *Equipment and supplies do not qualify for manufacturing exemption.*

Cost of direct materials includes, but is not limited to:

- 1) Raw materials
- 2) Supplies entering into the product
- 3) Supplies consumed in connection with the product
- 4) Freight-In shipping or any costs in getting the material to the point of manufacturing
- 5) Amounts paid for processing by a second party

Cost of direct labor includes, but is not limited to costs incurred in the shop:

- 1) Wages (basic and overtime)
- 2) Vacation and Holiday pay
- 3) Sick leave pay
- 4) Shift differential
- 5) Fringe benefits
- 6) Bonuses
- 7) Commissions
- 8) Health insurance
- 9) Workers' compensation
- 10) Pension and retirement
- 11) Profit sharing
- 12) Payroll taxes
- 13) Payments to a supplemental unemployment benefit plan
- 14) Any other payment incurred on behalf of employees directly engaged in production
- 15) Mixing, combining or blending at the job site prior to affixation
- 16) Includes only the production staff such as hands-on fabrication
- 17) Operation of fabricating machines
- 18) In-process material handling

Costs of direct labor **do not** include:

- 1) Labor used in shipping and receiving
- 2) The direct labor to cut, bend, assemble or install at the job site
- 3) Shop supervision
- 4) Machine maintenance
- 5) Machine repair
- 6) Building maintenance and repair
- 7) Other indirect labor

Finished Goods Inventory Value includes:

- 1) Direct Materials, as defined above
- 2) Direct Labor, as defined above
- 3) Includable Indirect Production Costs:

- Repairs and maintenance costs
- Utility costs
- Rent and taxes on buildings and machinery necessary for production
- Indirect labor and production supervisory wages (components are same as outlined in direct labor)
- Miscellaneous indirect costs including:
 - (a) Indirect materials and supplies
 - (b) Expensed tools and equipment
 - (c) Costs of quality control and inspection
 - (d) Depreciation and depletion incident to production or manufacturing operations or processes
 - (e) Employee benefits
 - (f) Cost attributable to strikes
 - (g) Rework Labor
 - (h) Scrap and spoilage
 - (i) Administrative costs of production
 - (j) Officers' salaries incident to production
 - (k) Insurance costs incident to production

NOTE: The indirect production costs are to be included only to the extent that such costs are incident to and necessary for production or manufacturing operations or processes.

The following costs should not be included in finished goods inventory:

- 1) Marketing, advertising, or selling expenses
- 2) Other distribution expenses
- 3) Interest
- 4) Research and experimental expenses including engineering and product development
- 5) General and administrative expenses incident to and necessary for the taxpayer's activities taken as a whole rather than to production or manufacturing operations or processes
- 6) Salaries paid to officers attributable to the performance of services which are incident to and necessary for the taxpayer's activities taken as a whole rather than to production or manufacturing operations or processes.

The same exemption applies to manufacturer/contractors that applies to regular contractors when tangible personal property is affixed to realty in contracts for:

- 1) Nonprofit hospitals
- 2) Nonprofit housing
- 3) Qualified pollution control facilities
- 4) Church sanctuaries (for purchases made on or after July 22, 1998)

The following definitions will help in determining the type of manufacturer/contractor by deciding if they make their product available for sale to others through a publication or price list.

Price List: A numerical or alphabetical enumeration of goods, wares, merchandise items or services, quoting wholesale and/or retail prices and printed on cards or sheets, presented in loose-leaf form--stapled, stitched or bound.

Publication: Includes, among other things, a catalog, sales pamphlet and sales handbill.

Catalog: A bound, stitched, sewed or stapled book or pamphlet, containing a list and description of goods, wares, merchandise or services, with specific information, with or without a price.

Sales Pamphlet: A printed work concerning goods, wares, merchandise or services, consisting of two or more sheets, stapled, sewed or stitched, with or without price.

Sales Handbill: A printed single sheet (sometimes called a circular or dodger) intended to be circulated and concerning goods, wares, merchandise or services.

Examples of Manufacturer/Contractor:

Asphalt Manufacturer/Contractor (Type 1)

Some asphalt companies manufacture asphalt that is both sold at retail and consumed in contracts. When the company consumes this asphalt, use tax is due on the inventory value. No distinction is made between "special blends" not sold at retail and regular blends. Use tax is due on the inventory value of both.

For asphalt manufacturers, determination has been made that cold patch and hot patch are two distinct products. This distinction is important when determining the tax base when the manufacturer acts as a contractor. For example, having an inventory of cold patch does not constitute having an inventory for hot patch. The tax base for the manufacturer, when acting as a contractor, would depend on which type of manufacturer/contractor they are, based on the criteria set forth in RAB 93-5.

In this example, if the manufacturer maintained an inventory of cold patch for sale to others, the tax base when the manufacturer used the cold patch in a contract would be "finished goods inventory value" (Type 1).

This same manufacturer could produce hot patch for their own use and not make it available for sale to others. The tax base for the hot patch would be the direct cost of labor to manufacture and the direct cost of material (Type 2). Maintaining

the cold patch inventory for sale to others did not make this manufacturer a Type 1 manufacturer/contractor for the hot patch.

A business can be engaged in more than one distinct business activity and the tax base for the manufacturer/contractor would depend on the circumstances for that particular part of the business. For example Company ZYX is a manufacturer, a retailer and a contractor:

Situation 1 - Company ZYX purchases kitchen cabinets for retail sale and may also act as the contractor when installing the cabinets. The tax base when acting as the contractor is the material cost.

Situation 2 - Company ZYX also manufactures a custom cabinet for the bathroom and maintains an inventory of their manufactured cabinet. If they need additional cabinets, they may purchase a standard cabinet for installation from an outside source. Their cost, when acting as a contractor, would be “finished goods inventory value” on the cabinets that they manufactured and material cost on the cabinets that they purchased (Type 1).

Situation 3 - By word of mouth, some customers have discovered that Company ZYX has the equipment to manufacture hardwood flooring. This specialty flooring is not available for sale through a publication or price list. Each floor is custom made to the customer’s specifications. The tax base when Company ZYX affixes the flooring to realty is the direct cost of material and the direct cost of labor to manufacture. The inventory of the wood products, including the standard cabinets that they either manufactured or purchased, in Situation 2 does not constitute inventory for the flooring when determining the tax base for the company when they affix the flooring to realty (Type 2).

When we examine the above three situations to ascertain the availability of the industrial processing exemption on equipment and utilities consider:

Situation 1 - In this situation Company ZYX is acting as a retailer and is not entitled to the processing exemption.

Situation 2 - Company ZYX is entitled to the processing exemption on the cabinets manufactured for retail sale or used in contracts (Type 1).

Situation 3 - Company ZYX would not be entitled to the processing exemption if they install all the custom hardwood flooring that they manufacture. However, if they make retail sales of the custom flooring, they would be entitled to the exemption based on a percentage determined by comparing the retail sales to the contract sales.

If a company bills “time and material” but has a subcontractor do the actual affixation to realty, the company still qualifies as a manufacturer/contractor. The subcontractor is never billed for the material; therefore, the manufacturer/contractor remains liable for any tax due following the guidelines in RAB 93-5.

If in the above illustration, materials are billed to the subcontractor, then the manufacturer is making a retail sale and does not qualify as a manufacturer/contractor. But the manufacturer/retailer would still qualify for industrial processing.

Examples of costs to be included for manufacturer/contractors:

Some asphalt manufacturer/contractors will use the asphalt removed from the current road bed in the production of the new asphalt since the disposal of this recycled (used) asphalt is very costly. The cost of transporting this recycled asphalt product to the asphalt plant should be included in the computation of the direct material cost as freight in. Included in this computation would be depreciation, oil, gas and maintenance of the roto mill. Also the labor costs of the roto mill operator would be included. These costs would be included for both Type 1 and Type 2 manufacturer/contractors.

Engineering/detailing costs that are related to manufacturing should be included in direct material costs for a manufacturer/contractor that fabricates and installs steel beams but makes no retail sales. This would include the cost of blue prints, certification tests and architectural design costs, whether done in house or by an outside company. These costs would be part of the direct material costs because they are necessary to determine what material to purchase for the job (what strength or grade of steel). These costs would be included for both Type 1 and Type 2 manufacturer/contractors.

The following are examples that demonstrate the difference between contractors, manufacturer/contractors and extractors:

- 1) The tax base for contractors who withdrew from their own pit for use in a contract and not for resale would be zero. The labor to extract would not be included. This taxpayer would be considered a contractor not an extractor.
- 2) If they withdrew from the pit of another, for use in a contract, their cost for tax purposes would be the amount paid to the pit owner for the material. The labor to extract would not be included. In this case the taxpayer would be considered a contractor not an extractor.
- 3) If a contractor bought a sand hill, the tax base would be the cost of the material. This taxpayer is a contractor not an extractor.
- 4) If an extractor/manufacturer/contractor maintained a standard inventory of aggregate for sale to others, their tax base, when using aggregate in performance of a contract, would be the inventory value – whether or not they extracted from their own pit or the pit of another.

PERSONAL USE OF MANUFACTURED PRODUCTS

If a manufacturer/contractor fabricates steel beams and then installs the beams in their own facility, the tax base of the beams would be:

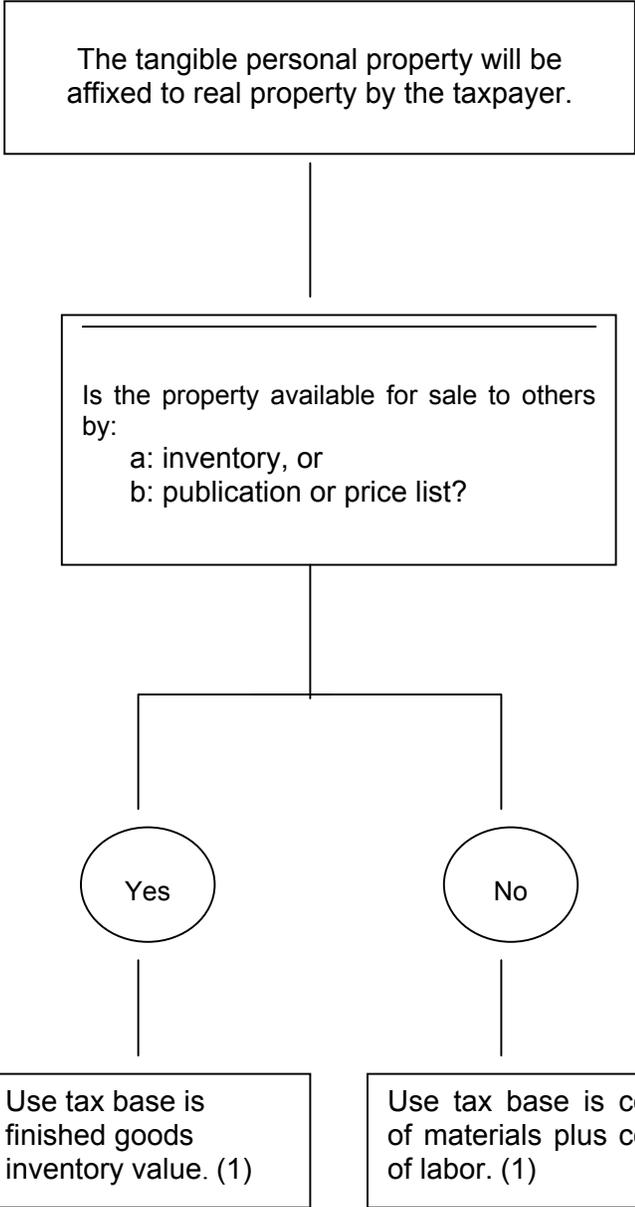
- Type 1: Finished goods inventory value
- Type 2: Material cost and direct cost of labor to manufacture

Refer to RAB 93-5 for additional examples of the two types of manufacturer/contractors.

See the following flowchart for help in determining the use tax base of tangible personal property (that will be affixed to realty) manufactured, fabricated or assembled by or for a taxpayer.

References: MCL 205.92(f)
RAB 93-5

**USE TAX BASE OF TANGIBLE PERSONAL PROPERTY
MANUFACTURED, FABRICATED, OR ASSEMBLED
BY OR FOR A TAXPAYER**



MATERIAL HANDLING

Pre-3/31/99 material handling was covered by limited statutory language and application of Rule 40.

MCL 205.94 (g) **Industrial processing.** Property sold to the following:

(i).... Industrial processing does not include receipt and storage of raw materials **purchased** or extracted by the user or consumer, or the preparation of food and beverages by a retailer for retail sale.

Rule 205.90:

(3) The industrial processing exemption does not include:

(d) Tangible personal property used for receiving and storage of materials, supplies, parts and components purchased by the user or consumer.

(4) The following examples of nontaxable sales illustrate the application of the industrial processing exemption:

(f) Machinery, equipment and materials used within a plant site for movement of tangible personal property in process of production.

(5) Industrial processing includes the following activities:

(g) Production material handling.

(6) Industrial processing does not include the following activities:

(a) Purchasing, receiving and storage of raw materials.

(b) Sales, distribution, warehousing, shipping and advertising departments.

The **BEGINNING** of the industrial process has been described as the “point at which the materials enter the first transformation, alteration or modification.” The **END** has been described as “the point where the recognizable unit or product exists in a form as seen by the ultimate consumer or an additional processor.”

Material handling equipment used by a manufacturer to move the production material from one process to the next process is exempt, within the same facility or same legal entity. This includes the material handling equipment used in shipping and receiving in-process material to a separate location of the same legal entity for subprocessing. Subsidiaries are considered unrelated entities when evaluating the tax status of material handling equipment. Vehicles licensed and titled for use on public highways are not eligible for the industrial processing exemption.

Receiving departments are taxable areas when receiving **purchased** materials. The shipping and receiving activity for in-process materials would be an exempt activity when conducted within the same legal entity. The in-process materials may come from another plant location or division of the taxpayer. The same

shipping and receiving activity conducted with a different legal entity is considered taxable. This dual shipping and receiving activity will require treating the same equipment as taxable and nontaxable.

The movements from raw material inventory to a staging area or an area adjacent to the processing equipment would be a taxable movement of the material. The exempt activity would not start until the raw material has entered the first step (move) prior to the first step of transformation, alteration or modification.

Post-3/30/99 periods are covered by statutory language that defines the beginning and ending of the industrial processing exemption. Some items that were taxable before 3/31/99 may be exempt after 3/30/99. The primary change is establishing the beginning and ending of the industrial processing exemption. Keep in mind that the exemption begins once the items are removed from raw material inventory and ends when the products first comes to rest in finished goods inventory.

Types of material handling equipment:

- Fork lift trucks
- Overhead cranes
- Low boy skid trucks
- Conveyors
- Electronic guided tracking systems

General types of material handling movements :

- Material handling equipment used in the receiving of **purchased** materials is taxable. **Pre- and Post 3/31/99.**
- Movement of the **purchased** material to raw materials inventory is taxable. **Pre- and Post 3/31/99.**
- Movement of the raw materials to an area adjacent to the production machinery is taxable **Pre-3/31/99. Post-3/30/99 EXEMPT.**
- Movement of the material from an area adjacent to the production machinery, or from inventory, to the production machinery is exempt. This is the first step (move) before production. **Pre- and Post 3/31/99.**
- Movement of in-process materials from one machine or production process to another machine or process is exempt. **Pre- and Post 3/31/99.**
- Movement of the completed product to finished goods inventory is generally taxable **Pre-3/31/99. Post-3/30/99 EXEMPT.**

- Movement of the completed product from finished goods inventory to the shipping area is taxable. **Pre- and Post 3/31/99.**
- Material handling equipment used in the shipping functions of finished goods is taxable. **Pre- and Post 3/31/99.**
- Within the same legal entity, the material handling equipment used by a manufacturer in the shipping and receiving functions of in-process materials/goods is exempt when the materials are sent out and returned for subprocessing. **Pre- and Post 3/31/99.** See RAB 2000-4.
- Between different legal entities, subsidiary or unrelated company, the material handling equipment used by a manufacturer in the shipping and receiving functions of in-process materials/goods is taxable when the materials are sent out and returned for subprocessing. **Pre and Post 3/31/99.** See RAB 2000-4.
- The shipping and receiving functions of the different legal entity subprocessor are taxable, as these functions are not considered exempt in-process material handling movements. It is raw material when received by the subprocessor and a finished product of the subprocessor when shipped out. **Pre- and Post 3/31/99.**
- Material handling equipment used for shipping from one plant (division) to a second manufacturing facility (division) of the same company is considered exempt as long as the product is still going through the process of production and has not reached the completed product that is marketed by the company. **Pre- and Post 3/31/99.**

Usually, in the industrial processing audits the material handling equipment will be used in both the taxable and nontaxable areas. The audit solution is to determine a taxable/nontaxable percentage of use.

