Michigan Department of TREASURY UPDATE

Published by the Tax Policy Division of the Michigan Department of Treasury

June 2020

In this issue:

Lawncare Company Ineligible for Sales and Use Tax Agricultural Production Exemption

What does it mean to be "engaged in the business enterprise of… caring for…things of the soil" for purposes of the sales and use tax acts' agricultural production exemption? After *TruGreen Ltd Partnership v Dep't of Treasury*, a published Court of Appeals decision which included both a concurring and dissenting opinion, Michigan now has an answer to that seemingly simple question: it requires that the business be engaged in the production of agricultural products.

The agricultural production exemption dates back to the earliest days of Michigan's sales and use taxes. In 1935, the Michigan Legislature, two years after initially enacting Michigan's General Sales Tax Act (GSTA), added the first two exemptions to sales tax: "industrial processing" and "agricultural production." See 1935 PA 77. Two years after that, the Use Tax Act (UTA) was enacted to fill in gaps left by the GSTA; the original enactment of the UTA contained the same two exemptions: "industrial processing" and "agricultural production." See 1937 PA 94. Over time, each exemption was further defined in light of those initial terms, and eventually the phrase "agricultural production" was removed from the exemption altogether. See 2004 PA 172 and 173.

TruGreen, a lawncare company that applies various products to commercial and residential grasses and ornamental plants, filed a refund request with Treasury based on the removal of the phrase "agricultural production." Specifically, TruGreen asserted that the exemption had been substantively changed by the phrase's removal and, because it was a business enterprise engaged in the business of caring for "things of the soil" (i.e., grass and ornamental plants), it was entitled to the exemption. Treasury denied the refund claim because, in conjunction with Mich Admin Code R 205.51, the exemption when read as a whole and in context made clear that it only applied to those businesses that are producing agricultural products.

TruGreen challenged the refund denial in the Court of Claims, which held in favor of Treasury finding that the history of the exemption clearly indicated that agricultural production is a prerequisite to the exemption. The court further held that removal of the words

continued on page 2

Recently Issued Guidance from Treasury

Notices

- Notice: Penalty and Interest Waived for 30 days for Monthly SUW Tax Returns Due March 20, 2020 (March 17, 2020)
- Notice Regarding Treatment of Kombucha Products under Michigan's Bottle Deposit Law (March 27, 2020)
- Notice: Penalty and Interest Waived for 30 Days for Monthly and Quarterly SUW Returns Due April 20, 2020 (April 14, 2020)
- Notice: Waiver of IFTA Credentialing Requirements for Certain Motor Carriers (April 15, 2020)
- Notice Regarding Electronic Requests for Infomal Conferences (April 17, 2020)
- Notice: Automatic Extension of State and Income Tax Filing Deadlines (April 17,2020)
- Notice: Automatic Extension City of Detroit Income Tax Filing Deadlines (IRS Notice 2020-23 Conformity)(April 28, 2020)
- Updated Notice: Waiver of IFTA Credentialing Requirements for Certain Motor Carriers (May 5, 2020)
- Notice: SUW Installment Payment Options Available (May 26, 2020)
- Notice: SUW Penalty and Interest Waived until June 20 (May 26, 2020)
- Notice: Phased Reestablishment of Bottle Deposit Return Program (June 1, 2020)

Archives of Treasury Update can be found on the website at Michigan.gov/Treasury under the Reports and Legal Resources tab.

continued from page 1

"agricultural production" did not change the substantive requirements of the exemption. TruGreen appealed the court's decision to the Michigan Court of Appeals.

On April 10, 2020, the Court of Appeals held in favor of Treasury, finding that the history of the exemption and the context within which the words "caring for things of the soil" are found clearly indicates that the exemption is only available to those engaged in the business of producing agricultural products. Specifically, the court found the words/phrases surrounding "things of the soil" (i.e., "tilling," "harvesting of things of the soil," "breeding," "raising," "caring for livestock, poultry, or horticultural products," and "the transfers of livestock, poultry, or horticultural products for further growth") combined with the history of the exemption made clear that the exemption requires agricultural production. Additionally, the court found that the removal of the words "agricultural production" in 2004 did not substantively change the exemption; rather, that change was intended to remove a certification requirement in light of Michigan joining the Streamlined Sales and Use Tax Agreement, which consolidated all exemption claim procedures into a single section.

