



STATE OF MICHIGAN
DEPARTMENT OF TREASURY
LANSING

RICK SNYDER
GOVERNOR

NICK A. KHOURI
STATE TREASURER

REVENUE ADMINISTRATIVE BULLETIN 2016-24

Approved: December 8, 2016

Effective: For Tax Years Beginning on or after January 1, 2005

**USE TAX BASE OF TANGIBLE PERSONAL PROPERTY AFFIXED TO
REAL ESTATE BY A MANUFACTURER/CONTRACTOR
OR OTHER CONTRACTOR**

**(Replaces Revenue Administrative Bulletin 1993-5 for Tax Years
Beginning on or after January 1, 2005)**

Pursuant to MCL 205.6a, a taxpayer may rely on a Revenue Administrative Bulletin issued by the Department of Treasury after September 30, 2006, and shall not be penalized for that reliance until the bulletin is revoked in writing. However, reliance by the taxpayer is limited to issues addressed in the bulletin for tax periods up to the effective date of an amendment to the law upon which the bulletin is based or for tax periods up to the date of a final order of a court of competent jurisdiction for which all rights of appeal have been exhausted or have expired that overrules or modifies the law upon which the bulletin is based.

**2016-24 Use Tax Base of Tangible Personal Property Affixed to Real Estate by a
Manufacturer/Contractor or Other Contractor.**

This Revenue Administrative Bulletin (“RAB”) replaces RAB 1993-5 and reflects legislation enacted after the issuance of RAB 1993-5, particularly 2012 PA 299 (“PA 299”), 2012 PA 474 (“PA 474”) and 2014 PA 121 (“PA 121”). The main focus of this RAB is to explain the use tax base for a manufacturer/contractor that affixes its product to the real estate of others. In addition, this RAB discusses the exemption from use tax available for tangible personal property purchased or manufactured by a contractor that is affixed to (and made a structural part of) real estate located in another state and the expansion of the industrial processing exemption available to certain manufacturer/contractors by PA 474. Although the changes made by PA 474 became effective on January 1, 2006, PA 121 applies those changes retroactively beginning on January 1, 2005. Accordingly, since there have been no other relevant statutory changes, this RAB applies to tax years beginning on or after January 1, 2005.

ISSUES

I. Who is a “contractor?” Who is a “manufacturer/contractor?”

II. Is tangible personal property purchased or manufactured by a contractor which is ultimately affixed to (and made a structural part of) real estate located in another state exempt from Michigan use tax?

III. What is the use tax base of a manufacturer/contractor's product that is affixed by the manufacturer/contractor to real estate located in Michigan in the case of a manufacturer/contractor that either: (i) maintains an inventory of the product available for sale to others, or; (ii) makes the product available for sale to others by publication or price list?

IV. What is the use tax base of a manufacturer/contractor's product that is affixed by the manufacturer/contractor to real estate located in Michigan where the manufacturer/contractor does not: (i) maintain an inventory of the product available for sale to others, or; (ii) make the product available for sale to others by publication or price list?

V. Are manufacturer/contractors eligible to claim an industrial processing exemption for tangible personal property used or consumed by them through industrial processing for property that is affixed to (and becomes a structural part of) real estate?

CONCLUSIONS

I. A "contractor" is a person directly engaged in the business of constructing, altering, repairing, or improving real estate for others. A "manufacturer" is a person who manufactures, fabricates, or assembles tangible personal property. When a person is both (i) the manufacturer of tangible personal property, and (ii) the contractor that affixes that tangible personal property to real estate, that person becomes a "manufacturer/contractor" in relation to that tangible personal property for use tax purposes.

II. Property purchased or manufactured by a person engaged in the business of constructing, altering, repairing, or improving real estate for others (i.e., a contractor) is exempt from use tax to the extent that the property is affixed to (and made a structural part of) real estate located in another state. This exemption may be claimed by contractors and manufacturer/contractors and applies regardless whether sales or use tax was due and paid in the other state with respect to such property.

III. Where a manufacturer/contractor either maintains an inventory of its product that is available for sale to others or makes its product available for sale to others by publication or price list, and affixes that product to real estate located in Michigan, the use tax base is the direct production costs and the indirect production costs of the product that are incident to and necessary for production or manufacturing operations or processes. In short, the use tax base is the finished goods inventory value of the product, as defined below.