Methods that can be employed to determine the taxable/nontaxable percentages:

- Number of taxable movements compared to the total number of movements
- Amount of time used in the taxable movements to the total time for all movements
- Specific allocation - number of pieces of equipment in the taxable areas compared to the total number of pieces of equipment
- Specific identification with a taxable area or department

Actual costs associated with taxable and/or exempt areas or activities are quite often available through cost accounting records.

MISCELLANEOUS

Situations may occur during audits where the availability of an industrial processing exemption may be in question. Below are some examples:

- A road builder entered into a contract to build an asphalt highway. The contractor sets up a batch plant at the job site to manufacture the asphalt. The batch plant is taxable.
- A magazine distributor picks up, shreds, and bales unsold magazines. The shredded magazines are sold to a paper mill. The shredding machine is exempt for industrial processing. LR 86-25

Pre-3/31/99 - The baler is taxable, since the sole purpose is to facilitate shipment. If the purchaser required the product be baled and banded, the equipment would be exempt.

Post-3/30/99 – The baler is exempt, because the baling and banding process occurs prior to the product coming to rest in finished goods inventory storage.

In the following scenarios, a roto mill is used to break up existing road surface, so it can be removed from the site. The site is then prepared for a new road surface.

- A road contractor is hired to replace a section of a highway. The contractor sells the crushed road surface material to a purchaser who will use it to make new road surface material.
- An asphalt manufacturer/contractor uses a roto mill at the job site to crush the asphalt. The crushed asphalt is taken to their manufacturing plant and recycled into new asphalt that is to be used for a future contract job.
- An asphalt manufacturer/contractor uses a roto mill at the job site to crush the asphalt. The crushed asphalt is taken to their manufacturing plant and recycled into new asphalt to be resold to a road contractor.
- ABC Company is hired by an asphalt manufacturer to remove asphalt from the highway. The asphalt manufacturer provides the company with a roto mill that crushes the asphalt so it can be recycled.
- An asphalt manufacturer-contractor removes asphalt from a highway and uses a roto mill at the job site to crush the asphalt. The crushed asphalt is taken to their manufacturing plant and recycled into new asphalt.

In the above situations the roto mill is taxable. The companies are using the roto mill to alter real property and the crushing of the asphalt facilitates transportation of the product. The fact that the form, composition, or character is changed is incidental to the service of removing the asphalt from the existing road surface.

PACKAGING EQUIPMENT

Pre-3/31/99:

NONFOOD INDUSTRY

For all nonfood processors, industrial processing ends at the “point where the recognizable unit or product exists in a form as seen by the ultimate consumer or an additional processor”. Depending upon the customer that the product is sold to, this will be different.

For instance, a retailer who sells items in bulk will require different packaging than the retailer who sells in individual units. A drug store will want paper towels in individual rolls, while a warehouse club will want those same paper towels packaged in groups of eight individual rolls. For the drug store product, industrial processing ends when the single roll of paper towels is wrapped. For the warehouse club, industrial processing ends when the eight individually wrapped rolls are packaged together as one unit. Another example is a car manufacturer purchasing oil filters that requires the product to be individually bagged and shipped in bulk containers, while the auto parts store will want the oil filters boxed for individual sale. For the car manufacturer, processing ends when the oil filter is bagged and for the auto parts store, processing ends when the oil filter is placed in the individual box.

Any equipment used to further package or move the completed product is taxable “one step beyond” the end of the industrial process. See the “Material Handling” section of this text. How do we determine “one step beyond”? It is not necessarily where there is a definite or visual break in production, such as the end of a conveyor, but it is **one step (move) after “the point where the recognizable unit or product exists in a form seen by the ultimate consumer or an additional processor”**. In our example above, “one step beyond” occurs when the individually wrapped paper towel rolls are **moved** from the wrapping machine. This move can be made by a short conveyor ride, by a forklift or another piece of equipment. Any machinery used to further package, palletize or ship the carton of individual paper towel rolls is taxable packaging equipment.

For the manufacturer who sells their product via mail, the equipment that **moves** normally separate items into a larger shipping container will be the final step in the exempt process. For example, a manufacturer of tulip bulbs sells its product in small plastic bags at retail outlets. It is also engaged in mail order sales where it is required that these plastic bags of tulip bulbs be boxed for further shipment. The equipment that **moves** the plastic bags of tulip bulbs to the boxing process would be the last operation to qualify for the IP exemption.

The following are examples of taxable packaging equipment for nonfood processors:

- Staple guns
 - Tape dispensers
 - Equipment for boxing completed products
 - Shrink wrappers
 - Palletizers
 - Banding machines

The same equipment may be used in both taxable and exempt packaging operations. The shrink wrap machine that wraps the unit of eight rolls of paper towels for the warehouse club may also shrink wrap twelve units of eight rolls to facilitate the shipping of those packages. Barcode/UPC machines may also be used in both taxable and exempt operations. If it is required that the recognizable unit in the form seen by the ultimate consumer or additional processor has a barcode, the barcode/UPC machine would be exempt for industrial processing. If the barcode is placed on a shipping container, the barcode machine is taxable. Methods to determine taxable/nontaxable percentages of use are discussed in various sections of this text and can also be applied to determine the taxable portion of packaging equipment.

FOOD PROCESSORS

The *Kellogg's* case has established that manufacturers of food for human consumption are allowed an exemption for all packaging equipment because the functions of casing, palletizing and shrink wrapping are “necessary to preserve the marketability of the product”.

Post-3/30/99:

For all processors, food and nonfood, industrial processing ends “when finished goods first come to rest in finished goods inventory storage”. This means that all the equipment the processor uses for the preservation or maintenance of a finished good before it first comes to rest in finished goods inventory storage will be exempt.

For instance, a sale of paper towels to a drug store will involve the packaging of the towels in individual rolls. If the towels are shrink wrapped and boxed before placement in finished goods storage the equipment will be exempt.

Any equipment used to further package or move the product after it is placed in finished goods inventory is taxable. For the drug store, when the paper towels

are taken from finished goods storage and shrink wrapped or boxed prior to shipment, the equipment is taxable.

A manufacturer of tulip bulbs sells its product in small plastic bags at retail outlets. It is also engaged in mail order sales where it is required that these plastic bags of tulip bulbs be boxed for further shipment. The equipment that moves the plastic bags of tulip bulbs from the finished goods storage to the boxing process would be taxable.

The same equipment may be used in both taxable and exempt packaging operations.

Barcode/UPC machines may also be used in both taxable and exempt operations. Methods to determine taxable/nontaxable percentages of use are discussed in various sections of this text and can also be applied to determine the taxable portion of packaging equipment.

The packaging function is illustrated for processors on the following chart.

References: MCL 205.54t(7)(a)

MCL 205.94o(7)(a)

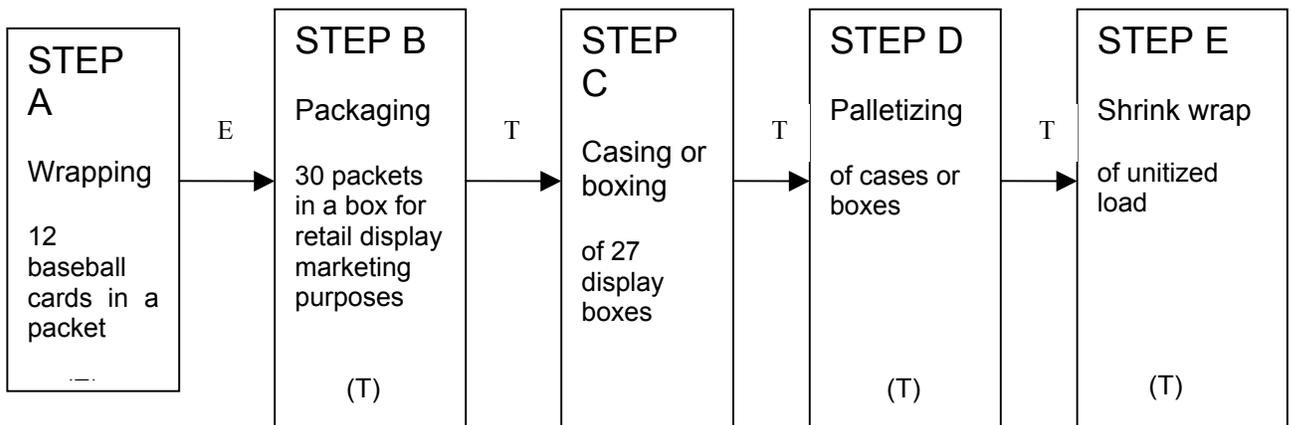
R 205.90(6)(b)

PACKAGING FUNCTION

Pre-3/31/99:

I. THE TAXABILITY OF THE PACKAGING FUNCTION FOR A NONFOOD MANUFACTURER

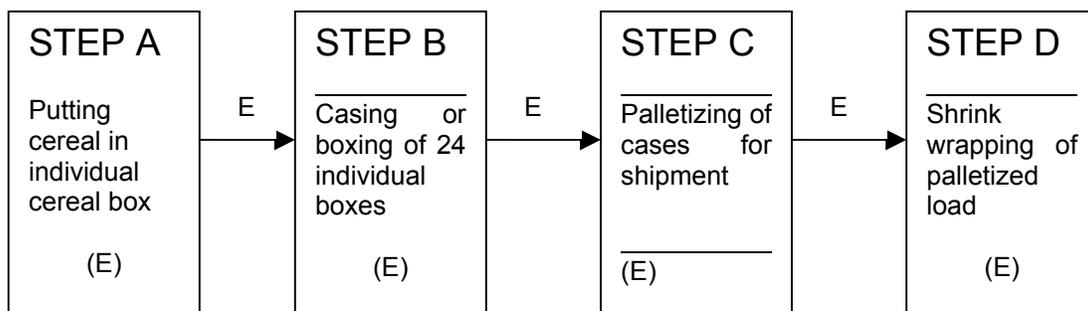
This example uses a baseball card manufacturer, but would be applicable to any manufacturer of a nonfood item.



NOTE: A finished product exists after step A (a marketable product as it will appear on the retail shelf). All subsequent packaging operations are taxable.

II. THE TAXABILITY OF THE PACKAGING FUNCTION FOR THE FOOD INDUSTRY

This example uses a cereal manufacturer, but would be applicable to any manufacturer of food for human consumption exempt by statute.

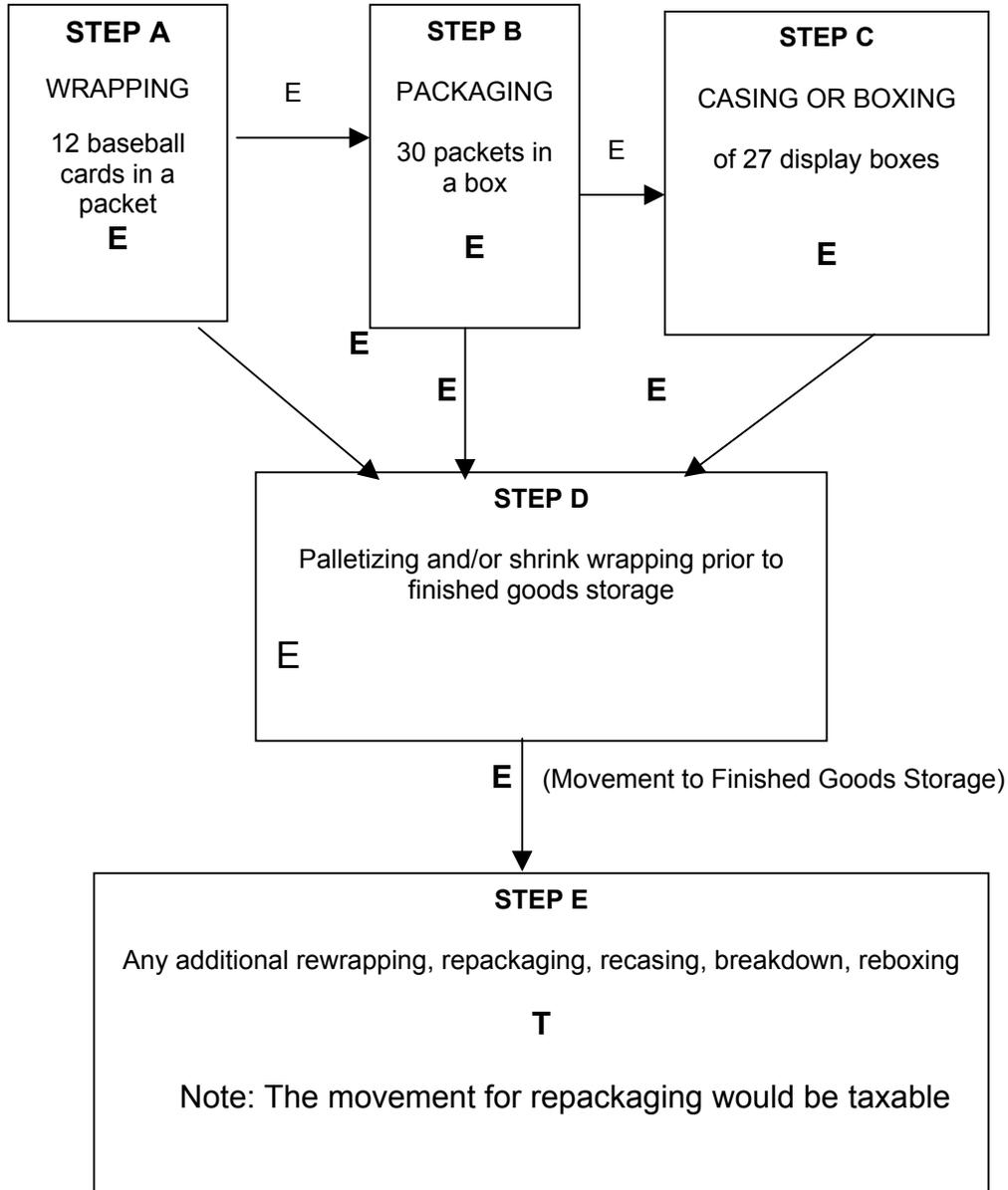


NOTE: All packaging functions for the food industry would be exempt per the *Kellogg* case to preserve the marketability of the product including the nonalcoholic beverage bottling industry.

Post-3/30/99:

THE TAXABILITY OF THE PACKAGING FUNCTION FOR A MANUFACTURER

This example uses a baseball card manufacturer, but would be applicable to any manufacturer.



PACKAGING MATERIALS

Pre-3/31/99 and Post-3/30/99

Letter Ruling 82-3 states that **nonreturnable** containers used to ship and deliver manufactured products are exempt. One time use shipping containers, packaging materials, shrink wrap, bags, tags, tape, staples, steel banding and similar shipping materials are exempt from tax for resale, as they accompany the item manufactured and sold.

Returnable containers are taxable unless they are used for:

- In-process storage
- In-process movement within the plant
- In-process movement between divisions

Nonreturnable containers and other shipping supplies used to ship and deliver products to a subprocessor that is a separate legal entity are taxable. Machinery and equipment used for this function are also taxable.

Nonreturnable containers and other shipping supplies used to ship and deliver products to a subprocessor that is the same legal entity (e.g. division) are nontaxable because they are in-process material handling. Machinery and equipment used for this function are also exempt.

If the same containers are used in both taxable and exempt movements, an evaluation should be made based on any of the methods described in the "Material Handling" section of this text.

DUNNAGE

Materials used to aid the shipping or transportation function are taxable. Any materials used to prevent containers from slipping or shifting during transportation such as bracing, padding or wedges (also known as dunnage) which are thrown away when the containers reach their destination are taxable. Dunnage is normally used in railcars and the trucking industry.

Dunnage is taxable if used **exclusively** on trucks or railcars transporting in-process materials to a subprocessor that is a separate legal entity. Dunnage is exempt if used for in-process storage or movement within or between plants operated by the same legal entity.

See the "Packaging Equipment" section of this text for taxability of packaging equipment.

References: R 205.68 LR 82-3
 RAB 2000-4 VI(10)

LR 86-13

PERCENTAGE APPLICATION

Pre-3/31/99 & Post-3/30/99

Public Acts 116 and 117 amended the Sales and Use Tax Acts, retroactive to 3/31/95, to allow apportioning the tax base to the extent the property is used for industrial processing purposes. The percentage of taxability will be determined based on a reasonable formula or method approved by the department.

Prior to Public Acts 116 and 117 the percentage allocation was based on Rule 40 "Industrial Processing". The Rule states "where the same tangible personal property can be used or consumed in the industrial processing area and 1 or more other areas, the tax will apply to such property unless it can be determined and substantiated to the satisfaction of the Revenue Division, Department of Treasury that a percentage or other apportionment thereof is equitable and practical".

References: MCL 205.54t(2) and y(2)
MCL 205.94o(2) and r(2)
R 205.90

POLICY (OR GOODWILL) ADJUSTMENT

DESCRIPTION: Policy adjustment occurs when a manufacturer (or their third party representative) repairs or replaces tangible personal property for a customer under the following conditions.