Michigan Court of Appeals Finds Application of CIT Apportionment Formula Unfairly Reflects Michigan Business Activity

In an appeal of Treasury's denial of a taxpayer's request to use an alternative method of apportioning its Michigan Business Tax (MBT) business income, the Michigan Court of Appeals in *Vectren Infrastructure Services Corp v Dep't of Treasury* held that the taxpayer met its burden of establishing that the statutory formula attributed business activity to Michigan that was out of all appropriate proportion to its actual business activity transacted in this state and was entitled to alternative apportionment.

The issue in *Vectren* was how the gain on the sale of an out-of-state business, which conducted some business activities in Michigan during the tax year, should be taxed under the MBT. The shareholders of the taxpayer's predecessor company sold their shares during the the taxpayer's 2011 MBT short period, electing to treat the sale as a deemed asset sale under the Internal Revenue Code. The taxpayer's predecessor was headquartered in Minnesota where it originated as a family business fifty-two years before its sale. It employed over 600 employees and served a 24-state territory on a project-by-project basis with different locations every year. It was retained to assist in the cleanup of a massive oil pipeline spill in Kalamazoo during the year of the sale. It brought

continued on page 3

continued from page 2

minimal equipment and employees to Michigan, renting most of the equipment and hiring Michigan union employees to perform the work.

The taxpayer initially included the gain on the sale both in its business income tax base and in the denominator of its apportionment sales factor when it filed its return. After Treasury's auditors removed the proceeds of the sale from the sales factor denominator, increasing the apportionment percentage from 15% to 70% and substantially increasing its tax liability, the taxpayer appealed to the Court of Claims seeking to exclude the gain from its business income tax base while conceding that the proceeds were not properly included in the apportionment factor because they did not meet the MBT definition of a "sale."

The Court of Claims denied alternative apportionment relief because the taxpayer took no issue with the statutory apportionment formula itself, but only disputed the inclusion of the sale in its tax base, which the court found did not concern the constitutionality of the apportionment formula. The court found that the sale proceeds were properly included in the tax base since they were included within the taxpayer's federal taxable income.

On appeal, the Court of Appeals reversed in part, holding that the statutory formula as applied to the taxpayer included income from a sale that was not related to the taxpayer's (or rather its precedessor entity's) business activity in Michigan. The Court of Appeals did not, however, grant the apportionment relief that the taxpayer sought, instead returning the matter to Treasury to determine the appropriate alternate method and encouraging the parties to engage in a good-faith collaboration to reach that determination.

The Court of Appeals' decision in *Vectren* reinforces several principles announced in Treasury's Revenue Administrative Bulletin 2018-28: 1) unusually large receipts from an extraordinary event or an isolated transaction are not grossly distortive per se; whether distortion has occurred will depend on the facts and circumstances unique to each taxpayer and 2) the use of an alternate method of apportioning income requires Treasury's approval. Therefore, a taxpayer may not use an alternate method unless Treasury has previously approved it.

Treasury is seeking leave to appeal the Court of Appeals' decision to the Michigan Supreme Court.

New Form Now Available for Requesting an Informal Conference or Hearing

You have received a notice from the Department of Treasury that you disagree with -- now what do you do? First check the notice you received for specific instructions on what to do and where to send your response. Some notices direct you to a specific P.O. Box, while others direct you to a street address.

If you have been given appeal rights that direct you to the Department of Treasury's Hearings Division at 430 W. Allegan for an informal conference under the Revenue Act, or a hearing under the City Income Tax Act, the Hearings Division has published a new fillable PDF form (Form 5713) for making your request.