IV. Where a manufacturer/contractor does not maintain an inventory of its product available for sale to others or make its product available for sale to others by publication or price list, and affixes that product to real estate located in Michigan, the use tax base is the sum of the materials cost of the product and certain direct labor costs. The cost of direct labor to (i) manufacture or

fabricate the product, regardless whether at the shop (i.e., “off-site), or at the site for affixation (i.e., the “job site”) and (ii) assemble the product at the shop or other off-site location is included in the use tax base. The cost of direct labor to “cut, bend, assemble, or attach” the product at the site for affixation (i.e., at the “job site”) is not included in the use tax base. The statutory reference in MCL 205.93a(1)(g) to the cost of direct labor to “cut, bend, or assemble” the product generally relates to the cost of labor for minor adjustments, alignments, assembly, alterations and similar changes to the product that must be made at the job site in order to affix the product to the real estate. In summary, costs of direct labor that are *included* in the use tax base for this type of manufacturer/contractor are those incurred to “manufacture” or “fabricate” the product, regardless whether the costs are incurred off-site or at the job site, and those incurred to assemble the product off-site, while the costs of direct labor to cut, bend, assemble, or attach the product are *excluded* from the use tax base when such costs are incurred at the job site.

V. A manufacturer/contractor may claim an industrial processing exemption for tangible personal property used or consumed by the manufacturer/contractor for industrial processing in connection with its product so long as the product is either: (i) ultimately sold at retail, or; (ii) affixed to (and becomes a structural part of) real estate *located in another state*.¹ The industrial processing exemption is limited to the percentage of exempt use to total use determined by a reasonable formula or method approved by the Department. The formula or method used does not have to be pre-approved by the Department, but it must reasonably reflect the percentage of exempt use to total use. If the tangible personal property (i.e., product) is available for sale at retail to others as finished goods inventory or by publication or price list, but is affixed to (and becomes a structural part of) real estate located in Michigan, the manufacturer/contractor may not claim an industrial processing exemption for any tangible personal property used or consumed in industrial processing relating to that product because of its affixation to real estate located in Michigan.

LAW AND ANALYSIS

I. A “contractor” is a person directly engaged in the business of constructing, altering, repairing, or improving real estate for others.² A “manufacturer” is a person who manufactures, fabricates, or assembles tangible personal property.³ To “manufacture” means to convert or condition tangible personal property by changing the form, composition, quality, combination, or character of the property.⁴ To “fabricate” means to modify or prepare tangible personal property for affixation or assembly.⁵ To “assemble” means “to gather into a group or collect” or “to fit or put together the parts of.”⁶ Thus, a manufacturer that affixes its product to the real estate of others is a “manufacturer/contractor” and must remit use tax at the time the product is converted

¹ The expansion of the industrial processing exemption to include property affixed to and becoming a structural part of real estate located outside of Michigan is a result of PA 474. Because the changes to the industrial processing exemption under PA 474 refer both to property “becoming a structural part of real estate” and property “made a structural part of real estate,” the Department interprets these phrases as being synonymous.

² MCL 205.94(1)(z); R 205.71(1).

³ MCL 205.93a(5)(m).

⁴ MCL 205.93a(5)(l).

⁵ MCL 205.93a(5)(g).

⁶ Webster’s New World Dictionary (Third College Edition).

to the contract (i.e., withdrawn from inventory for affixation to the real estate of another under the contract), but only if the real estate where the product is to be affixed is located in Michigan.⁷ As explained in Section II, if the product is affixed to real estate *located in another state*, no use tax is due.⁸ Where the use tax is imposed, the use tax base will vary depending on whether the product is maintained in inventory available for sale to others or is made available for sale to others by publication or price list.⁹

II. Property purchased or manufactured by a person engaged in the business of constructing, altering, repairing, or improving real estate for others (i.e., a contractor) is exempt from use tax so long as the property is affixed to (and made a structural part of) real estate located in another state.¹⁰ This exemption applies regardless whether sales or use tax was due and paid in the other state where the real estate is located. Therefore, if a manufacturer/contractor affixes the property to a contract, but the property is to be affixed to (and made a structural part of) real estate located in another state, no use tax applies. Likewise, the purchase by a contractor engaged in the business of constructing, altering, repairing, or improving real estate for others of tangible personal property in Michigan for affixation to (and to be made a structural part of) real estate located in another state is not subject to use tax. However, the retail sale of tangible personal property *in Michigan* (i.e., by a Michigan retailer) to the contractor would be subject to sales tax regardless whether the tangible personal property is ultimately affixed to (and becomes a component part of) real estate, whether located in Michigan or another state, because there is no exemption under the General Sales Tax Act, MCL 205.51 *et seq*, similar to MCL 205.94(1)(z).¹¹