- The repair is free of charge to the customer.
- The repair is made after the original manufacturer warranty period has expired.

Policy adjustment may also be known as “goodwill service” or “secret warranty.” It is performed to keep customers happy and maintain market share.

TAXABILITY OF PARTS REPLACED UNDER POLICY ADJUSTMENT: It is our position that parts provided free of charge to customers, and not covered by the original manufacturer’s warranty, would be subject to sales or use tax. The tax base would be:

- Cost of the part if the manufacturer performs the repair.
- The price billed to the manufacturer for parts if a dealer or other third party representative performs the repair.

NOTE: Do not confuse policy (goodwill) adjustments with parts supplied by a manufacturer under the original manufacturer’s warranty, federally mandated recalls, or company initiated recalls. Parts provided by a manufacturer under any of these three programs would not be subject to sales or use tax.

References: *General Motors Corporation vs. Michigan Department of Treasury*

PRINTED MATERIAL SOLD WITH OR FOR MANUFACTURED PRODUCTS

Pre-3/31/99 and Post-3/30/99:

EXEMPT:

Printed material that is a **necessary accompaniment** to a sale and **for the benefit of the customer** (e.g., installation instructions, assembly instructions, parts list, operating manuals, safety brochures, list of service centers, service manuals) is exempt for resale by the manufacturer.

A warranty statement is a nonreturnable item and considered to be an exempt necessary accompaniment of the product.

All labels that are directly placed on the final product or final product containers are exempt for resale (e.g., bar code labels, UPC labels, mailing/shipping labels, advertising labels).

TAXABLE:

Printed material serving as an **administrative** or **sales promotion** is taxable (e.g., warranty registration certificate, product survey, accessories parts catalog, advertising brochures, product catalogs). Printed material used for the **manufacturer's benefit** is taxable.

A warranty registration certificate is a returnable item and is taxable.

Bills of lading and packing lists are taxable whether they accompany the product or not, since they serve an administrative and shipping function.

PARTIALLY EXEMPT:

When the warranty statement and warranty registration certificate are combined, apply a reasonable percentage of taxability for the returnable warranty registration certificate.

References: R 205.94
LR 86-16

PRINTERS

SALES TAX:

The sales of the following items are exempt from sales tax:

- 1) A newspaper or periodical admitted under federal postal laws and regulations effective September 1, 1985 as second-class mail matter or
- 2) A controlled circulation publication or qualified to accept legal notices for publication in this state, as defined by law, or
- 3) Any other newspaper or periodical of general circulation, if: (a) established not less than 2 years, and (b) published not less than once a week.
- 4) Supplements delivered directly to the newspaper or periodical to be distributed as part of the newspaper or periodical.
- 5) Service sales where the printer is merely printing on stock furnished by the customer. The customer must provide the paper as well as the layout, composition, etc. For example, if the aforementioned criteria are met, the printing of business cards on customer furnished stock would be exempt.

NOTE: the federal postal laws and regulations were amended in 1996. Due to reform changes within the postal service, "second class" has been renamed "periodical". "Periodical" is designated for newspapers and other publications. All "second class" *categories* remain the same. These regulations became effective July 1, 1996.

Also, due to these same postal law and regulation changes, "controlled circulation publications" are now classified as "requestor publications".

Due to these changes, until such time as the sales and use tax acts are amended, see your supervisor if you have questions regarding the taxability of certain publications.

USE TAX:

A printer qualifies as an industrial processor when printing most products sold.

EXEMPT NEWSPAPERS AND PUBLICATIONS

A printer does not qualify for industrial processing when printing the exempt newspapers and publications mentioned in items 1) through 3) above under

sales tax. However, the paper and ink, which become a component part of the exempt publication, would not be subject to sales or use tax on cost. This would include the cost of paper and ink used to produce the newspaper advertising supplements.

The following items used to produce exempt publications would be taxable to the printer at cost:

- 1) Fixed Assets
- 2) Utilities
- 3) Other consumable supplies, etc.

These items would normally be taxed based on a percentage of exempt publication sales divided by total sales (or some other equitable method).

The full IP exemption would apply for the manufacture of newspaper or magazine advertising supplements.

NOTE: PA 490 and 491 of 1998 amended the laws after December 1993 to exempt tangible personal property used or consumed in producing a newspaper or periodical that is published **14 times or less per year**. Therefore, the paper, ink, machinery, equipment, power, etc. used in creating a newspaper or periodical, such as alumni magazines, that is published 14 times or less per year are exempt.

PERSONAL USE OF MANUFACTURED PRODUCTS

Most printers print letterhead, envelopes, business cards, calendars, promotional materials, etc. for their own use. The recent *IBM* case in the Court of Appeals indicated that the proper use tax base for these items is raw material cost. No industrial processing exemption would exist for utilities, fixed assets, etc. used to manufacture these self consumed items.

See the "Inventory Withdrawals/Consumed Goods" section of this text for further discussion.

References: MCL 205.54a(f)
MCL 205.94(l) and o(v)
R 205.113
RAB 88-33
LR 80-6
LR 86-28
LR 87-36

PROTOTYPES

Pre-3/31/99:

The development, design and manufacture of a prototype by the industrial processor are exempt activities pursuant to Rule 40 (MAC R205.90). For example, if one of the automotive companies developed their own auto-related prototype, this activity would be industrial processing.

The automotive companies define **PROTOTYPE** as any part or unit that is not in production.

Prototypes are also an issue for servicers who are not manufacturers of the part or unit for which the prototype is being developed. The sales and use tax statutes provide that a servicer must be acting as an "industrial processor" to obtain the industrial processing exemption. "Industrial processor" is defined in the statutes to be "a person who transforms, alters or modifies tangible personal property by changing its form, composition or character for ultimate sale at retail or sale to another industrial processor for further processing and ultimate sale at retail".

Critical analysis must be given to whether or not there is an ultimate sale at retail. A common scenario is where a manufacturer takes designs or prints to a servicer and contracts for the building of a prototype. In these scenarios, the prototype is a custom made item which is sold at retail to the manufacturer. In other words, the manufacturer is seeking the tangible prototype as the **real object** of the transaction. As a result, the servicer is entitled to industrial processing exemption on its purchases to manufacture the prototype.

In contrast, a second common scenario is where a manufacturer does not take designs or prints to the servicer, but instead asks the servicer to provide an engineering or design solution to a problem. The servicer frequently will build one or more prototypes, which become the property of the manufacturer and are often used to test the design or engineering solution. In these scenarios, the prototype is nothing more than a manifestation of the service of engineering or designing a solution to the manufacturer's problem. In other words, the manufacturer is seeking the service of an engineering or design solution as the **real object** of the transaction. As a result the servicer is not entitled to an industrial processing exemption on its purchases to make the prototypes.

Two Michigan Tax Tribunal cases of prototype nature have been decided. Each case has special facts and circumstances that contribute to the rulings issued. We would look for the existence of these same special facts and circumstances before following the rulings of the Tribunal for another taxpayer.

The first case is *Specialized Vehicles, Inc. vs. Michigan Department of Treasury*. The important fact/circumstance in this case is that Specialized Vehicles built its prototype largely by modifying a vehicle owned by its customer. The Tribunal ruled that Specialized Vehicles, Inc. was not entitled to the industrial processing exemption.

The second case is *Creative Industries Group, Inc. vs. Michigan Department of Treasury*. The important fact/circumstance in this case is that Creative Industries' customer originally issued a purchase order for design/engineering services, and later placed an addendum to the purchase order for building the prototype from the design created earlier. The Tribunal ruled that Creative Industries was entitled to the industrial processing exemption. The addendum is treated as a separate transaction from the engineering/design purchase order. It is for custom building of an item for which the customer provided the design.

Post-3/30/99:

Prototypes used to be an issue for servicers who were not manufacturers of the part or unit for which the prototype was being developed. After 3/30/1999 the definition of an industrial processor was expanded to include "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".

Prototypes developed by servicers for industrial processors are now **exempt** as research or experimental activity. Research or experimental activity is defined as "activity incident to the development, discovery, or modification of a product or a product related process". (See Quality Control/Research or Experimental/Engineering section of this text.)

"Product" as defined in the General Sales Tax Act MCL 205.54t(7)(c) and Use Tax Act MCL 205.94o(7)(c) includes but is not limited to a prototype, pilot model, process, formula, invention, technique, patent, or similar property, whether intended to be used in a trade or business or to be sold, transferred, leased, or licensed.

QUESTIONS & ANSWERS

- 1) **Question:** I do research and design for a company. I provide the company with my design information, but do not provide any tangible personal property to the company. Is there any sales tax due on this service?

If I purchase parts and/or equipment that I use as part of my research and development, can I claim exemption from sales tax for these parts and/or equipment? If so, what is the exemption?

Answer:

Pre-3/31/99:

When operating in this manner you are operating as a servicer. You would not collect sales tax as you are not making a retail sale. However, as a servicer, you are responsible to pay tax on whatever materials, equipment and supplies are purchased to perform your service. Refer to the "Computers Used in Industrial Processing" section of this text for the CAD/CAM exemption for servicers.

Post-3/30/99:

As a servicer working on behalf of an industrial processor you would not pay tax on any materials, equipment and supplies. Refer to the "Computers Used in Industrial Processing" section of this text for the CAD/CAM exemption for servicers.

- 2) **Question:** I do research, design and build a product for a company based on their requirements. I purchase parts and build a product for a company based on their requirements. I purchase and build the product using my design. I then provide the product to the company.

Is sales tax required on the cost of the materials or the total charge for developing the product?

Can the company claim sales tax exemption if the product is a prototype for a product that they will be producing (e.g., I make a circuit board which they are going to manufacture and sell)?

Can the company claim sales tax exemption if the product is used as equipment in their production process (e.g., I make a piece of equipment which they use to test their product before they sell it)?

Can the company claim sales tax exemption for the product if not directly used in manufacturing (e.g., I make a computer that is used in their engineering lab)?

Answer:

Pre-3/31/99:

When you take an order from a manufacturer to design and build a product to their specifications and purchase materials needed to build the product, you are operating as an industrial processor if you sell that product to the final consumer. You are required to have a sales tax license, report retail sales made, and remit sales tax due on those sales on the gross proceeds, unless a valid exemption applies.

The Michigan Sales Tax Act, MCL 205.54a(g), provides exemption from tax of tangible personal property used or consumed in industrial processing. An industrial processor is defined as 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.

When making purchases that are to be used or consumed in industrial processing, you must claim that exemption by providing your supplier with a signed statement indicating that the tangible personal property purchased will be used or consumed in industrial processing. Likewise, when you sell to an industrial processor, your customer must supply you with an exemption claim. Items that are used in a manufacturer's production process and computers used for design and research in a manufacturer's engineering lab would qualify for the industrial processing exemption.

If you take an order from a manufacturer to design a product and make a prototype to illustrate your design and engineering service, you are acting as a servicer and your tax treatment is described in the response to the first question.

Post-3/30/99:

When you take an order from a manufacturer to design and build a product to their specifications and purchase materials needed to build the product, you are operating as an industrial processor. You are required to have a sales tax license, report retail sales made, and remit sales tax due on those sales, unless a valid exemption applies.

The Michigan Sales Tax Act, MCL 205.54a(g), provides exemption from tax of tangible personal property used or consumed in industrial processing.

When making purchases that are to be used or consumed in industrial processing, you must claim that exemption by providing your supplier with a signed statement indicating that the tangible personal property purchased will be used or consumed in industrial processing. Likewise, when you sell to an industrial processor, your customer must supply you with an exemption claim. Items that are used in a manufacturer's production process and computers used for design and research in a manufacturer's engineering lab would qualify for the industrial processing exemption.

If you take an order from a manufacturer to design a product and make a prototype to illustrate your design and engineering service, you are acting as a servicer working on behalf of a processor and your tax treatment is described in the response to the first question.

- 3) **Question:** I do research, design and build a product for a company based on their requirement. The company I work for supplies the components (e.g., they are a manufacturing company and have the components). Is sales tax involved? If so, on what portion?

Same question as number two regarding exemption from sales tax.

Answer:
Pre-3/31/99:

When designing and working on your customer's property you are performing a service, not making a retail sale of the finished product, so no collection of sales tax is involved. As a servicer, you are liable for tax as explained in the answer for question number one.

Post-3/30/99:

When designing and working on your customer's property you are performing a service, not making a retail sale of the finished product, so no collection of sales tax is involved. As a servicer acting on the behalf of an industrial processor, you are not liable for tax as explained in the answer for question number one.

- 4) **Question:** I do research and design for a company. They provide me with a sample of their existing product and I make design changes and add parts to that product. Is sales tax involved? If so, on what portion?

Answer:
Pre-3/31/99:

Same as the answer to question three. However, because you are working on property owned by another, you may separately itemize charges for parts, and tax only the parts unless your customer makes a valid claim of exemption.

Post-3/30/99:

Same as the answer to question three.

References: MCL 205.54t(7)(c)
MCL 205.94o(7)(c)
RAB 2000-4 III (2)

QUALITY CONTROL / RESEARCH OR EXPERIMENTAL / ENGINEERING

Pre-3/31/99:

The Sales and Use Tax Acts do not mention that quality control or research, development, and engineering are part of the industrial processing exemption. This exemption has always been allowed for industrial processors and included in the Administrative Rules.

The Michigan Administrative Code (MAC), Rule R 205.90 states that industrial processing includes the following activities:

- Patent
- Experiment
- Development
- Engineering Inspection
- Quality Control

An industrial processor is defined in the statute to be “a person who transforms, alters or modifies tangible personal property by changing its form, composition or character for ultimate sale at retail or sale to another industrial processor for further processing and ultimate sale at retail”.

If the taxpayer qualifies as an industrial processor, equipment and supplies directly used in quality control, research, development, and engineering would be exempt.

If the taxpayer does not qualify as an industrial processor, they would be considered a servicer and all supplies and equipment would be taxable. Refer to the “Servicer” section of this text.

The above exemptions would not include the following:

- Quality control of **purchased** material cannot be in the receiving area. This would be inspection of raw material and considered receiving. **This would be exempt Post-3/30/99.**
- Storage facilities would be taxable. Racks used to store test tubes, dies or any other equipment/material would be taxable. **These would also be taxable Post-3/30/99.**
- Blueprint storage cabinets are taxable. **These would also be taxable Post-3/30/99.**

Post-3/30/99:

Research or experimental

After 3/30/1999 the research and experimental exemption for industrial processing was expanded to include third party servicers acting for the processor.

Research or experimental activity as defined by the statute means “activity incident to the development, discovery, or modification of a product or a product related process”. It also includes activity necessary for a product to satisfy a government standard or receive governmental approval.

Some examples of activities that are **not qualified** for research or experimental exemption:

- Efficiency surveys
- Management surveys
- Market or consumer surveys
- Advertising or promotions
- Research for literacy, historical, or similar projects.

Quality Control

All equipment and supplies used in the testing of raw material and the inspection of the product or the process at any point, including in receiving, are exempt, up to the time the product is put into finished goods inventory storage, whether the testing or inspection is done by the processor or a third party servicer. Once the product is placed in finished goods storage any quality control testing functions are taxable. By definition industrial processing stops once the product is placed in finished goods inventory storage.

Engineering

The statute states that engineering related to industrial processing is exempt.

CAUTION: Not all engineering costs are related to industrial processing, for example, building maintenance, receiving, equipment removal, etc.

See the “Utilities” section of this text.

References: MCL 205.54t(3)(b-d)
MCL 205.94o(3)(b-d)
R 205.90(5)(b)

REAL vs. PERSONAL PROPERTY

Tangible personal property that becomes a structural part of realty is taxable except for nonprofit housing, nonprofit hospitals and qualified pollution control facilities. This becomes an issue for the industrial processor if the tangible personal property would be eligible for the industrial processing exemption. Generally, if it is considered real property, it is taxable.

To determine whether property remains tangible or is made a structural part of realty, we look to the following test which is cited primarily in the Michigan Supreme Court decision in *Sequest v Fabiano*, 274 Mich. 643: 265 NW 488 (1936) and other documentation including the State Tax Commission Assessor Manual:

1) The property must be attached to the realty.

Annexation to the realty, either actual or constructive. This test has to do with the manner in which an item is attached to the real property. If the item is attached in such a permanent manner that its removal would destroy the building or do substantial injury to the building, the item is usually held to be real property.

This test looks for the permanence of the affixation (e.g., bolted to the floor or wall). Leaving a void is not the only test for determining real property.

2) Its function must benefit the realty.

Adaptation or application to the use or purpose to which that part of the realty to which it is connected is appropriated. This test suggests that if an item was intended (built or purchased specifically) to function as part of the particular building or if it carries out part of the function of the real property, that item is probably real property.

An example of this type of real property would be screens which are built to fit the windows of a particular building. Another example would be theater seats in a theater generally bolted to the floor and an essential part of the function of the building.

3) It is intended to be a permanent part of realty.