Under subsections 21 and 21a of Michigan's Revenue Act, MCL 205.21 and 205.21a, there are three types of notices that are appealable to an informal conference within the Department of Treasury. Notices of Intent to Assess are appealable under MCL 205.21(2)(c). Notices of Refund Denials and Notices of Final Audit Determination that resulted in a credit audit are both appealable under MCL 205.21a. Requests for informal conference must be filed within 60 days of the notice.

For Detroit Income Tax matters being administered by the Michigan Department of Treasury, the City Income Tax Act also provides an opportunity for a taxpayer to file a written protest of an Intent to Assess, Refund Denial, or credit audit and to seek an opportunity for a hearing with the Department under MCL 141.673(3). Form 5713 may also be used by those Detroit taxpayers who are seeking a hearing with Treasury. Requests for hearing under the City Income Tax Act must be filed within 30 days of the notice.

The new Form 5713 (Request for Hearing/Informal Conference) is located in the forms and instructions section under the Treasury Hearings and Appeals website located at www.michigan.gov/treasuryhearings. The form is not mandatory; however, use of the form is highly recommended as it provides a means for Treasury to more efficiently evaluate inbound correspondence, and helps ensure that all required information is properly submitted with the request.

Statement of Acquiescence/Non-Acquiescence Regarding Certain Court Decisions

In each issue of the quarterly Treasury Update, Treasury will publish a list of final (unappealed), non-binding, adverse decisions issued by the Court of Appeals, the Court of Claims and the Michigan Tax Tribunal, and state its acquiescence or non-acquiescence with respect to each. "Acquiescence" means that Treasury accepts the holding of the court in that case and will follow it in similar cases with the same controlling facts. However, "acquiescence" does not necessarily indicate Treasury's approval of the reasoning used by the court in that decision. "Non-acquiescence" means that Treasury disagrees with the holding of the court and will not follow the decision in similar matters involving other taxpayers.

ACQUIESCENCE:

Wings-Up IV, LLC v Dep't of Treasury, Court of Claims Nos. 17-000326 and 18-0000062. Treasury acquiesces to the court's holding that a taxpayer is not disqualified as a "lessor" under the Use Tax Act merely because it leases aircraft to related entities when such leases are subject to arms-length transactions and the leases are intended to generate a profit or gain for the taxpayer.

NON-ACQUIESCENCE:

No cases this quarter

Court of Appeals Upholds Bank's Approach to Unitary Tax Base Calculation and Claim of Previously Assigned Tax Credits

In *Comerica Inc v Dep't of Treasury*, the Michigan Court of Appeals, in a published decision, rejected Treasury's averaging methodology for determining the unitary business group (UBG) taxpayer's franchise tax base. Also, the court agreed with the taxpayer that a merger between two financial institutions allows certain Single Business Tax (SBT) credits to transfer by operation of law even though the credits had previously been assigned and could not be reassigned.

The case arose from a Treasury audit which adjusted the UBG's Michigan Business Tax (MBT) franchise tax liability. The adjustments were related to a merger between two of the UBG members, Comerica-Detroit and Comerica-Texas.

The Court of Appeals first ruled against Treasury as to the proper method for calculating the UBG's net capital. Under the MBT, net capital is determined by adding the financial institution's net capital at the close of the current tax year and preceding four tax years and dividing the resulting sum by five (or the number of years the financial institution existed, if less than five years). Treasury computes the tax base of UBGs by computing each member's tax base and then summing them. For financial institution UBGs, Treasury averages each member's tax base over the lookback period before summing, as it did with Comerica. Since Comerica-Texas was in existence less than five years, this resulted in a smaller averaging divisor and an increased tax base.

Comerica asserted that the merger of its Detroit and Texas members was merely a change in the place of organization of one member and therefore treated Comerica-Texas as though it had been in existence for five years for each of the MBT years at issue. For each year, the taxpayer consolidated the net capital of Comerica-Detroit with Comerica-Texas and averaged by five years to calculate the net capital of Comerica-Texas.