III. MCL 205.93a(1)(f) outlines the use tax base for a manufacturer/contractor who affixes its product to real estate in Michigan and either: (i) maintains an inventory of its product that is available for sale to others, or; (ii) makes its products available for sale to others by publication or price list:

For a manufacturer who affixes its product to real estate in this state and maintains an inventory of its product that is available for sale to others or who makes its product available for sale to others by publication or price list, the price is the direct production costs and indirect production costs of the product affixed to the real estate in this state that are incident to and necessary for production or manufacturing operations or processes, as defined by the department.

For this type of manufacturer/contractor, the use tax base of the product (unless the product is affixed to real estate located in another state and therefore exempt from use tax) is the sum of the direct production costs and the indirect production costs of the product that are incidental and

⁷ MCL 205.92(b), 205.92(q), and 205.93(1). See also R 205.71(6).

⁸ MCL 205.94(1)(z).

⁹ See MCL 205.93a(1)(f)-(g).

¹⁰ MCL 205.94(1)(z).

¹¹ For further information see RAB 2016-18 (Sales and Use Taxation of the Construction Industry – Excluding Manufacturer/Contractors) and RAB 2016-4 (Determination of Property as Tangible Personal Property or Real Property for Purposes of Sales and Use Tax).

necessary for production or manufacturing operations or processes, which is equivalent to the finished goods inventory value of the property as further outlined in this Section.

A manufacturer/contractor “maintains an inventory” of its product that is available for sale to others when it has on hand a stock of its self-manufactured product that customers can purchase.

The following criteria are used to determine whether a manufacturer/contractor is a manufacturer/contractor identified under MCL 205.93a(1)(f):

- The inventory must be similar to the product that the manufacturer/contractor affixes to realty. For example, a countertop manufacturer/contractor might have a retail inventory of shelving that it sells to walk-in customers, even though it custom makes countertops to order. The retail sales of the shelving, alone, do not require the contractor to pay use tax on the finished goods inventory value of installed countertops.
- Although the “inventory” will be a finished product in many cases, the inventory need not be a completely finished product in order to meet the definition of a product that is “available for sale to others.” For example, a contractor that fabricates and erects structural steel could have bar steel inventory in stock that it will bore out for retail sale at a customer’s request. The product sold is similar to the product erected, even though not in a finished state.
- The retail sale of related products should be more than *de minimis*.
- A book or tax accounting inventory is not a requirement, only the existence of an actual physical inventory.

In general, a manufacturer/contractor makes its product available for sale to others by publication or price list when it makes available to its customers a description of its final product(s) and/or the final price(s) of its products from which the customer may order the product(s).

“Price list” as used in MCL 205.93a(1)(f) and (g) means a numerical and/or alphabetical enumeration of products, goods, wares, merchandise items or services, quoting wholesale and/or retail prices, and presented, maintained or otherwise displayed in any written or electronic form and which represents the final cost (price) of the finished product.

A “price list” includes, but is not limited to, a printed card or sheet, or pricing available within a database, or through an internet website. Price list does not include a preliminary price quote or general advertisement that is (or presents) merely an estimate of the approximate purchase price or cost of the product or which is not made available to the public or potential customers.¹²

¹² For example, an advertisement, brochure or pamphlet that contains general (base) floor plan layouts that a purchaser can choose from which a customized product (e.g., modular home) can be built does not constitute a “price list” for purposes of MCL 205.93(a)(1)(f) and (g).

“Publication” as used in MCL 205.93a(1)(f) and (g) includes, among other things, a catalog, sales pamphlet, sales handbill (e.g., a circular or dodger), or pricing on an internet website.

The publication or price list must reflect the amount charged for tangible personal property (exclusive of installation costs) and must reflect the finished goods price rather than the cost of the raw materials. Although a price list is an indicator of the existence of a finished goods inventory, the Department will not treat the existence of a price list as the sole determinative factor as to the existence of a finished goods inventory. The Department will take into consideration, for purposes of determining whether a document, display, or other media conveying pricing information is a “price list” for purposes of MCL 205.93a(1)(f), whether the prices reflect current or otherwise up-to-date sales prices or (through the passage of time) have become stale and do not adequately reflect finished goods inventory value.