Intention to make the article a permanent accession to the freehold. This test has usually been found to be the most important. It asks whether the item in question is intended to become part of the real estate.

In simple terms, if the tangible personal property serves a function of realty or the building and if it is attached to realty and permanently affixed to realty, it would usually be considered real property.

Various opinions of the State Board of Tax Appeals, as well as Administrative Rulings, have determined that certain equipment remains personal property even though it may appear to be part of real property in the form of building equipment, such as air make-up units, electrical distribution equipment, etc. Since some items can have the appearance of being real property, it is important to ascertain all the facts before making a final decision.

The chart that follows gives several examples of both real and personal property and the possible tax consequences for sales and use taxes for industrial processors.

Real property is taxable for sales and use tax purposes. However, the courts or the Department have determined that sometimes tangible personal property that appears to be affixed to realty actually maintains the properties of tangible personal property for sales and use tax purposes.

**REAL vs. PERSONAL PROPERTY
TAX STATUS FOR INDUSTRIAL PROCESSORS**

NO.	DESCRIPTION	REAL or PERSONAL FOR SALES/USE	SALES & USE TAX STATUS FOR IP
1.	ACOUSTICAL CEILINGS: BUILDING CEILING CONSTRUCTION IP EQUIPMENT SOUND ATTENUATION	REAL PERSONAL	TAXABLE EXEMPT
2.	AIR COMPRESSOR FOR SPECIFIC IP MACHINERY	PERSONAL	EXEMPT
3.	AIR COMPRESSORS (PART OF CENTRAL SYSTEM)	REAL	TAXABLE
4.	AIR CONDITIONING SYSTEMS FOR GENERAL BUILDING	REAL	TAXABLE
5.	AIR CONDITIONING UNITS: WINDOW TYPE UNITS FLOOR OR CABINET TYPE - NO DUCTWORK PROCESS – CENTRAL SYSTEM EVAPORATORS	PERSONAL PERSONAL REAL REAL	T or E depending on use T or E depending on use TAXABLE TAXABLE
6.	AIR MAKEUP UNIT FOR SPECIFIC IP FUNCTION	PERSONAL	EXEMPT (1)
7.	ALARM SYSTEMS	PERSONAL	TAXABLE (7)
8.	ANNEALING FURNACES (small furnace to heat up parts)	PERSONAL	EXEMPT
9.	AWNINGS – CANOPIES/MARQUEES	REAL	TAXABLE
10.	BERMS	REAL	TAXABLE
11.	BINS: PORTABLE BUILT-IN	PERSONAL REAL	T or E (10) TAXABLE
12.	BOILER (ONE BOILER) – NEW	REAL	TAXABLE, building function
13.	BOILER (ONE BOILER) – REPLACEMENT	REAL	TAXABLE
14.	BOILER FOR IP USE – REPLACEMENT	PERSONAL	EXEMPT (2)
15.	BOILERS (MULTIPLE)	R or P DEPENDING ON USE	% BASED ON USE
16.	BOOTHES: IP EQUIPMENT TYPE BUILDING TYPE -- ROOM LIKE	PERSONAL REAL	EXEMPT TAXABLE

NO.	DESCRIPTION	REAL or PERSONAL FOR SALES/USE	SALES & USE TAX STATUS FOR IP
17.	BRIDGES: SPECIFIC TO IP EQUIPMENT SPECIFIC TO BUILDING	PERSONAL REAL	EXEMPT TAXABLE
18.	BUNKERS AND SILOS	REAL	TAXABLE
19.	BUS DUCT FOR GENERAL ELECTRICAL DISTRIBUTION (See "Utilities" Section of this text)	REAL	TAXABLE
20.	BUS DUCT FOR IP EQUIPMENT (See "Utilities" section of this text)	PERSONAL	EXEMPT
21.	CATWALKS: ATTACHED TO IP EQUIPMENT ATTACHED TO BUILDING	PERSONAL REAL	EXEMPT TAXABLE
22.	CENTRAL CONTROL SYSTEMS: DIRECT CONTROL SPECIFIC IP EQUIP. GENERAL CONTROL POWER WIRING CONTROL BUILDING	PERSONAL REAL REAL	EXEMPT TAXABLE TAXABLE
23.	CLOCKS: PAYROLL AND WATCHMAN CLOCKS	PERSONAL	TAXABLE
24.	COMMUNICATIONS SYSTEMS -- PERMANENT: PHONE PUBLIC ADDRESS PNEUMATIC TUBES TELEVISION (PART OF SECURITY SYSTEM) TELEVISION (PART OF SPECIFIC M & E)	PERSONAL PERSONAL PERSONAL PERSONAL PERSONAL	TAXABLE (7) TAXABLE (7) TAXABLE (7) TAXABLE (7) TAXABLE (7)
25.	COMPRESSOR FOR GENERAL BUILDING AIR CONDITIONERS	REAL	TAXABLE
26.	CONVEYOR OR CARRIER ENCLOSURES (SEE ENCLOSURES)		
27.	CONVEYORS	PERSONAL	% BASED ON USE
28.	COOLING TOWERS	REAL	TAXABLE
29.	CRANE TRACKING OR RAILS (CRANEWAYS)	PERSONAL	% BASED ON USE (4)
30.	CRANES	PERSONAL	% BASED ON USE (4)
31.	DECKS AND DRAINS (PROCESS)	REAL	TAXABLE
32.	DEHUMIDIFIERS: PORTABLE PART OF HEATING AIR CONDITIONING	PERSONAL REAL	% BASED ON USE TAXABLE

NO.	DESCRIPTION	REAL or PERSONAL FOR SALES/USE	SALES & USE TAX STATUS FOR IP
33.	DIKES OR LEVEES: SURROUNDING STORAGE TANKS RIVER OR LAKE CONTROL	REAL REAL	TAXABLE TAXABLE
34.	DOCK BUMPERS AND SEALS	REAL	TAXABLE
35.	DOCK LEVELERS	REAL	TAXABLE
36.	DOCKS, RAMPS (BUILT-IN)	REAL	TAXABLE
37.	DOOR OPERATORS	REAL	TAXABLE
38.	DOORS (GARAGE AND PASS DOORS)	REAL	TAXABLE
39.	DRYERS, PROCESSING	PERSONAL	EXEMPT
40.	DUCTWORK: BUILDING FOR IP EQUIPMENT	REAL PERSONAL	TAXABLE EXEMPT
41.	DUMBWAITERS	REAL	TAXABLE
42.	DUST COLLECTORS	PERSONAL	EXEMPT
43.	DUST OR SPRAY COLLECTION EQUIPMENT FOR SPECIFIC IP MACHINES	PERSONAL	EXEMPT
44.	DYNAMOMETER TESTING CELLS	REAL	TAXABLE, building function
45.	ELECTRICAL DISTRIBUTION MATERIALS & EQUIPMENT UP TO LAST TRANSFORMER & UP TO THE SECONDARY SUBSTATION	REAL	TAXABLE (5)
46.	ELECTRICAL DISTRIBUTION MATERIALS & EQUIPMENT INSTALLED AFTER USABLE POWER IS PROVIDED TO BE USED FOR IP FUNCTIONS	PERSONAL	EXEMPT (5)
47.	ELECTRICAL SUBSTATION ENCLOSURES	REAL	TAXABLE
48.	ELEVATORS	REAL	TAXABLE
49.	EMERGENCY LIGHTS	REAL	TAXABLE
50.	ENCLOSURES: BUILDING FREESTANDING FOR IP EQUIPMENT	REAL PERSONAL	TAXABLE EXEMPT
51.	ENERGY MONITORS:		

NO.	DESCRIPTION	REAL or PERSONAL FOR SALES/USE	SALES & USE TAX STATUS FOR IP
	GENERAL BUILDING FOR SPECIFIC IP EQUIPMENT	REAL PERSONAL	TAXABLE EXEMPT
52.	ESCALATORS – BUILDING	REAL	TAXABLE
53.	EXHAUST SYSTEMS: DUCTED FROM IP EQUIPMENT BUILDING VENTILATION	PERSONAL REAL	EXEMPT TAXABLE
54.	FANS: FREESTANDING FOR IP AREA BUILDING VENTILATION, BUILT-IN	PERSONAL REAL	TAXABLE, employee comfort TAXABLE
55.	FENCING	REAL	TAXABLE
56.	FIRE PROTECTION SYSTEMS: BUILDING SPRINKLERS BUILDING CO ₂ , HALON, H1-X FOAM FOR IP M & E, CO ₂ , HALON, H1-X FOAM SUPPLEMENTAL WATER SYSTEM TO ASSIST BLDG. SUPPLEMENTAL WATER SYSTEM FOR M & E ONLY FIRE EXTINGUISHER CABINETS, REELS, VALVES FIRE EXTINGUISHERS (CANISTER OR TANKS) FIRE ESCAPES	REAL REAL PERSONAL REAL PERSONAL REAL PERSONAL REAL	TAXABLE TAXABLE TAXABLE TAXABLE TAXABLE TAXABLE TAXABLE
57.	FLAG POLES, IN GROUND OR ON BUILDING	REAL	TAXABLE
58.	FLOOR FINISHES: SPECIAL COVERINGS (WOOD BLOCK, STEEL TILE) STANDARD COVERINGS (CARPET, LINOLEUM, TILE)	REAL REAL	TAXABLE TAXABLE
59.	FLOOR GRATES – NOT ADJACENT TO MACHINERY	REAL	TAXABLE, function of realty
60.	FLOOR GRATES ADJACENT TO MACHINERY	REAL	TAXABLE, function of realty
61.	FLOORING, RAISED OR COMPUTER ROOM	PERSONAL	TAXABLE
62.	FOUNDATIONS FOR SPECIFIC IP EQUIPMENT	PERSONAL	EXEMPT
63.	FREEZERS: BUILDING TYPE CONSTRUCTION, WALK-IN PORTABLE – FREESTANDING	REAL PERSONAL	TAXABLE % BASED ON USE

NO.	DESCRIPTION	REAL or PERSONAL FOR SALES/USE	SALES & USE TAX STATUS FOR IP
64.	FURNACES: ONE – NEW ONE – REPLACEMENT FOR IP USE – REPLACEMENT MULTIPLE	REAL REAL PERSONAL R or P DEPENDING ON USE	TAXABLE TAXABLE EXEMPT % BASED ON USE
65.	GAS DISTRIBUTIONS SYSTEMS: GAS LINES TO PROCESS SYSTEM GAS LINES TO BUILDING SYSTEMS	PERSONAL REAL	EXEMPT (5) TAXABLE
66.	GATE OPERATORS: PART OF FENCE -- LAND IMPROVEMENTS	REAL	TAXABLE
67.	GENERATOR – ONE WHICH SERVICES THE FACILITY	REAL	TAXABLE, building function
68.	GENERATOR USED FOR SPECIFIC IP MACHINE	PERSONAL	EXEMPT
69.	GUARD RAILS AND POSTS: PROTECT IP EQUIP. (NOT ATTACHED TO EQUIP.)	REAL	TAXABLE
	PROTECT IP EQUIPMENT (ATTACHED TO EQUIP.)	PERSONAL	EXEMPT
	PROTECT INVENTORY ROADS, PARKING, BUILDING	REAL REAL	TAXABLE TAXABLE
70.	HEATERS:	REAL	TAXABLE
	UNIT HEATERS, HANGING	PERSONAL	EXEMPT
	MANUFACTURING PROCESS PORTABLE	PERSONAL	TAXABLE, employee comfort
71.	HEATING & VENTING SYSTEMS (GENERAL BUILDING TYPE)	REAL	TAXABLE
72.	HOISTS:	REAL	TAXABLE
	BUILT-IN PORTABLE	PERSONAL	% BASED ON USE
73.	HUMIDIFIERS:	PERSONAL	EXEMPT
	PORTABLE, IP FUNCTIONS BUILT-IN	REAL	TAXABLE
74.	INCINERATORS	REAL	TAXABLE

NO.	DESCRIPTION	REAL or PERSONAL FOR SALES/USE	SALES & USE TAX STATUS FOR IP
75.	INSULATION & PIPING IN WALL FOR REFRIGERATED ROOMS	REAL	TAXABLE
76.	KILNS, CERAMIC AND LUMBER FOR IP FUNCTIONS: FREESTANDING BUILT-IN	PERSONAL REAL	EXEMPT TAXABLE
77.	LIGHTING, ELECTRICAL: GENERAL BUILDING LAND IMPROVEMENTS SUPPLEMENTAL -- BUILDING SYSTEM (Fixtures extended down from general building. Wiring to a specific IP machine.) SUPPLEMENTAL -- M & E (Fixtures, plugged into an outlet, that are extended down to a specific IP machine)	REAL REAL REAL PERSONAL	TAXABLE TAXABLE TAXABLE EXEMPT
78.	LIGHTNING ARRESTERS	REAL	TAXABLE
79.	LOADING DOCK	REAL	TAXABLE
80.	LOCKER ROOM FACILITIES: PLUMBING FIXTURES, SHOWERS PERMANENT PARTITIONS TOILET PARTITIONS LOCKERS, FREESTANDING LOCKERS, RECESSED INTO WALL	REAL REAL REAL PERSONAL REAL	TAXABLE TAXABLE TAXABLE TAXABLE TAXABLE
81.	OFFICE – PORTABLE FOREMAN'S	PERSONAL	TAXABLE
82.	OPERATORS, DOORS & WINDOWS	REAL	TAXABLE
83.	PARKING CONTROL SYSTEMS	REAL	TAXABLE
84.	PARTITIONS: PORTABLE IN MANUFACTURING AREA PERMANENTLY ATTACHED	PERSONAL REAL	TAXABLE, building function TAXABLE
85.	PIPE RACK SUPPORTS	REAL	TAXABLE
86.	PIPING: FROM WALL TO SPECIFIC IP MACHINERY UTILITY PIPING, GAS, WATER, ETC.	PERSONAL REAL	EXEMPT TAXABLE
87.	PLASTIC DOOR STRIPS (AIR GUARD STRIPS) TO SEPARATE AREAS	REAL	TAXABLE – general building

NO.	DESCRIPTION	REAL or PERSONAL FOR SALES/USE	SALES & USE TAX STATUS FOR IP
88.	PLUMBING, GENERAL BUILDING	REAL	TAXABLE
89.	PLUMBING, TO SPECIFIC IP EQUIPMENT	PERSONAL	EXEMPT
90.	PRESS PIT	PERSONAL	EXEMPT – machine foundation
91.	PUMP HOUSES	REAL	TAXABLE
92.	RAMPS: PORTABLE BUILT-IN	PERSONAL REAL	TAXABLE TAXABLE
93.	ROOMS WITHIN A PLANT, NOT A STRUCTURAL PART OF REALTY USED FOR IP FUNCTIONS	PERSONAL	EXEMPT (6)
94.	SCALE HOUSES	REAL	TAXABLE
95.	SCALES: PORTABLE BUILT-IN TRUCK, BUILT-IN	PERSONAL REAL REAL	T or E depending on use TAXABLE TAXABLE
96.	SECURITY SYSTEMS	PERSONAL	TAXABLE (7)
97.	SHED – BOLTED TO CONCRETE SLAB	REAL	TAXABLE (8)
98.	SHED – PORTABLE FOR STORAGE	PERSONAL	TAXABLE
99.	SIGNS: ATTACHED TO BUILDING INTEGRAL PART OF IP EQUIPMENT NONEQUIPMENT RELATED	REAL PERSONAL PERSONAL	TAXABLE EXEMPT TAXABLE
100.	SILO – RAW MATERIAL STORAGE	REAL	TAXABLE (8)
101.	SPRAY BOOTHS, PERMANENTLY ATTACHED	REAL	TAXABLE
102.	STAINLESS STEEL WALL PANELS FOR FOOD INDUSTRY	REAL	TAXABLE
103.	TANKS: PORTABLE – IN-PROCESS STORAGE PORTABLE – MIXING IP MATERIAL PORTABLE – RAW MATERIAL STORAGE BUILT-IN (attached to a building or foundation) – RAW MATERIAL AND IN-PROCESS STORAGE	PERSONAL PERSONAL REAL REAL	EXEMPT EXEMPT TAXABLE TAXABLE
104.	TELEPHONE WIRING IN WALL	REAL	TAXABLE
105.	TOILET FACILITIES:		

NO.	DESCRIPTION	REAL or PERSONAL FOR SALES/USE	SALES & USE TAX STATUS FOR IP
106.	PLUMBING FIXTURES, SHOWERS PARTITIONS PORTABLE VATS FOR MIXING (MANUFACTURING PROCESS)	REAL REAL PERSONAL PERSONAL	TAXABLE TAXABLE TAXABLE EXEMPT
107.	WASH FOUNTAINS	REAL	TAXABLE
108.	WELDING BOOTH, PORTABLE	PERSONAL	EXEMPT
109.	WOOD BLOCKING FOR FLOOR IN PRESS ROOM	REAL	TAXABLE (9)

- 1) AIR MAKE-UP UNITS FOR SPECIFIC MACHINERY HAVE BEEN DETERMINED TO BE PERSONAL PROPERTY BY THE COURTS. (E.W. ENSROTH & CO., MILLER PLATING, INC. VAN DYKEN HEATING, INC.)
- 2) BOILERS FOR SPECIFIC MACHINERY HAVE BEEN DETERMINED TO BE PERSONAL PROPERTY (KELVINATOR, INC.)
- 3) CONSIDERED PERSONAL PROPERTY FOR SALES/USE PURPOSES
- 4) PER RULE 40 AND RAB 2000-4
- 5) ROOMS WITHIN A PLANT USUALLY REPRESENT ROOMS ASSEMBLED BY PORTABLE PARTITIONS (PANELS). THE PARTITIONS CAN EXTEND FROM FLOOR TO CEILING AND, IN MOST INSTANCES, ARE NOT BOLTED TO THE FLOOR OR ATTACHED IN ANY OTHER WAY. THE PARTITIONS DO NOT SUPPORT ANY PART OF THE REALTY, NOR ARE THEY WEIGHT BEARING. THE PARTITIONS ARE FOR INTERIOR WALL USE WITHIN THE FACILITY. THE ROOMS ARE USED FOR SANITATION PURPOSES OR OTHER SIMILAR FUNCTIONS RELATED TO THE PROCESSING FUNCTION.
- 6) PERSONAL PROPERTY PER LR 88-53. THE WIRING IN THE WALLS WOULD BE REAL PROPERTY; HOWEVER, IN THE PAST THE PERCENTAGE OF TAXABLE MATERIAL IN THE WALLS WAS IMMATERIAL; THEREFORE, THE ENTIRE JOB WAS TREATED AS A RETAIL SALE OF PERSONAL PROPERTY. CHECK FOR MATERIALITY.
- 7) RAB 90-2
- 8) WOOD BLOCKING USUALLY COVERS A LARGE AREA. IT ABSORBS OIL AND PROVIDES A NON-SLIPPERY SURFACE.
- 9) SEE "WASTE REMOVAL" SECTION OF THIS MANUAL

RECONDITIONING/REMANUFACTURING

Pre 3/31/99:

A reconditioner/remanufacturer is a company that purchases used products (engines, carburetors, batteries, furniture, etc.), reconditions the product by repairing, remachining or reshaping and sells the reconditioned product.