The Tax Tribunal had rejected both parties' method of determining the tax base, holding that the capital of Comerica-Detroit should be completely removed from the five-year averaging calculation, even though that capital continued to exist over the five-year lookback period, first within Comerica-Detroit and later within Comerica-Texas. The Court of Appeals vacated the Tribunal's decision and remanded it back to the Tribunal with an order to direct Treasury to recalculate the tax base in accordance with *TCF National Bank v Dep't of Treasury*, which held that the averaging required to compute a financial institution UBG's tax base is applied to the UBG's total net capital as an aggregate of its

continued on page 5

continued from page 4

members' net capital and not to each individual member's net capital. The Court of Appeals rejected Treasury's position that the *TCF* case was distinguishable because no merger of member entities was involved in that case.

The Court of Appeals also held in favor of the taxpayer's use of Historic Preservation and Brownfield credits that had previously belonged to Comerica-Detroit before the merger. The taxpayer took the position that the credits now belonged to Comerica-Texas as a result of the merger. Treasury disallowed use of the credits because they had previously been assigned once already to Comerica-Detroit and reassignment is statutorily prohibited. The Court of Appeals held that the SBT Act was silent on whether subsequent transfers by means other than assignment are prohibited. The court interpreted this silence to mean that the Legislature did not intend to prohibit subsequent transfers by means other than assignment, such as by operation of law. The court characterized the credits to be property rights, and as such were automatically transferred to Comerica-Texas under a provision applicable to bank consolidations in the Michigan banking code.

Treasury is seeking leave to appeal the court decision to the Michigan Supreme Court.

Court of Claims Upholds Treasury Interpretation of Oil and Gas Expense Elimination from Taxable Income

Revenue Administrative Bulletin (RAB) 2018-8, published April 13, 2018, establishes Treasury's interpretation of Section 30(1)(w)(ii) of the Income Tax Act requiring the elimination of expenses of producing oil and gas in computing Michigan taxable income. A challenge to that interpretation was recently resolved in Treasury's favor at the Michigan Court of Claims in *Mannes v Dep't of Treasury*.

Section 30(1)(w)(ii) of the Income Tax Act, MCL 206.30(1)(w)(ii), requires the elimination of "expenses of producing oil and gas" in computing Michigan taxable income. As set forth in RAB 2018-8, Treasury interprets that phrase as inclusive of any expense connected with the production of oil and gas, including, for example, expenses from pre-production activities such as geological and geophysical surveys, intangible drilling costs, and other initial setup costs incident to production at the wellhead. The taxpayer in *Mannes* posited a contrary interpretation that focused on the timing of the expenses within the overall production process such that only expenses incurred within the production-phase of oil and gas operations are eliminated. Therefore, the principal dispute for resolution was whether the elimination required by

continued on page 6

About *Treasury Update*

Treasury Update is a periodic publication of the Tax Policy Division of the Michigan Department of Treasury.

It is distributed for general information purposes only and discusses topics of broad applicability. It is not intended to constitute legal, tax or other advice. For information or advice regarding your specific tax situation, please contact your tax professional.

For questions, ideas for future newsletter or Revenue Administrative Bulletin topics, or suggestions for improving Treasury Update, please contact:

Lance Wilkinson
Director, Tax Policy Bureau
517-335-7477

Stewart Binke
Administrator, Tax Policy Division
517-335-7478

Email address:
Treas_Tax_Policy@michigan.gov

Use Tax Assessment Upheld; Rolling Stock Exemption Disallowed

The Michigan Court of Claims upheld Treasury's use tax assessment in the case *M.L. Chartier Excavating, Inc v Dep't of Treasury,* February 12, 2020 (Docket No. 18-000081).

The taxpayer challenged Treasury's use tax assessment claiming that it was entitled to a rolling stock use tax exemption under MCL 205.94k(4) because it was an "interstate fleet motor carrier" as defined in MCL 205.94k(6)(d). The Use Tax Act exempts from use tax "the storage, use, or consumption of rolling stock used in interstate commerce and purchased, rented, or leased by an interstate fleet motor carrier." MCL 205.94k(4). To be an "interstate fleet motor carrier" the taxpayer had to prove: 1) it was engaged in the business of carrying persons or property for hire across state lines, and 2) the property carried was the property of others.