“Finished goods inventory value” is calculated according to the full absorption method of inventory valuation for manufacturers as described in 26 CFR 1.471-11. In general, this valuation method includes all direct production costs, defined as components of either direct material or direct labor, and certain indirect production costs. The following list illustrates items included as direct costs:

- A. Direct material, including but not limited to:
 - 1. raw material;
 - 2. supplies entering into the product;
 - 3. supplies consumed in connection with the product;
 - 4. freight-in shipping and other costs incurred to move the material to the point of manufacturing;
 - 5. amounts paid for sub-processing activity performed by an outside party.¹³

- B. Direct labor, including but not limited to:¹⁴
 - 1. basic wages;
 - 2. overtime wages;
 - 3. vacation and holiday pay;
 - 4. sick leave pay;
 - 5. shift differential;
 - 6. fringe benefits, including but not limited to:
 - i. severance pay
 - ii. accident and health insurance
 - iii. voluntary membership dues and payments (e.g., union dues)
 - iv. clothing and laundry reimbursements
 - v. long-term disability insurance
 - vi. meals and meal allowances
 - vii. voluntary employee benefits association (VEBA) payments

¹³ It does not matter if the sub-processing occurs before or after the transfer of ownership to (or possession by) the manufacturer/contractor.

¹⁴ Direct labor generally pertains to staff directly engaged in the production of the property which is affixed to real estate located in Michigan. As illustrated more fully below, direct labor does not include staff performing shipping and receiving, shop supervision, or maintenance and repair functions.

7. payroll taxes;
8. payments to a supplemental unemployment benefit plan;
9. profit sharing, pension and retirement;
10. other payments incurred on behalf of employees directly engaged in production.

As noted above, the full absorption method of inventory valuation also includes indirect production costs. Indirect production costs are included in finished goods inventory value only to the extent that such costs are incident to and necessary for production or manufacturing operations or processes. The following list illustrates items includable as indirect production costs:

- A. expenses for maintenance;
- B. repair costs;
- C. utility costs;
- D. rent and taxes on buildings and machinery necessary for production;
- E. indirect labor and production supervisory wages, including but not limited to:
 1. basic wages;
 2. overtime wages;
 3. vacation and holiday pay;
 4. sick leave pay;
 5. shift differential;
 6. fringe benefits;
 7. payroll taxes;
 8. payments to a supplemental unemployment benefit plan;
 9. profit sharing, retirement and pension;
 10. other payments incurred on behalf of employees whose labor is incident to and necessary for production or manufacturing operations or processes.
- F. miscellaneous indirect costs such as:
 1. indirect materials and supplies;
 2. tools and equipment expensed and not capitalized;
 3. costs of quality control and inspection;
 4. depreciation and depletion incident to and necessary for production or manufacturing operations or processes (including buildings, machinery, and equipment);
 5. other employee benefits (including workers compensation expenses);
 6. costs attributable to strikes incident to production or manufacturing operations or processes;
 7. rework labor incident to and necessary for production or manufacturing operations or processes;
 8. scrap and spoilage incident to and necessary for production or manufacturing operations or processes;
 9. administrative costs of production incident to and necessary for production or manufacturing operations or processes;

10. officers' salaries incident to and necessary for production or manufacturing operations or processes;
11. insurance costs incident to and necessary for production or manufacturing operations or processes.

The following list illustrates costs that are not included in finished goods inventory value:

- A. marketing, advertising, or selling expenses;
- B. other distribution expenses;
- C. interest;
- D. research and experimental expenses, including engineering and product development expenses;
- E. 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;
- F. salaries paid to officers attributable to the performance of services which are incident to and necessary for the taxpayer's activities as a whole rather than to production or manufacturing operations or processes;
- G. the costs of labor to cut, bend, assemble or attach tangible personal property at the job site as described in this RAB.

The following examples assume that the tangible personal property (i.e., manufacturer/contractor's product) affixed to the real estate of others by the manufacturer/contractor is located in Michigan and is either: (i) withdrawn from the manufacturer/contractor's inventory and is available for sale to others, or; (ii) is made available by the manufacturer/contractor for sale to others by publication or price list.

Example 1: A custom cabinetmaker enters into a contract to build and install cabinets in an office building. The cabinetmaker maintains a price list for the cabinets even though the cabinetmaker has no ready inventory. The use tax base of the cabinets is their finished goods inventory value, as outlined in this RAB.