Raw materials are considered to be salvaged component parts obtained from the “used” products, as well as any new parts used in the process. Cleaning, inspection and disassembly are receiving functions and taxable. Reshaping and remachining are determined to be exempt industrial processes.

Post 3/30/99:

Remanufacturing is exempt per statute. It is defined as “overhauling, retrofitting, fabricating, or repairing a product or its component parts for ultimate sale at retail”.

Disassembly, inspecting, sorting, cleaning and reassembly would now be exempt. Disassembly and subsequent reassembly merely to clean is not exempt.

The following examples illustrate this concept:

Example: # 1

A company purchases used car hoods, doors and fenders to be sold to automobile body shops. The company only cleans these used car parts and then sells them. Would the equipment and supplies consumed in the cleaning of these used car parts qualify for the industrial processing exemption?

Pre 3/31/99 and Post 3/30/99 Answer: No, cleaning of purchased inventory without modifying or repairing does not meet the definition of industrial processing.

Example: # 2

A company purchases used car hoods, doors and fenders to be sold to automobile body shops. Not only are the used car parts cleaned but they are disassembled, repaired, painted and reassembled. Would the company qualify for industrial processing on all of the equipment and supplies used to restore the used car parts?

Pre 3/31/99 Answer: The washing equipment and supplies as well as the disassembly operations would be taxable as they are receiving functions. The equipment and supplies used to repair, paint and reassemble the hoods, doors, and fenders would qualify for the industrial processing exemption.

Post 3/30/99 Answer: Yes, all of the equipment and supplies would be exempt for IP. Remanufacturing includes the activities of disassembly and reassembly as well as repairing and painting. IP starts when property is removed from raw material storage to begin processing. This would exempt the washing equipment and supplies.

Equipment can be partially taxable depending on their taxable and exempt uses. Many exempt percentages have increased, however, due to the Act's definition of the beginning and end of the industrial process.

Refer to the RAB 2000-4 on industrial processing for additional clarification of the remanufacturing exemption.

References: MCL 205.54t(3)(g) & (7)(d)
MCL 205.94o(3)(g) & (7)(d)
RAB 2000-4

REFRIGERATION & FREEZERS

Pre-3/31/99 and Post-3/30/99:

Equipment and electricity consumed to bring a product to a frozen or refrigerated state is exempt from sales tax for the reason of industrial processing. Product preservation and storage do not qualify for the industrial processing exemption.

Tangible personal property acquired for storing and delivery of ice is taxable (see Rule 39).

References: R 205.89

REPACKAGING

The following examples illustrate the concept of repackaging and the industrial processing treatment of the packaging equipment.

Situation 1: A nail manufacturer places nails in a 2-pound box for ultimate sale at retail. The product is ultimately purchased at the retail level in this same 2-pound box.

Pre-3/31/99 and Post-3/30/99 Determination: The packaging operation to put the nails in 2-pound boxes is exempt for IP.

Situation 2: This same nail manufacturer also contracts with a separate company to package certain types of nails in 2-pound boxes. Again, the product is purchased at the retail level in the same 2-pound box.

Pre-3/31/99 and Post-3/30/99 Determination: This packaging servicer would be entitled to the IP exemption, even if the nail manufacturer provided the 2-pound boxes.

Situation 3: Same circumstances as situation 2 above with one additional fact. In certain instances the outside packager may have to repackage nails if the boxes become damp, yellowed, or otherwise unsuitable for retail sale.

Pre-3/31/99 Determination: This second time packaging function would also be exempt for industrial processing. However, any equipment, areas, etc., used in the disassembly of the first packaged product would be taxable.

Post-3/30/99 Determination: All equipment and areas would now be exempt. The industrial processing RAB states that the activity of disassembly is now exempt for a remanufacturer.

Situation 4: A wholesale distributor of nails now inserts the nails into 2-pound boxes for ultimate sale at retail.

Pre-3/31/99 and Post-3/30/99 Determination: The wholesaler would be entitled to the IP exemption on the packaging equipment.

Situation 5: A large retail store purchases the same nails in bulk quantities. They then repackage the nails in 2-pound boxes and place them on their shelves for retail sale.

Pre-3/31/99 and Post-3/30/99 Determination: The retailer would be entitled to IP exemption for the packaging equipment.

RETAIL PREPARATION OF FOOD

Pre-3/31/99:

Both the Sales and Use Tax Acts remove from the industrial processing exemption **the preparation of food and beverages by a retailer for retail sales.**

This provision in both Acts eliminates from the exemption kitchen equipment used in restaurants and similar facilities. The Department's position for the activity where the items are sold and/or transferred to themselves (company owned restaurants/stores) is that no industrial processing exemption is allowable. Equipment may be taxable or exempt as illustrated in the following examples.

- A wholesale distributor of produce has a banana ripening room that hastens the ripening of bananas. The banana room and equipment, if not considered real property, would qualify for the industrial processing exemption.
- A chain of grocery stores has a produce warehouse used only for distribution to its own stores. The warehouse has a banana ripening room. The banana ripening room and equipment would not qualify for the industrial processing exemption because it would be considered to be preparation of food by a retailer for retail sale.
- A bakery produces products that it sells to wholesalers and also sells in its own retail store. The preparation of the items for the retail store would not qualify for the industrial processing exemption.

The Michigan Supreme Court ruled in the *Elias Brothers* case that equipment and supplies are exempt if the taxpayer meets all of the following facts:

- 1) The taxpayer is a food processor, food distributor and owns retail outlets.
- 2) The taxpayer operates as a wholesaler/retailer and the processed food is "sold", not merely transferred. The food is "sold" at the same price to owned and noncompany owned outlets.
- 3) The food processing activity is a distinct, identifiable and clearly severable activity from the retail outlets, with separate billing records, income statements and asset listings for the commissary.
- 4) Food processing activities are treated as a separate and distinct operation by the taxpayer. Separate profit centers are maintained.

- 5) Food products are prepared similarly for both company owned and noncompany owned outlets. Accounting records and other procedures for the sale of processed food is identical for company owned and noncompany owned outlets, including ordering, processing, handling, delivery, invoicing, billing and sales procedures.
- 6) Food processing equipment is of a nature not found in a retail restaurant.

Post-3/30/99:

The treatment for kitchen equipment used in restaurants has not changed. The equipment and operating supplies are taxable.

The statute does provide at 205.54t(5)(h) and 205.94o(5)(h) the following language: (5)“Property that is not eligible for an industrial processing exemption includes the following: (h) Tangible personal property used for the preparation of food or beverages by a retailer for ultimate sale at retail through its own locations.”

Ref: 205.54t(5)(h)
205.94o(5)(h)

RETAILERS and the INDUSTRIAL PROCESSING EXEMPTION

The tax status for the situations presented below do not change for the **Pre-3/31/99 and Post-3/30/99** periods.

Occasionally, industrial processing may take place in a retail setting.

Examples of exempt activities:

- The local hardware store sells duplicate keys. The key grinder would qualify for the exemption.
- The local auto parts store sells custom hoses that are produced by buying bulk rubber hose and using on site equipment to pressure fit metal ends onto the rubber hose. The equipment and supplies would qualify for the industrial processing exemption.
- Company A purchases large quantities of nails, screws or other items in large containers and repackages the nails, screws or other items into smaller quantities. The equipment/supplies/utilities used for this purpose would qualify for the industrial processing exemption.
- A local jewelry store makes custom jewelry it sells at retail in their own store. The equipment/tools/supplies used would qualify for the industrial processing exemption.
- The local optician buys eyeglass frames and uncut lens. The lenses are ground to fit the frames. The equipment/tools/supplies used to grind the lens and insert them into the frames would qualify for the industrial processing exemption.
- The local paint or hardware store customizes paint colors for its customers. The paint mixing machines would qualify for the industrial processing exemption.
- The local trophy store uses engraving machines to engrave trophies prior to the time of sale. The machines used to engrave the trophies would qualify for the industrial processing exemption.
- Used vehicle/heavy equipment dealers recondition the vehicles/heavy equipment prior to selling their products. The tools and equipment used for this portion of their business operation is exempt to the extent the items are used to repair and recondition the items prior to sale.

- Prosthetic clinics would be afforded the IP exemption for tools and equipment used to make artificial limbs (the same treatment as the optician).
- All retailers or service providers making repairs covered under an original manufacturers warranty are entitled to the industrial processing exemption for equipment/tools/supplies used for this activity.

Examples of some taxable activities:

- The local lumberyard cuts a sheet of plywood down to requested size. No exemption is allowed as they are merely cutting to size. If the customer is charged for this service, it would be part of the gross proceeds subject to sales tax.
- Can and plastic bottle crushers at the local grocery store.
- Tools and equipment used by dental labs to make dentures would not be exempt because they are providing a service.
- Coin operated coffee and soft drink vending machines.

References: LR 85-20

LR 87-52

SAMPLES

Samples are items where title and possession are transferred to another without consideration. Samples are usually used to give a prospective customer an opportunity to test a product prior to purchasing the product.

Samples sometimes represent a small component of an entire product (e.g., small pieces of wallpaper, one seat of auditorium seating, swatches of fabric).

Samples withdrawn from inventory and given away without charge are taxable. The tax base is computed as follows:

- Samples that are manufactured products are taxable on material cost.
- Samples that are not complete manufactured products are taxable on material cost (e.g., high-pressure laminate chips, a.k.a. Formica chips).
- Samples that are purchased are taxable on cost.

Sometimes manufacturers produce a product for trial marketing purposes and give the product away to other industrial processors with the intent of making future sales. Samples given away for trial marketing purposes are taxable on material cost.

EXCEPTIONS:

- Prescription drug samples given away by manufacturers of prescription drugs to health professionals are exempt. However, all packaging materials and packaging equipment would be taxable.
- Prescription drug samples given away by a wholesale distributor to health professionals are exempt.
- Samples donated by a manufacturer, wholesaler or retailer to a qualified exempt entity are not taxable. A qualified exempt entity is a nonprofit school, nonprofit hospital, nonprofit home for the care of the aged or children (operated by certain types of organizations), parent cooperative preschool, or church.
- Samples of food items are exempt, including prepared food.

NOTE: Since the tax base of inventory withdrawals is material cost, the percentage of equipment (with materiality considered) used to produce inventory withdrawals would also be taxable.

Items withdrawn from a Michigan inventory and given away at no cost to the recipient for promotional purposes are taxable, regardless of where the item is shipped. Items withdrawn from a non-Michigan inventory and shipped into Michigan may be taxable with an appropriate credit for any sales or use tax that had been legally due and paid in another state at the time of acquisition. If the tax paid was less than the tax imposed by Michigan, tax is due on the difference.

EXCEPTION: Due to the *Sharper Image Corporation* court case, samples shipped from an out-of-state source may be exempt. The following must be met for exemption of samples shipped from an out-of-state source:

- The distribution is made by mail or by common carrier
- The distribution originated from out-of-state
- The consumer/purchaser of the sample has no control in Michigan over the distributed items. See the “Inventory Withdrawals/Consumed Goods” section of this text for further clarification.

References: MCL 205.92(b)
MCL 205.94t
R 205.112
RAB 93-5
Honeywell, Inc. vs. Michigan Department of Treasury
IBM Corp. vs. Michigan Department of Treasury
Sharper Image Corporation vs. Michigan Department of Treasury
Syntex Laboratories, Inc. vs. Michigan Department of Treasury
Wilson Sporting Goods vs. Michigan Department of Treasury

SCRAP DEALERS & RECYCLERS

The following equipment (or areas when talking about utility studies) are treated accordingly for industrial processing purposes:

1) ROLLOFFS (DUMPSTERS):

- A. A scrap dealer places his rolloffs on the site of an industrial processor. The processor stores his production waste in these containers for removal by the scrap dealer.

Pre-3/31/99 and Post-3/30/99 Tax Treatment: These containers are taxable. Their purpose for the scrap dealer is receiving, collection and transportation. The purpose for the processor is the storage of production scrap for removal from its plant.

- B. A recycler has rolloffs at its location to receive recyclable materials (plastic bottles, aluminum cans, newspapers, etc.). Individuals trying to conserve resources place their recyclable materials into these containers.

Pre-3/31/99 and Post-3/30/99 Tax Treatment: These containers are taxable. Their purpose for the recycler is receiving and raw material storage.

2) HOPPERS:

A scrap dealer provides self-dumping portable hoppers to an industrial processor to aid in its movement of production scrap. Scrap from the line is put into these hoppers and subsequently transported to the dumpsters for removal from the plant site.

Pre-3/31/99 Tax Treatment: The industrial processing exemption for waste accumulation is only available to the industrial processor. Since these hoppers were owned by the scrap dealer, the industrial processing exemption is not allowable.

Post-3/30/99 Tax Treatment: Containers used to accumulate production waste are exempt if they are not the final container used to store production waste for removal from the plant. Use of the container in processing and not ownership determines the exemption.

3) RADIATION MONITORS:

Detects amounts of radiation contained in delivered scrap metal and are usually located near the scales for incoming scrap.

Pre-3/31/99 Tax Treatment: These monitors would be taxable as part of receiving.

Post-3/30/99 Tax Treatment: The statute exempts raw material testing. Therefore, these radiation monitors would be exempt from tax.

NOTE: Do not exempt the area where these monitors are located in your utility studies, as industrial processing has not started.

4) FREON RECOVERY MACHINES:

These machines extract cooling gases from air conditioners, freezers, etc. before the actual shredding of the appliance. These gases are then usually sold.

Pre-3/31/99 Tax Treatment: These machines would be exempt. The form composition, quality, combination or character of the material is changed for ultimate sale at retail.

Post-3/30/99 Tax Treatment: The recovery equipment is exempt for industrial processing. The exemption is based on the statute that classifies recycling of used materials for ultimate sale at retail as an industrial process.

5) EQUIPMENT USED FOR THE DISASSEMBLY OF VARIOUS MIXED SCRAP PARTS:

Pre-3/31/99 Tax Treatment: This activity and items used for this purpose are taxable. This is considered a receiving function.

Post-3/30/99 Tax Treatment: The disassembly equipment is exempt. Industrial processing begins when tangible personal property begins movement from raw material storage.

6) LOADING AND UNLOADING EQUIPMENT:

Pre-3/31/99 and Post-3/30/99 Tax Treatment: This equipment is taxable if the transfer of materials is to or from a separate legal entity. Loading and unloading equipment used to handle in-process materials within the same legal entity is exempt.

7) SORTING EQUIPMENT SUCH AS CRANES, LOADERS, AND LIFT TRUCKS:

Pre-3/31/99 Tax Treatment: Sorting is an exempt function if the combination or composition of the materials is changed for ultimate sale at retail.