The court applied the standard for an interstate fleet motor carrier set forth in *Midwest Power Line, Inc v Dep't of Treasury*, 324 Mich App 444 (2018) that requires the taxpayer to be primarily in the business of carrying persons or property across state lines. The court found that the taxpayer's primary business is providing excavating services, and not in transporting property across state lines. Further, the evidence established that the taxpayer was carrying its own property rather than property belonging to its customers. The court found that the taxpayer picking up necessary supplies to complete excavation and transporting them to job sites was merely incidental to its primary business of excavation. The court said that occasionally transporting a customer's property across state lines is not, by itself, sufficient to establish it as an "interstate fleet motor carrier" under the statute.

The taxpayer has appealed to the Court of Appeals.

continued from page 5

Section 30(1)(w)(ii) is limited by the time period within which the expense was incurred.

The court agreed with Treasury that there was no such limitation. The court first noted that the plain language of Section 30(1)(w)(ii) does not explicitly include any timing requirement but rather uses terms that suggest the elimination should be understood broadly. For example, the court found that the term "expenses" can be understood as "something expended to secure a benefit or bring about a result" and that the term "of" can be similarly understood as requiring only a "mere association with something." Construing those two terms together, the court found an overarching legislative intent that eschewed consideration of the timing of the expense in favor of a broader consideration of the character of the expense and its relationship to the successful production of oil and gas. In other words, any expense incurred to bring about the particular result of oil and gas production — regardless of when it is incurred — must be eliminated under the plain language of Section 30(1)(w)(ii).

Applying that general framework, the court upheld the elimination of the various expense items at issue in the case. This included, in particular, the amortized portion of pre-production geological and geophysical expenses, intangible drilling costs, depreciation expenses recorded both prior to and during periods of production, consulting fees paid as a guaranteed payment to an LLC member, and certain transportation and processing costs incurred throughout the oil and gas operation. Consequently, the court upheld the interpretation set forth within RAB 2018-8 and its application to the facts presented in the case.

The taxpayer did not appeal to the Michigan Court of Appeals. Treasury will continue to follow RAB 2018-8 for the elimination of oil and gas income and expenses in determining Michigan taxable income. A copy of that RAB can be located under the "Reports and Legal" tab at www.michigan.gov/taxes.

Focusing In: Sales Tax Information for Photographers

As small business owners, professional photographers need to be knowledgeable about taxes that affect them. Many Michigan photographers mistakenly believe that they do not need to register for or pay Michigan sales tax because the "thing" that they provide to customers is simply "photography services." Others are confused about which transactions they should be charging sales tax on, and which are or may be exempt from tax. Still others question whether their own purchases of equipment and business tools may be exempt from sales tax. As technological advances have continued to change the

continued on page 7

continued from page 6

landscape of the photography industry, these kinds of questions have increased, and the answers have become more complex. Accordingly, the purpose of this article is for Treasury to address a number of common questions and concerns regarding the application of sales tax law to the photography industry.

Michigan's General Sales Tax Act (GSTA), MCL 205.51 et seq., imposes a 6% tax on the gross proceeds of "all persons engaged in the business of making sales at retail, by which ownership of tangible personal property is transferred for consideration." A "sale at retail" is defined as "a sale, lease, or rental of tangible personal property for any purpose other than resale …." The statute defines "tangible personal property" as personal property that can be seen, weighed, measured, felt, touched, or that is in any other manner perceptible to the senses. This includes things such as electricity and prewritten computer software. All sales of tangible personal property are subject to sales tax unless a specific statutory exemption applies. It is important for business owners to understand that in Michigan, sellers do not simply collect the sales tax from customers; rather, the tax obligation is imposed directly upon sellers, and the tax is owed whether or not it is collected from the customer.