Example 2: A business that fabricates and installs heating and cooling devices enters into a contract to install new thermostats at an apartment complex. The business takes the thermostats from its inventory available for sale to others, and installs them within individual apartments at the complex. The use tax base of the thermostats is their finished goods inventory value, as outlined in this RAB.

Example 3: A company that produces vinyl replacement windows contracts to supply and install its replacement windows in a commercial building. The company, a manufacturer/contractor, maintains a sales brochure publication describing its products (with or without a price list). The use tax base of the replacement windows is their finished goods inventory value, as outlined in this RAB.

Example 4: A cabinetmaker advertises that it sells and installs cabinets and offers a separate publication advertising specific styles and sizes of its cabinets for retail sale. The cabinetmaker also advertises in the publication that it will make and sell other sizes and styles of cabinets upon special order. If the cabinetmaker removes advertised cabinets from its inventory and installs them for a customer, the use tax base of the cabinets is their finished goods inventory value, as outlined in this RAB. If the cabinetmaker makes and installs custom-made cabinets upon special order, the use tax base of those cabinets is also their finished goods inventory value, because the custom cabinets are made available for sale to others by publication.

Example 5: A cabinetmaker advertises that it sells and installs cabinets. A separate publication advertises kitchen-style cabinets for retail sale. If the cabinetmaker removes the advertised cabinets from its inventory and installs them for a customer, the use tax base of the cabinets is their finished goods inventory value, as outlined in this RAB. If the cabinetmaker custom-makes a bathroom cabinet (similar to a kitchen cabinet) to specifications of the customer, the use tax base of the cabinet is its finished goods inventory value, as outlined in this RAB. The cabinetmaker has made cabinets, as a general class of product, available for sale to others through its publication and inventory.

Example 6: A window manufacturer maintains a price list noting the price per square inch of its custom-made windows. The manufacturer installs its custom-made windows in an office building. The use tax base for the custom-made windows installed by the manufacturer/contractor is the finished goods inventory value, as outlined in this RAB. The manufacturer's sales of its windows, if the windows are not installed by the manufacturer, are taxable on the full sales price of the windows.

Example 7: An asphalt company manufactures asphalt that is both sold at retail and consumed in contracts. When the company consumes this asphalt, use tax is due on the finished goods inventory value. No distinction is made between so-called "special blends" not sold at retail and "regular" blends. Use tax is due on the finished goods inventory value of both. Furthermore, the Department considers "cold patch" and "hot patch" as two distinct products.

IV. MCL 205.93a(1)(g) outlines the use tax base for a manufacturer/contractor who affixes its product to real estate of others that is located in Michigan, but does not maintain an inventory of its product that is available for sale to others or make its product available for sale to others by publication or price list:

For a manufacturer who affixes its product to real estate in this state but does not maintain an inventory of its product available for sale to others or make its product available for sale to others by publication or price list, the price is the sum of the materials cost of the property and the cost of labor to manufacture, fabricate, or assemble the property affixed to the real estate in this state, but not the cost of labor to cut, bend, assemble, or attach the property at the site for affixation to real estate in this state.

“Materials cost” as used in MCL 205.93a(1)(g) means the invoice price of raw materials and supplies entering into or consumed in connection with the contract and other necessary charges incurred in acquiring possession of the goods. Materials cost includes the cost of “direct material” as outlined in Section III of this RAB.

“Cost of labor” as used in MCL 205.93a(1)(g) means the cost of “direct labor” as outlined in Section III of this RAB. The cost of labor does not include payments made for shipping assembly, loading and unloading or otherwise transporting the product to the job site.

The cost of direct labor to “manufacture” or “fabricate” tangible personal property (i.e., the product) affixed to real estate located in Michigan is included in the use tax base regardless whether such activity occurs off-site (e.g., at the shop) or at the job site. The cost of direct labor to “assemble” the product is only included in the use tax base if the costs are incurred off-site.

In contrast, the statute explicitly *excludes* from the use tax base the cost of direct labor to “cut, bend, assemble, or attach” the product “at the site for affixation to real estate in Michigan” (i.e., at the job site located in Michigan). The statutory reference in MCL 205.93a(1)(g) to the cost of direct labor to “cut, bend, or assemble” the product generally relates to the cost of labor to make minor adjustments, alignments, assembly, alterations and similar changes to the product that must be made at the job site in order to affix the product to the real estate.