Post-3/30/99 Tax Treatment: The trash heap is considered the recycler's raw materials. Sorting will be exempt.

8) **EQUIPMENT USED TO CUT, BREAK, AND CRUSH (AFTER DISASSEMBLY):**

Pre-3/31/99 and Post-3/30/99 Tax Treatment: This recycling equipment is exempt as this activity meets the definition of industrial processing. We would also exempt conveyers connected to this type of machinery.

9) **PAPER SHREDDING EQUIPMENT:**

Pre-3/31/99 and Post-3/30/99 Tax Treatment: This equipment used by scrap dealers and recyclers would be exempt for IP if the property is sold.

10) **COMPRESSING EQUIPMENT:**

Pre-3/31/99 Tax Treatment: This equipment would be taxable if the compressing was performed to facilitate the transportation and shipment of the scrap to the purchaser. This is normally the situation with equipment used to compress newspaper scrap. Compressing equipment could be exempt if the purchaser requires the product be delivered in a compressed state.

Post-3/30/99 Tax Treatment: The compressing equipment would be exempt as the compressing is an industrial process that occurs after the move out of the raw material storage area and prior to the product coming to rest in finished goods inventory storage.

11) **BANDING AND BALING EQUIPMENT:**

Pre-3/31/99 Tax Treatment: This equipment is taxable if its sole purpose was to facilitate the transportation and shipment of the scrap to the purchaser. If the purchaser required that the product be baled and banded, the equipment would be exempt.

Post-3/30/99 Tax Treatment: If the banding and baling process took place prior to the product coming to rest in finished goods inventory storage, the equipment would be exempt.

References: MCL 205.54t(3)(i)
MCL 205.94o(3)(i)
LR 86-25

SERVICERS

Pre 3-31-99:

There are two basic types of servicers, those that act as industrial processors and those that do not. The servicers that act as industrial processors (heat treating, plating, etc.) are allowed the industrial processing exemption as it pertains to their operations. Servicers that do not act as an industrial processor do not qualify for the industrial processing exemption.

A person providing a service for an industrial processor that does not transform, alter or modify tangible personal property by changing the form, composition or character of the property for ultimate sale at retail or sale to another industrial processor for further processing for ultimate sale at retail is not an industrial processor. Tangible personal property used or consumed in performing services upon property owned by others, where the services did not transform, alter or modify the property, does not qualify for the industrial processing exemption.

For example, an industrial processor may contract with a waste disposal company to remove waste from the premises of the manufacturing plant. The waste disposal company, no matter how important its activities are to the manufacturing plant, does not meet the definition of an industrial processor. Thus, purchases of any equipment, material and other items used by the waste disposal company in performing the waste removal service for the industrial processor are not eligible for an industrial processing exemption.

The exception to this provision is where the person performing the service for the industrial processor has purchased computers and computer equipment to be used in industrial processing in one of the following four ways:

- 1) A computer used in operating industrial processing equipment
- 2) Equipment used in a computer assisted manufacturing system
- 3) Equipment used in a computer assisted design or engineering system integral to an industrial process
- 4) A subunit or electronic assembly comprising a component in a computer integrated industrial processing system

See the "Computers Used in Industrial Processing" section of this text for CAD/CAM exemption for servicers.

The Michigan Court of Appeals (*Beckman Production Services*) has held that a person performing a service on the property of an industrial processor, where that service does not transform, alter or modify the property, is not entitled to the industrial processing exemption.

The Michigan Court of Appeals also ruled that testing services did not qualify the company as an industrial processor. There was no change in form, composition or character nor was there an ultimate sale at retail.

Some companies manufacture products and also perform service activities. The service department is sometimes called "SRO" (service/repair/overhaul). Repairing, overhauling or rebuilding property owned by others is a service activity. The equipment, tools or supplies used in the performance of the service are taxable. If the servicer manufactures repair parts, the equipment to produce the repair parts qualifies for the industrial processing exemption. A percentage of taxability would apply to any equipment, tools or supplies used for both the manufacturing activity and service activity.

Subprocessors work on the property of others; however, they are treated as industrial processors because they change the form, composition, or character of tangible personal property for ultimate sale at retail. Examples of subprocessors are plating companies, steel slitters and heat-treating companies.

Post 3-30-99:

Servicers can receive an industrial processing exemption for equipment, tools and supplies used in a repair or service activity when providing the service or repair to an industrial processor. The equipment used in the service or repair activity qualify for the exemption if tangible personal property is used by the servicer to perform an industrial processing activity for or on the behalf of an industrial processor. The servicer or repairer can qualify for the exemption if the service or repair work is being made to exempt equipment of the customer. An example would be the exemption for tools used by a repair company to repair a stamping press of a steel parts manufacturer. Keep in mind the same tools used to repair the loading dock or office equipment will remain a taxable use. Apportioning the taxable and nontaxable usage of the servicer's equipment will now be allowable.

There has been no statutory change in the area covered above on the computer service providers.

STORAGE TANKS & MIXING TANKS

If a storage tank or mixing tank is determined to be real property rather than tangible personal property, it is taxable to the contractor and not subject to any type of industrial processing exemption. Buried or built-in tanks are real property. See the “Real vs. Personal Property” section of this text.

The Michigan Sales Tax Act provides exemption from tax of tangible personal property used or consumed in industrial processing. The Use Tax Act provides a similar exemption. An industrial processor 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 for further processing and ultimate sale at retail.

Storage tanks do not fall under the industrial processing guidelines and are taxable as a storage function. The storage of a product that will be consumed or altered in industrial processing is not an exempt function. The storage of a finished product is not an exempt function.

A mixing tank that is a component part of the industrial process is exempt as processing equipment. An exception to this rule is a soft drink bottling company’s mixing or transfer tanks, which are lightweight stainless steel canisters capable of holding five gallons of pre- or post mix. They are not within the scope of the industrial processing exemption. The Michigan Tax Tribunal ruled that no mixing of product components occurred within the tanks, although they were designated “mixing tanks” (*Pepsi-Cola Metropolitan Bottling vs. Department of Treasury*). The tanks were used to store and deliver the product.

Grain bins are usually exempt under industrial processing or agricultural producing. This is covered under the “Grain Elevators” section of this text.

GAS CYLINDERS

Steel cylinders used only to distribute gas (there is no mixing system inside the tank) are taxable because no industrial processing is going on within the tanks. However, the tanks can be purchased tax free for leasing purposes if the tanks are rented. An industrial processor can make a claim of exemption for IP on the rental charge of the cylinder (LR 88-16).

Tanks with a mixing system inside used to mix different gases uniformly and remix the gas when released are exempt for industrial processing.

Portable tanks used to store gas, etc. to repair exempt equipment or used in an exempt area would be exempt if consumption occurred in the processing area from the same tank.

References: LR 88-16

STORES ACCOUNTS (NONPRODUCTION INVENTORY)

Some companies purchase nonproduction inventory or noninventory items tax free that have an account classification as “stores” or “general supplies”. The end use of these items usually is not known until the item is withdrawn from “stores”. The taxpayer may be accruing tax on some of these items at the time of withdrawal.

Items that may be included in these accounts include small tools, screws/fasteners, belts, gloves, maintenance supplies, etc.

The “stores” area is taxable. It is not considered in-process storage. It is nonprocess storage. Utilities, shelving, equipment (including automatic retrieval systems) and supplies used in this area are taxable regardless of tax status of items withdrawn from “stores”.

**TAXABILITY OF ITEMS
WHEN USED IN EXEMPT PRODUCTION AREAS – NO SHIPPING, RECEIVING, ETC.**

ITEM	DESCRIPTION OF ITEM	TAX STATUS	REASON
1.	AIR MAKE-UP UNIT (ONE) FOR GENERAL HEATING/COOLING/VENTILATION PURPOSES	T	NONPROCESSING – GENERAL AIR CIRCULATION. REAL PROPERTY
2.	AIR MAKE-UP UNIT TO EXHAUST PRODUCTION FUMES	E	PERSONAL PROPERTY – REMOVES CONTAMINATED AIR
3.	ASPIRIN OR SALT TABLETS	T	FIRST AID, SAFETY
4.	AUTOMATIC SPOOLING DEVICES, EVEN THOUGH THEY HELP ELIMINATE CARPAL TUNNEL	E	PART OF THE MACHINERY, ENABLES CONTINUED PRODUCTION
5.	BALLAST FOR OVERHEAD LIGHTING FIXTURES	T	REAL PROPERTY
6.	BINS USED TO COLLECT RM PACKAGING SCRAP NEXT TO PRODUCTION LINE	E	SCRAP REMOVAL EXEMPT BY STATUTE
7.	BLUEPRINT STORAGE CABINET	T	NONPRODUCTION STORAGE
8.	BOOKS OR MANUALS THAT CONTAIN DATA DETAILING FORMULAS, ETC. FOR SPECIFIC PRODUCTION REQUIREMENTS	E	INDUSTRIAL PROCESSING
9.	BOOKS OR MANUALS THAT CONTAIN GENERAL ENGINEERING, QC, ETC. INFORMATION FOR ENGINEERING, PRODUCTION, & QC STAFF	T	TRAINING RELATED
10.	BROCHURES – OSHA MANDATED “SAFETY IN THE WORKPLACE” BROCHURES	T	SAFETY AND TRAINING RELATED
11.	BROOM AND MOPS FOR CLEANING THE FLOORS	T	REAL PROPERTY MAINTENANCE
12.	CAMERAS & FILM USED IN R & D TO FILM PRODUCT	E	R & D EXEMPT BY STATUTE
13.	CAMERAS FOR SECURITY OR PERSONNEL USE	T	PLANT SECURITY, PERSONNEL
14.	CATWALKS OR PLATFORMS AROUND IP MACHINES (ATTACHED TO MACHINE OR BOLTED TO FLOOR)	E	PERSONAL PROPERTY, MACHINE MAINTENANCE, NECESSARY FOR CONTINUED PRODUCTION
15.	CLEANERS AND DEGREASERS USED TO CLEAN IP EQUIPMENT	E	MACHINE MAINTENANCE

ITEM	DESCRIPTION OF ITEM	TAX STATUS	REASON
16.	CLEANING TISSUE FOR SAFETY GLASSES	T	EMPLOYEE CONVENIENCE
17.	COMPUTER USED TO MONITOR PRODUCTION CONTROL	E	PRODUCTION CONTROL, SCHEDULING EXEMPT PER STATUTE
18.	COMPUTER USED IN ENGINEERING DEPT. FOR ADMINISTRATIVE PURPOSES	T	ADMINISTRATIVE, OFFICE EQUIPMENT
19.	CONTAINERS FOR THE STORAGE OF WORK-IN-PROCESS MATERIALS	E	IN-PROCESS STORAGE EXEMPT PER STATUTE
20.	COPY MACHINE USED IN ENGINEERING FOR DEVELOPMENT OF PRODUCT	E	DEVELOPMENT, ENGINEERING EXEMPT PER STATUTE
21.	COPY MACHINE USED TO EXCLUSIVELY REPRODUCE DRAFTING DOCUMENTS	E	EQUIPMENT USED FOR PRODUCTION DESIGN
22.	COVERALLS, UNIFORMS, APRONS, ETC. FOR GENERAL ATTIRE PURPOSES	T	EMPLOYEE CONVENIENCE
23.	COVERALLS, UNIFORMS, APRONS, ETC. FOR SANITATION PURPOSES IN FOOD PROCESSING PLANTS	E	PRODUCT PROTECTION
24.	COVERALLS, UNIFORMS, APRONS, ETC. TO PROTECT EMPLOYEE CLOTHING	T	EMPLOYEE CONVENIENCE
25.	COVERALLS, UNIFORMS, APRONS, ETC. TO PROTECT THE BODY	E	INDUSTRIAL PROCESSING
26.	DESK & CHAIR IN ENGINEERING DEPT.	T	OFFICE FURNITURE
27.	DESK OR MODULAR FURNITURE USED TO HOLD COMPUTER THAT IS USED FOR IP	T	OFFICE FURNITURE
28.	DRAFTING TABLE & CHAIR IN ENGINEERING	E	INDUSTRIAL PROCESSING
29.	DUST OR FUME RESPIRATOR	E	INDUSTRIAL PROCESSING
30.	E-MAIL/INTERNET SOFTWARE FOR COMMUNICATIONS BETWEEN PRODUCTION DEPARTMENTS	T	COMMUNICATION
31.	EAR PLUGS	E	INDUSTRIAL PROCESSING
32.	EMERGENCY BACK-UP GENERATOR FOR GENERAL BUILDING	T	REAL PROPERTY – FUNCTION OF THE BUILDING
33.	EMERGENCY BACK-UP GENERATOR FOR	E	INDUSTRIAL PROCESSING

ITEM	DESCRIPTION OF ITEM	TAX STATUS	REASON
	SPECIFIC IP MACHINERY		
34.	EYE WASH AND HAND WASHING STATIONS	T	REAL PROPERTY – FIRST AID
35.	FANS – PORTABLE UNITS	T	EMPLOYEE COMFORT
36.	FAX MACHINE USED TO TRANSMIT PRODUCTION RUN DOCUMENTS BETWEEN AREAS	T	COMMUNICATION DEVICE, LR 86-12
37.	FINGER TIP PADS	E	INDUSTRIAL PROCESSING
38.	FIRE EXTINGUISHERS AND FIRE HOSES ATTACHED TO THE WALL	T	GENERAL BUILDING – SAFETY
39.	FIRE EXTINGUISHERS AND FIRE HOSES ATTACHED TO A PRODUCTION MACHINE	E	PART OF IP EQUIPMENT
40.	FIRST AID SUPPLIES (BANDAGES, OINTMENTS, ETC.), PLANT HOSPITAL SUPPLIES & EQUIPMENT	T	FIRST AID, HOSPITAL PER STATUTE
41.	FLASHLIGHTS USED BY PRODUCTION EQUIPMENT SERVICE WORKERS	E	EXEMPT MACHINE MAINTENANCE
42.	FLOOR MARKINGS (PAINT OR TAPE)	T	SAFETY – REAL PROPERTY MAINTENANCE
43.	FLOOR MATS (TO STAND ON WHEN WORKING AT A MACHINE) FOR WORKER COMFORT	T	EMPLOYEE COMFORT
44.	FLOOR MATS (TO STAND ON WHEN WORKING) TO AVOID ELECTROCUTION	E	INDUSTRIAL PROCESSING
45.	FLOOR OIL ABSORBENT (OIL DRY) FOR CLEANING FLOORS	T	BUILDING MAINTENANCE
46.	FLOOR OIL ABSORBENT (OIL DRY) FOR SPILLS ON FLOOR AROUND SPECIFIC IP MACHINES	T	BUILDING MAINTENANCE
47.	FLOOR OIL ABSORBENT (OIL DRY) PLACED IN A CONTAINER ON OR UNDER A MACHINE TO CATCH OIL THAT SPILLS FROM THE MACHINE	E	WASTE REMOVAL, LR 87-43
48.	FLOOR SWEEPER TO CLEAN UP AROUND MACHINES	T	BUILDING MAINTENANCE
49.	FOREMAN'S DESK, CHAIR, FILE CABINET,	T	GENERAL OFFICE FURNITURE

ITEM	DESCRIPTION OF ITEM	TAX STATUS	REASON
	ETC.		
50.	FORMS FOR SCHEDULING EMPLOYEES WORK HOURS	T	ADMINISTRATIVE FUNCTION
51.	FORMS FOR SCHEDULING PRODUCTION "RUNS"	E	PRODUCTION SCHEDULING
52.	FORMS USED FOR COST CONTROL PURPOSES	T	ADMINISTRATIVE & ACCOUNTING
53.	GLOVES (COTTON, CANVAS, OR RUBBER)	E	PRODUCT AND/OR EMPLOYEE PROTECTION, LR 88-18
54.	GOLF CART (USED AS A PERSONNEL CARRIER)	T	EMPLOYEE COMFORT
55.	GUARD RAIL AROUND IP MACHINE	T	SAFETY
56.	GUARD RAIL ATTACHED TO IP MACHINE	E	PART OF IP EQUIPMENT
57.	HAIR NETS (FOR SANITATION PURPOSES) IN FOOD PROCESSING PLANTS	E	PRODUCT PROTECTION
58.	HAND SOAP OR CREAM	T	EMPLOYEE CONVENIENCE
59.	HARD HAT OR HELMETS WORN BY ASSEMBLY LINE WORKERS	E	INDUSTRIAL PROCESSING
60.	HEADBANDS OR SWEATBANDS WORN BY ASSEMBLY LINE WORKERS (PRODUCT INTEGRITY NOT IN JEOPARDY)	T	EMPLOYEE COMFORT
61.	HEIGHT-ADJUSTABLE PLATFORMS	E	INDUSTRIAL PROCESSING
62.	LAB COATS WORN BY QUALITY CONTROL LAB TECHNICIANS (PROTECTS CLOTHES)	T	EMPLOYEE CONVENIENCE
63.	LADDER FOR PRODUCTION MACHINERY REPAIR	E	MAINTENANCE OF EXEMPT MACHINERY
64.	LIGHT FIXTURES ATTACHED TO THE CEILING	T	REAL PROPERTY
65.	LIGHTS (FLUORESCENT LAMPS) FOR CEILING FIXTURES	E	LAMPS & ELECTRICITY EXEMPT IN IP AREAS
66.	LITERATURE (PROMOTIONAL) AND PARTS ORDER FORMS THAT GO WITH THE PRODUCT	T	SERVES A MARKETING OR PROMOTIONAL PURPOSE
67.	LOUD SPEAKER SYSTEMS	T	ADMINISTRATIVE & PERSONNEL