While there are a few statutory exceptions, sales of services are not generally taxable. However, it is very common for a single sales transaction to involve a mixture of non-taxable services and taxable tangible personal property. Many, if not most, sales made by photographers include the sale of some type of tangible personal property. This is called a "single mixed sales transaction" and when it occurs, the service provider (in this case, the photographer) must determine the predominant nature of the sales transaction in order to determine whether the transaction is taxable. The entire transaction will be either fully taxable or fully non-taxable – an "all or nothing" result.

The test used to determine whether a mixed sales transaction is predominantly the sale of a service or the sale of tangible personal property is known as the "Catalina test" because it was established by the Michigan Supreme Court in *Catalina Marketing Sales Corp v Dep't of Treasury*, 470 Mich 13 (2004). Although the *Catalina* court identified six separate factors that should be evaluated in making the determination, two of the factors are considered the most important and thus bear the most weight. These factors are, first, what the buyer sought as the object of the transaction and, second, whether the tangible goods can be purchased without the service. Additionally, although not at issue in *Catalina*, the method of delivery of related goods also bears on the taxability of the transaction. Goods provided completely digitally, such as through email, are not considered to be tangible personal property and are generally not subject to Michigan sales tax. Against this brief background of the general application of Michigan sales tax law to photography, Treasury has compiled the following frequently asked

continued on page 8

continued from page 7
questions regarding the taxability of specific types of sales made by photographers, as well as a few related issues.

Q.1: Am I supposed to charge sales tax on the sitting fee or session fee, which is my charge for taking the client's photograph? The sitting is a separate session, and no products are sold at that time. The client comes in for a separate appointment at a later date to order prints or other products that they wish to purchase.

A.1: If the sitting fee is not part of a package of goods, is charged as a separate transaction, and the client paying the sitting fee is not required to purchase any additional prints or other products, then the sitting fee is a charge for a service which is nontaxable. However, in many cases, the sitting fee simply represents the initial step in the photography process and is part and parcel of the end result (the images ultimately produced). That is, if the sitting fee is part of a package that includes prints or the purchase of prints is required with the purchase of a sitting appointment, the entire package is subject to tax. Applying the *Catalina* test, what the client seeks to purchase is photographic images, and it is not possible for a client to purchase prints or other products without also purchasing the photographer's services. Therefore, the entire sales transaction is taxable. Regardless of when the sitting fee is charged, or whether it is separately broken out on an invoice, if the sitting fee is part of an ultimate sale of prints or other products, then the entire sales transaction is taxable.

Q.2: I charge customers a set price for a total graduation portrait package, which includes the sitting fee, the digital file for the yearbook, a digital file suitable for social media, and various prints, framed portraits, and other products. Do I charge sales tax only on the tangible items sold as part of the package, or on the entire package?

A.2: Applying the *Catalina* test, what the client seeks to purchase is graduation portraits. It is not possible for a client to purchase a package of photographic products without also purchasing the initial photography services. Therefore, the entire sales transaction is taxable. Although several of the items in the package are delivered digitally, and digital items are not generally taxable, the primary items in the package (prints, framed portraits) are tangible personal property. The entire set package price is taxable.

Q.3: I give my clients the option of how they want their images delivered. Many clients prefer to have their images loaded onto a flash drive, so that they can print copies themselves. If I provide a flash drive, but no prints, is this a taxable sale?

continued on page 9

continued from page 8

A.3: Yes. Applying the *Catalina* test, this mixed sales transaction is subject to tax if the sale includes tangible personal property. In this case, even though the images themselves are digital, they are being delivered by means of a flash drive (also called a thumb drive), which is an item of tangible personal property. The same reasoning would also apply if digital images were delivered to the client on a CD or DVD.

Q.4: I give my clients the option of how they want their images delivered. Some clients prefer to have their images available as digital downloads. In this case, I typically upload the images to an online "drop box" type service, and the client receives access to their images by means of a password. If images are provided this way, is this a taxable sale?