ITEM	DESCRIPTION OF ITEM	TAX STATUS	REASON
68.	MANUALS FOR OPERATING THE TAXPAYER'S NEW PRESS (PURCHASED SEPARATELY, NOT REPLACEMENT MANUALS)	T	TRAINING MATERIAL
69.	MANUALS OR INSTRUCTION – INSTALLATION OR ASSEMBLY INSTRUCTION THAT GO WITH THE PRODUCT	E	FOR RESALE, REQUIRED PART OF PRODUCT SOLD
70.	RAGS FOR REMOVING OIL FROM PRODUCTION MACHINERY	E	MACHINE MAINTENANCE
71.	RAGS TO RID OIL FROM WORKER'S HANDS (PRODUCT INTEGRITY NOT IN JEOPARDY)	T	EMPLOYEE CONVENIENCE
72.	REFRIGERATORS IN QC DEPARTMENT TO STORE RM TESTING COMPOUNDS	T	NONPROCESS STORAGE
73.	SAFETY GLASSES – NONPRESCRIPTION	E	EMPLOYEE PROTECTION
74.	SAFETY GLASSES – PRESCRIPTION	E	EXEMPT BY STATUTE
75.	SAFETY SHOES ONLY WORN IN IP AREA (PROVIDED FREE BY EMPLOYER)	E	EMPLOYEE PROTECTION
76.	SAFETY SHOES WORN IN IP AREA TO PERFORM IP FUNCTIONS FOR OR ON BEHALF OF AN INDUSTRIAL PROCESSOR PRIOR TO 3/31/99, PURCHASED BY EMPLOYEE	T	EMPLOYEE IS NOT AN INDUSTRIAL PROCESSOR
77.	SAFETY SHOES WORN IN IP AREA TO PERFORM IP FUNCTIONS FOR OR ON BEHALF OF AN INDUSTRIAL PROCESSOR AFTER 3/30/99, PURCHASED BY EMPLOYEE	E	PER STATUTE, SINCE THEY ARE PERFORMING IP FUNCTIONS FOR AN INDUSTRIAL PROCESSOR
78.	SHELVING FOR THE TOOL CRIB	T	NONPROCESS STORAGE
79.	SHELVING IN QUALITY CONTROL DEPARTMENT TO STORE RAW MATERIALS	T	NONPROCESS STORAGE
80.	SHRINK WRAP MATERIAL	E	RESALE PER RULE 18
81.	SIGNS – OSHA REQUIRED SIGNS ATTACHED TO PRODUCTION MACHINERY	T	SAFETY, NOT A TRUE PART OF EXEMPT MACHINERY
82.	SIGNS -- OSHA REQUIRED SIGNS ATTACHED TO THE WALL	T	SAFETY, NONPRODUCTION

ITEM	DESCRIPTION OF ITEM	TAX STATUS	REASON
83.	SPACE HEATERS	T	EMPLOYEE COMFORT
84.	STOOL (FOR THE EMPLOYEE TO SIT AT WHILE OPERATING PRODUCTION EQUIPMENT)	T	EMPLOYEE COMFORT
85.	TABLE NEXT TO MACHINE TO HOLD TOOLS FOR MAKING MACHINE ADJUSTMENTS	E	MACHINE MAINTENANCE
86.	TAGS (OK TO USE) IN QUALITY CONTROL	E	QUALITY CONTROL EXEMPT BY STATUTE
87.	TAGS USED FOR RAW MATERIAL OR FINISHED GOODS INVENTORY PURPOSES	T	SHIPPING & RECEIVING TAXABLE BY STATUTE
88.	TAGS USED TO INDICATE THE PERFORMANCE OF A QUALITY CONTROL FUNCTION	E	QUALITY CONTROL EXEMPT BY STATUTE
89.	TANKS (SOFT DRINK MIX CANISTERS)	T	NONPROCESS STORAGE
90.	TELEPHONES AT PRINTING FACILITY USED SOLELY TO INSTRUCT PERSONNEL OF MACHINERY TO IMMEDIATELY START OR STOP PRODUCTION	T	COMMUNICATION DEVICE
91.	TELEPHONES USED FOR COMMUNICATION BETWEEN VARIOUS PRODUCTION DEPTS.	T	COMMUNICATION DEVICE
92.	TOOL AND DIE RACKS ATTACHED TO A MACHINE	E	PART OF MACHINE
93.	TOOL AND DIE RACKS IN A SEPARATE STORAGE AREA	T	STORAGE FUNCTION
94.	TOOL AND DIE RACKS MOUNTED ON A WALL	T	STORAGE FUNCTION
95.	TOOL AND DIE RACKS NEXT TO A MACHINE	T	STORAGE FUNCTION
96.	TOOL BOXES (THE PORTABLE TYPE FOR PRODUCTION MACHINE REPAIR WORKERS)	E	MACHINE MAINTENANCE FOR IP EQUIPMENT
97.	TOOL POUCHES FOR MACHINE REPAIR WORKERS	E	MACHINE MAINTENANCE FOR IP EQUIPMENT
98.	TOOLS PURCHASED BY EMPLOYEES TO PERFORM IP FUNCTIONS FOR OR ON BEHALF OF AN INDUSTRIAL PROCESSOR PRIOR TO 3/31/99	T	EMPLOYEES ARE NOT AN INDUSTRIAL PROCESSOR

ITEM	DESCRIPTION OF ITEM	TAX STATUS	REASON
99.	TOOLS PURCHASED BY EMPLOYEES TO PERFORM IP FUNCTIONS FOR OR ON BEHALF OF AN INDUSTRIAL PROCESSOR AFTER 3/30/99	E	PER STATUTE, SINCE THEY ARE PERFORMING IP FUNCTIONS FOR AN INDUSTRIAL PROCESSOR
100.	TRADE BOOKS OR MAGAZINES FOR ENGINEERING OR OTHER PRODUCTION DEPARTMENTS	T	TRAINING MATERIAL (MAY QUALIFY FOR EXEMPTION UNDER RULE 53)
101.	TRAINING MATERIALS	T	MATERIALS DO NOT CHANGE THE FORM, COMPOSITION, CHARACTER, ETC. LR 87-30
102.	TV, VCR, VCR TAPES USED FOR SECURITY OR TRAINING	T	TRAINING, PERSONNEL, PLANT SECURITY
103.	TV, VCR, VCR TAPES USED TO VIEW PRODUCT DESIGN, R & D	E	EXPERIMENTAL, DEVELOPMENT, DESIGN, ETC.
104.	WARRANTY CERTIFICATES THAT GO WITH THE MANUFACTURED PRODUCT	E	REQUIRED PART OF PRODUCT SOLD
105.	WARRANTY REGISTRATION CARD TO BE RETURNED TO THE MANUFACTURER	T	ADMINISTRATIVE FUNCTION
106.	WASTE BINS FOR PRODUCTION SCRAP	E	SCRAP REMOVAL EXEMPT BY STATUTE
107.	WRIST BRACE TO ASSIST IN LIFTING HEAVY PRODUCTION MATERIALS	E	EMPLOYEE PROTECTION
108.	WRIST BRACE TO PREVENT CARPAL TUNNEL SYNDROME	T	EMPLOYEE COMFORT, SAFETY

References: MCL 205.54r
MCL 205.94o
R 205.90
RAB 2000-4

TRANSFERS OF FIXED ASSETS BETWEEN RELATED ENTITIES

Transfers from parent to subsidiary, subsidiary to parent, or subsidiary to subsidiary:

- Since two different entities exist, a transfer to a Michigan based manufacturing firm could be taxable (if not exempt for industrial processing or any other valid reason). If the transferor is licensed or required to be licensed for Michigan sales tax, the transferor is responsible for collecting and remitting sales tax. If the transferor is not licensed or required to be licensed for Michigan sales tax, the transferee is responsible for remitting use tax.
- The tax base would be selling price on the date of transfer. This is the value or price recorded in the purchaser's books, often times representing the net book value at the time of transfer.
- No credit would be allowed for tax paid by the transferring entity.
- Tax would not be due on the transfer of a business. See Section 205.94g of the Use Tax Act for a discussion of what constitutes a "transfer of a business" and for exceptions to the definition.

Exceptions to the above: If the item being transferred is a motor vehicle, ORV, mobile home, aircraft, snowmobile, or watercraft, tax is due on the higher of the transfer selling price or retail market value per the Use Tax Act [205.93(2)]. A vehicle could be exempt if transferred in connection with the organization, reorganization, dissolution, or partial liquidation of a business and the beneficial ownership is not changed and Michigan tax has been previously paid.

Transfers between divisions of the same legal entity:

- As no sale has taken place, the tax base would be the original cost (not net book value) of any fixed asset transferred from out of state to Michigan.
- Credit would be given for any sales or use tax paid to another state or other local jurisdiction, if proof can be shown.
- Tax would generally not be due on transfers between Michigan based divisions.
- The date of transfer to a Michigan division would determine whether the transaction was within the 4-year statutory audit period, not the purchase date.

Transfers between plants or locations of the same division:

- As no sale has taken place, the tax base would be the original cost of any fixed asset transferred from an out of state location to a Michigan location.
- Credit would be given for any sales or use tax paid to another state or other local jurisdiction, if proof can be shown.
- Tax would generally not be due on transfers from one Michigan location to another Michigan location.
- The date of transfer from an out of state location to a Michigan location would determine whether the transaction was within the 4-year statutory audit period, not the purchase date.

NOTE: Transfers between divisions or within divisions are generally not supported by invoices or other documentation. It may be necessary to review journal entries, asset location records, property apportionment worksheets, etc. when auditing taxpayers with substantial intra-corporate transfers from out of state to Michigan.

References: MCL 205.51(g)

Terco, Inc. vs. Michigan Department of Treasury

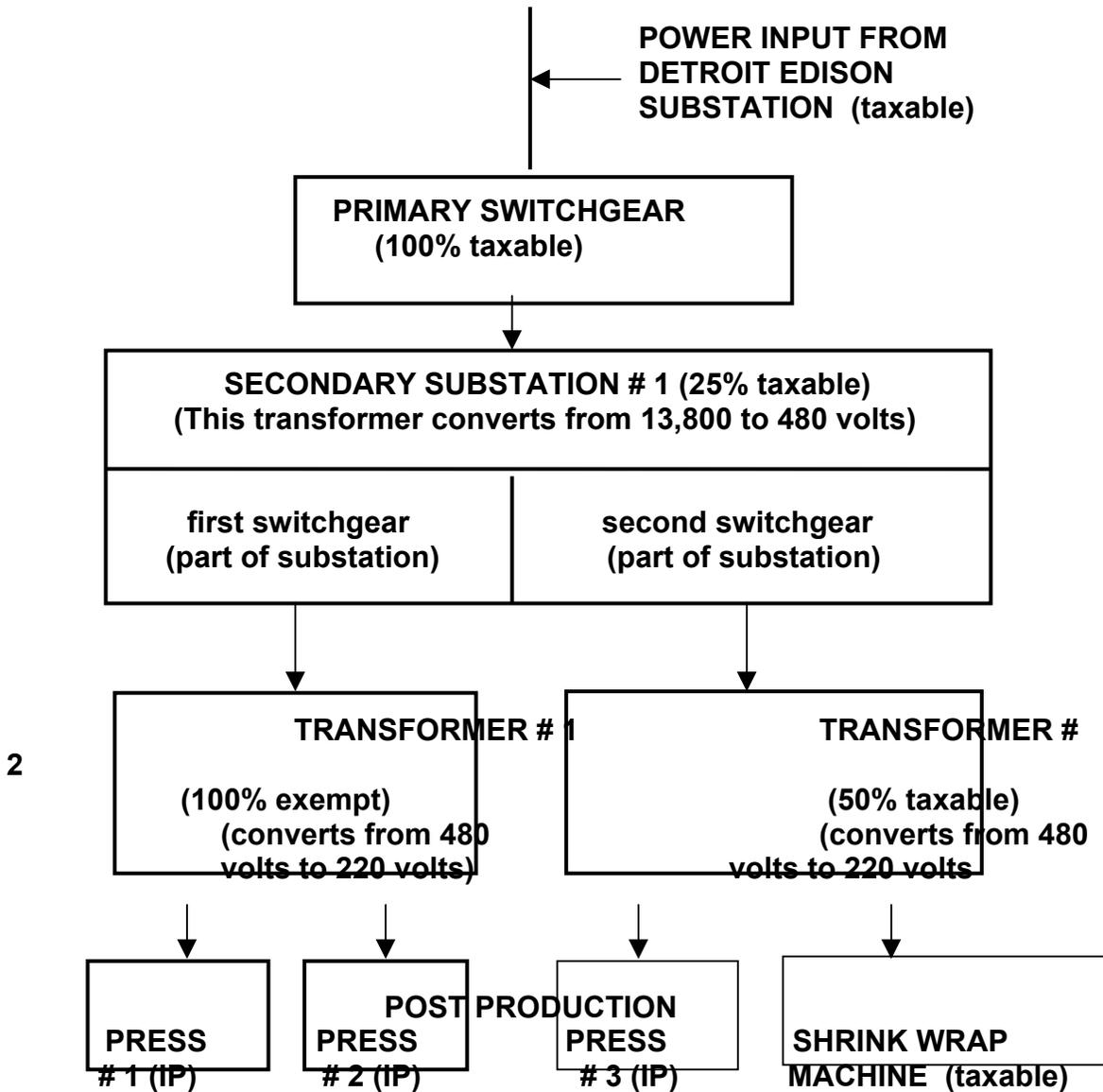
UTILITIES

Manufacturers primarily use the following types of utilities:

- Electricity
- Gas
- Steam

Electricity, gas and steam used in nonprocessing areas are taxable. Electricity, gas and steam used in processing functions and/or areas are exempt (see the “Taxability of Utility Areas” chart in this text for examples of taxable and nontaxable areas).

ELECTRICAL DISTRIBUTION SYSTEMS



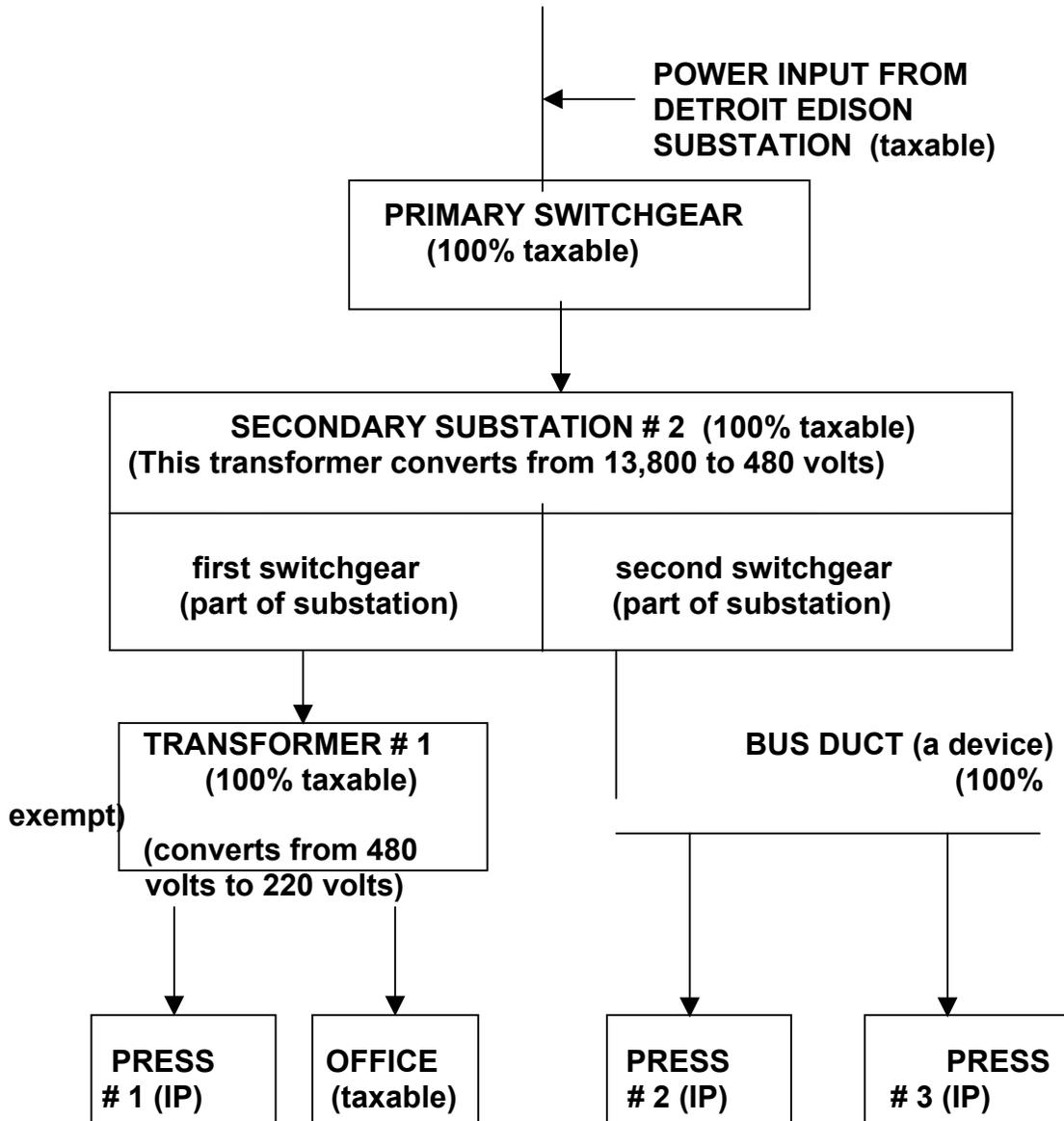
NOTE: Assuming equal usage of all four machines, the secondary substation is 25% taxable.

The secondary substation and transformers can get full or partial exemption, as they do not service the building's general utility system.

Transformer #1 is 100% exempt, since it services industrial processing equipment.

Transformer # 2 is 50% taxable, since it services both an exempt industrial processing machine and a taxable machine.

ELECTRICAL DISTRIBUTION SYSTEMS

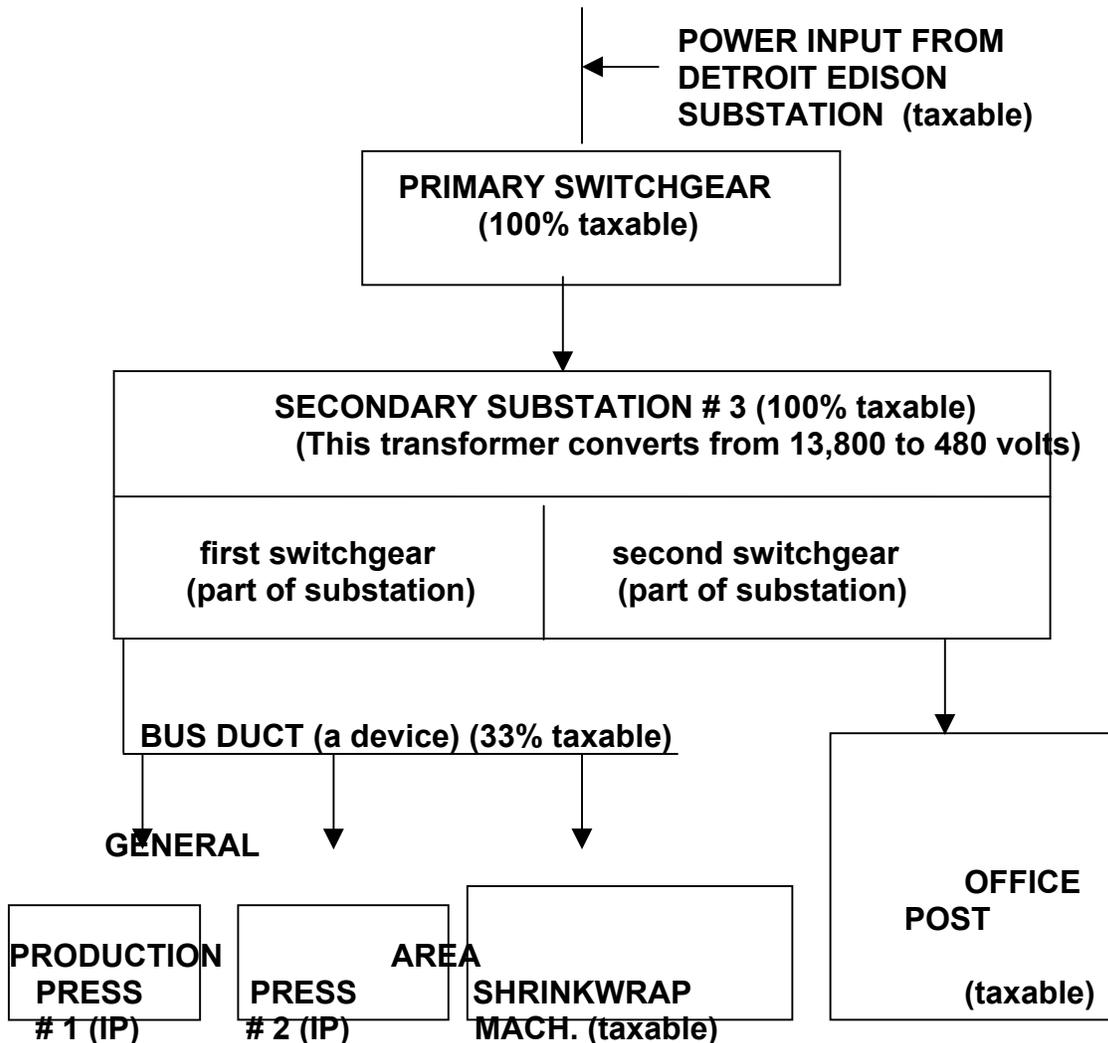


NOTE: The secondary substation and transformer are 100% taxable as they are directly or indirectly connected with the building's general utility system.

The bus duct is not connected with the building's general utility system and services exempt equipment; therefore, it is 100% exempt for industrial processing purposes.

Equal electrical usage by the three presses and office area is assumed.

ELECTRICAL DISTRIBUTION SYSTEMS



NOTE: The secondary substation is 100% taxable as it services the building's general utility system.

Equal usage by the two presses and the shrink wrap machine is assumed. Therefore, the bus duct is 33-1/3% taxable. The bus duct does not service any of the building's general utility system; therefore, a percentage of taxability may be applied.

Gas:

Gas can be used for heating and to operate equipment or machinery.

Gas used for heating of processing areas is exempt. Heating of nonprocessing areas is taxable.

We do not tax the consumption of a by-product of an industrial processing function (e.g., excess heat from an exempt IP operation that is used to heat taxable office space). If tangible personal property (e.g., steam tunnels, heat ducts, blowers, etc.) is used to accommodate the use of the heat in the office, such materials would be taxable.

Heating studies can be conducted on a square footage basis. Summer and winter months are compared to determine gas used for heating purposes versus processing usage and then a percentage is computed according to the taxable exempt usage areas.

Pre-3/31/99:

If the lessor does not separately bill out the utilities to the lessee, the purchase of the gas or electric from the supplier is taxable, since the lessor is not an industrial processor.

Post-3/30/99:

The lessor may claim partial exemption from the utility company for the portion of the utilities used by the lessee industrial processor to perform industrial processing functions.

References: MCL 205.54t(4)(e) and (5)(a)
MCL 205.94o(4)(e) and (5)(a)
RAB 2000-4
R 205.90 (3)(a)
LR 87-53
LR 90-16

TAXABILITY OF AREAS FOR UTILITY STUDIES

ITEM	DESCRIPTION OF AREA	TAX STATUS
1.	AISLES BETWEEN A TAXABLE AREA AND AN EXEMPT AREA	50% T
2.	AISLES BETWEEN EXEMPT AREAS	EXEMPT
3.	AISLES BETWEEN TAXABLE AREAS	TAXABLE
4.	BOILER ROOM AREAS a. One boiler b. Multiple boilers	TAXABLE % based on use
5.	DIE STORAGE AREAS	TAXABLE
6.	ENGINEERING AREAS Note: If there is a separate building for engineering, care must be taken to properly tax areas within the facility that do not qualify for the industrial processing exemption (e.g., administrative areas, payroll areas, receiving areas, etc.)	EXEMPT
7.	FOREMAN'S OFFICE	TAXABLE
8.	INSPECTION SUPERVISOR'S OFFICE	TAXABLE
9.	MACHINE SHOP REPAIR AREA (EXEMPT MACHINES)	EXEMPT
10.	MARKET RESEARCH AREAS	TAXABLE
11.	PRODUCTION AREAS DURING PERIODS OF NEW MACHINE INSTALLATION OR MACHINE REPAIR	EXEMPT
12.	PRODUCTION AREAS DURING PERIODS WHEN EXISTING MACHINES ARE BEING REMOVED	TAXABLE
13.	PRODUCTION AREAS DURING PLANT VACATION CLOSURE PERIODS	TAXABLE
14.	PRODUCTION AREAS DURING PRODUCTION PERIOD	EXEMPT
15.	PRODUCTION AREAS DURING SHIFTS WITH NO PRODUCTION	TAXABLE
16.	PRODUCTION AREAS IDLED BY DOWNSIZING, LOST PRODUCTION, ETC.	TAXABLE

ITEM	DESCRIPTION OF AREA	TAX STATUS
17.	PURCHASING DEPARTMENT AREAS	TAXABLE
18.	QUALITY CONTROL AREAS a. Not in receiving area b. In receiving area	EXEMPT TAXABLE
19.	RECEIVING AREAS FOR PURCHASED PRODUCT Note: For scrap dealers & recyclers, tax the area where radiation monitors are located, since industrial processing has not started. See the "Scrap Dealers & Recyclers" section of this text.	TAXABLE
20.	RESEARCH AND DEVELOPMENT AREAS Note: If there is a separate building for engineering, care must be taken to properly tax areas within the facility that do not qualify for the industrial processing exemption (e.g., administrative areas, payroll areas, receiving areas, etc.)	EXEMPT
21.	RESTROOMS	TAXABLE
22.	SHIPPING AREAS	TAXABLE
23.	"STORES" AREAS	TAXABLE
24.	VENDING AREAS, BREAKROOMS, LUNCHROOMS	TAXABLE
25.	WAREHOUSE AREAS	TAXABLE

WASTE REMOVAL

Pre-3/31/99:

R 205.90(5) Industrial processing includes the following activities:
(e) Disposal of production scrap and waste.

The disposal of production scrap and waste is exempt as an industrial processing activity. Equipment used for this activity is exempt.

Production scrap and/or waste can include:

- Material spoilage
- Damaged material
- Chips
- Shavings
- Sludge
- Residue
- Dust
- Sand
- Grit
- Fly
- Ash
- Slag

It would also include the containers (e.g., cardboard boxes, plastic bags, drums) that held processing materials. It does not matter at what point in the process the waste is generated.

Examples of production waste include:

- Cardboard boxes discarded after the removal of production parts in the raw materials inventory area.
- Cardboard boxes discarded after the removal of production parts in the production area.
- Raw materials scrapped that have never left the raw materials inventory.
- Materials that are scrapped because they do not pass final inspection.

This exemption would only be allowable to the industrial processor. The exemption would be allowable for machinery, equipment and parts used to collect the production waste. Generally, material handling and shipping costs to dispose of production waste materials would not qualify for the exemption. Some examples are:

- The cardboard boxes mentioned above are collected in a bin. A forklift moves the bin to the back of the plant. The cardboard in the collection bin is dumped into a cardboard compactor and compacted. The only item qualifying for the industrial processing exemption is the first collection bin. Any movement of the bin after the initial collection is taxable.
- Metal shavings from a machine process fall through a floor grate and onto a conveyor belt that moves the shavings to a collection hopper at the end of the production line. The conveyor belt and hopper would qualify for the industrial processing exemption, as the items are used to collect the production waste.

The exemption would not be available to a servicer providing the waste disposal service for the industrial processor. See the “Servicers” section of this text.

Some items may be considered by-products of the industrial process. When by-products are sold, equipment used during shipment is taxable.

Disposal of nonproduction scrap and waste would not qualify for tax exemption. Non-production waste would include the disposal of accounting or sales records or old production reports.

Some industries are required to neutralize or treat waste materials and/or water for environmental or regulatory purposes prior to their disposal. The cost of the equipment, materials, supplies and utilities used for this purpose are taxable. For example:

- A heat treat company purchases chemicals to neutralize water contaminated in the heat treating process. The cost of the equipment, supplies and utilities do not qualify for the industrial processing exemption.
- A metal plating company neutralizes production chemicals and scrap prior to disposal at a solid waste landfill. The cost of equipment and supplies to analyze and neutralize the liquid and solid waste is taxable. However, equipment and supplies used for these functions are exempt if materials are treated and/or disposed of on-site.

Post-3/30/99:

MCL 205.54t(3):

Industrial processing includes the following activities:

- (h) Processing of production scrap and waste up to the point it is stored for removal from the plant of origin.

The plant of origin includes a contiguous manufacturing complex. It does not include facilities in separate locations. For example, the entire Rouge Complex is a plant of origin, but the Wayne and Wixom complexes are separate locations, even though they are part of the same company and/or division.

The exemption would be allowable for machinery, equipment and parts used to collect and move the production waste to where it is stored for final removal from the plant of origin. This includes:

- The initial collection
- Any movement to the final resting point prior to removal
- Any processing for further use
- Any processing for sale to another if performed by a servicer or industrial processor

For example:

- The cardboard boxes discarded after the removal of production parts either in the raw materials inventory area or the production area are collected in a bin. A forklift moves the bin to the back of the plant. The collection bin is dumped into a cardboard compactor and compacted. The exemption is allowed up to the point that the compacted cardboard is stored for removal from the plant.

Shipping costs to dispose of production waste materials off site would not qualify for the exemption whether incurred by the industrial processor or servicer.

The cost of the equipment, materials, supplies and utilities used to neutralize or treat waste materials and/or water prior to their disposal are exempt up to the point it is stored for removal from the plant of origin. If the waste is not removed from the plant of origin, but disposed of on site, the exemption extends to that point of disposal. Some examples are:

- A heat treat company purchases chemicals to neutralize water contaminated in the heat treating process. The cost of the equipment, supplies and utilities qualify for the industrial processing exemption.
- A metal plating company neutralizes production chemicals and scrap at the plant of origin prior to disposal **off site**. The cost of equipment and supplies to analyze and neutralize the liquid and solid waste is not subject to tax up to the point it is stored for removal from the plant site. This

activity is also exempt for a servicer if performed at the manufacturer's plant of origin.

- A metal plating company neutralizes production chemicals and scrap at the plant of origin prior to disposal **on site**. The cost to process the liquid and solid waste is not subject to tax. This activity is also exempt for a servicer if performed at the manufacturer's plant of origin.

If, in the above metal plating example, the analyzing and neutralizing is not done at the plant of origin, the cost of the equipment and supplies used would be taxable to whoever performs the service.

Pre and Post 3/31/99

Pollution problems have resulted in the acquisition of elaborate facilities to dispose of various wastes. The Sales and Use Tax Acts have been amended to exempt anything that becomes a part of an air or water pollution control facility, whether it is tangible personal property that may be exempt for industrial processing or real property. These facilities are exempt if the taxpayer obtains the proper pollution control certificate through the State Tax Commission.

CAUTION: The air and water pollution control certificates issued by the State Tax Commission have an itemization of applicable equipment and a stated dollar amount being exempted. The final cost of material in the pollution control facility may exceed this amount. Amounts exceeding this limitation are subject to tax. Replacement equipment and repair parts acquired in subsequent years may be taxable items if their additional costs would cause the project to exceed the stated exempt value in the original exemption certificate. The utility costs associated with the operation of these facilities do not qualify for the exemption given to the facilities.

Real property construction contracts involving municipally owned waste water treatment plants are taxable to the contractor. Governmental units are not able to obtain water or air pollution control certificates, this exemption is for private industry only. However, tangible personal property used in municipally owned waste water treatment plants would qualify for the governmental exemption.

ENVIRONMENTAL CLEAN UP

Tangible personal property purchased by or sold to an industrial processor used to clean up toxic spills or other environmental contaminants may qualify for exemption under the waste removal provisions of MCL 205.54t(3)(h). If the clean up is required due to contamination by in-process materials or supplies, then the exemption would apply. The exemption would not apply if the contamination is

caused by raw materials or finished goods generating the need for the environmental clean up.

Many items are purchased by industry to protect the environment from potential environmental hazards. Purchases used for this purpose are taxable. For example, a pit liner used for a containment area by an oil producing company to protect ground water in the event of an oil spill would be taxable.

The exemption would not apply to equipment used by a servicer doing the environmental clean up for the industrial processor.

References: MCL 205.54t(3)(h)
MCL 205.94s
R 205.137
RAB 90-2
RAB 2000-4, Examples 12 & 15