A.4: This transaction would not be subject to sales tax. Although the transaction is mixed in that both services and photographic images are being sold, the images are digital and are being delivered solely through digital means. No tangible personal property is involved in this particular sale. Note, however, that the addition of any item of tangible personal property – such as a flash drive or a few prints – would cause the transaction to become taxable.

Q.5: If I make a sale to a tax-exempt client, such as a school, what paperwork do I need from the school for tax purposes?

A.5: The burden of proving entitlement to a sales tax exemption rests on the taxpayer asserting the exemption. When any sales or use tax exemption is claimed, the purchaser must provide the seller with its relevant identifying information, the reason for the exemption claimed, and any other information required by statute. The seller is required to maintain this supporting documentation in case of audit. Treasury will accept a variety of exemption formats, but one of the simplest is for the seller to obtain a Michigan Sales and Use Tax Certificate of Exemption (Form 3372) from the purchaser at the time of the sale. For more information about sales and use tax exemption claim procedures, please see Revenue Administrative Bulletin 2016-14, available on Treasury's website.

Q.6: If a client pays for a taxable product in December, but the product is not created or delivered until the following taxing year, when is the sales tax required to be reported and paid?

A.6: Sales tax is generally levied under Section 2(1) of the GSTA, MCL 205.52(1), on retail sales by which ownership of tangible personal property is transferred for consideration. Because the transfer of ownership does not occur in this case until the delivery of the product in the following tax year, the sales tax should be reported and remitted in that following year.

continued on page 10

For More Information

Taxpayers can register for Michigan sales tax, and obtain more information, by visiting the Sales and Use Tax page on Treasury's website. This page contains links to, among other things, New Business Registration, the text of the Sales Tax Act and related administrative rules, Forms and Instructions, and Frequently Asked Questions regarding many sales and use tax topics. Taxpayers needing additional information or who have a specific question regarding sales tax should call Treasury's Sales and Use Tax division at (517) 636-6925.

continued from page 9

Q.7: Is equipment that I purchase for use in the creation and development of photographic images for my clients exempt from sales tax under the industrial processing exemption?

A.7: It depends on the particular processes used to develop the photographic images. The industrial processing exemption under Section 4t of the GSTA, MCL 205.54t, applies, in pertinent part, to "the activity of converting or conditioning tangible personal property…for ultimate sale at retail." Because digital products are not considered tangible personal property in Michigan, the industrial processing exemption will not generally be applicable for equipment used in the creation, development, and sale of digital products, including digital photographic images. However, certain techniques used to develop "old school" non-digital photographic images – such as the development of exposed film or film negatives – may qualify as an industrial processing activity under the above definition, and equipment used within that activity may be exempt to the extent provided for under the statute.

Q.8: I have a photo editing program installed onto a computer and I use it to modify digital photographs. Certain "actions" within that program apply a pre-programmed set of procedures or effects to an image. These "actions" can be purchased online and are simply downloaded onto the hard drive of my computer after purchase. None of these "actions" are customized for any particular purchaser. Is my purchase of an "action" subject to sales tax in this case?

A.8: Yes. Tax is generally imposed on tangible personal property, which includes "prewritten computer software." The term "prewritten computer software" refers to "computer software, including prewritten upgrades, that is delivered by any means and that is not designed and developed by the author or other creator to the specifications of a specific purchaser." The term "computer software" is, in turn, defined as a "set of coded instructions designed to cause a computer or automatic data processing equipment to perform a task."

Here, the "action" provides a specific set of instructions to the photo editing program to accomplish a particular task; that is, it is "computer software." Because that computer software is installed directly onto the hard drive of your computer (i.e., it is "delivered") and is not customized to the specifications of a specific purchaser, it is "prewritten computer software." The "action" is therefore subject to tax in Michigan because it is "prewritten computer software" that is used in Michigan. If Michigan sales tax was not collected by the vendor at the time of purchase (such as, for example, an online vendor that does not have nexus with Michigan), you must report and remit use tax on the purchase.