In summary, costs of direct labor *included* in the use tax base for this type of manufacturer/contractor who affixed the product to real estate located in Michigan are: (i) the costs of direct labor to manufacture or fabricate the product (regardless whether those costs are incurred off-site or at the job site), and; (ii) the costs of direct labor to assemble the product which are incurred off-site. The costs of direct labor to cut, bend or assemble the product are *excluded* from the use tax base when such costs are incurred at the job site.

The following examples assume that the product affixed to the real estate of others located in Michigan is not: (i) taken from the manufacturer/contractor’s inventory available for sale to others, or; (ii) made available by the manufacturer/contractor for sale to others by publication or price list. In these situations, finished goods inventory value should not be used to determine the use tax base. The use tax base will be determined in accordance with MCL 205.93a(1)(g).

Example 8: A custom cabinetmaker enters into a contract to build and install cabinets in an office building. None of the cabinets are available from inventory or through publication or price list. The cabinets are constructed at the cabinetmaker’s off-site workshop and transported to the office building for installation. The use tax base of the cabinets is the cost of materials plus costs of off-site labor to construct the cabinets (to the extent that the construction of the cabinets falls within the definition(s) of “manufacture” and/or “fabricate” under MCL 205.93a(5) and/or “assemble” as that term is defined in Section I of this RAB). Costs of labor to cut, bend, assemble or attach the cabinets to the real estate at the job site are not included in the use tax base.

Example 9: A heating and cooling manufacturer/contractor enters into a contract to build and install heating and cooling ducts in an apartment complex. The manufacturer/contractor bends, cuts, and forms the sheet metal in its off-site workshop before transporting the product to the job site and installing the ductwork. The use tax base of the ducts is the cost of materials plus the costs of labor to bend, cut and form the sheet metal in the workshop (to the extent that the bending, cutting, and forming of the sheet metal falls within the definition(s) of “manufacture” and/or “fabricate” under MCL 205.93a(5) and/or “assemble” as that term is defined in Section I of this RAB).

Example 10: A glazier enters into a contract to install special windows in a commercial building. The glass requires pre-installation shop preparation, tinting and cutting. The use tax base of the windows is the cost of materials plus the cost of labor to prepare, tint and cut the glass in the shop (to the extent that the preparation, tinting, and cutting fall within the definition(s) of “manufacture” and/or “fabricate” under MCL 205.93a(5) and/or “assemble” as that term is defined in Section I of this RAB).

Example 11: A road builder enters into a contract to build an asphalt highway. The road builder sets up a batch plant at the job site to manufacture the asphalt. In this context, the road builder (who is generally a contractor) is a manufacturer/contractor to the extent of the batch plant asphalt manufacturing operation. The use tax base of the asphalt produced at the batch plant is the cost of materials plus the cost of labor at the job site batch plant to manufacture the asphalt. The cost of labor at the job site to modify the asphalt by the use of additives is not included in the tax base.

Example 12: A manufacturer/contractor enters into a contract to build a house. In its off-site workshop, the manufacturer/contractor cuts 10-foot long 2x4 studs to 8-foot lengths, then uses the shortened studs to frame the house at the jobsite. The use tax base of the shortened studs is the cost of the 10-foot 2x4 studs plus the cost of labor to cut the studs to 8-foot lengths in the workshop (to the extent that the cutting falls within the definition(s) of “manufacture” and/or “fabricate” under MCL 205.93a(5)).

Example 13: A manufacturer/contractor enters into a contract to build a house. In its off-site workshop, the manufacturer/contractor cuts 10-foot long 2x4 studs to 8-foot lengths and assembles the shortened studs into sub-frames for the house. The manufacturer/contractor then transports the sub-frames to the job site, assembles the sub-frames into complete framing, and installs the completed framing as part of the construction of the house. The use tax base is the cost of the 10-foot 2x4 studs plus the cost of labor incurred at the workshop both to cut the lumber to 8-foot lengths and to assemble the studs into the sub-frames (to the extent that the cutting and assembly falls within the definition(s) of “manufacture” and/or “fabricate” under MCL 205.93a(5) and/or “assemble” as that term is defined in Section I of this RAB). The cost of labor performed at the job site to assemble the sub-frames into completed framing and to install the completed framing as part of the construction of the house is not included in the use tax base.

Example 14: A steel fabricator enters into a contract to build a parking ramp. In its steel yard, the fabricator cuts, drills, and paints steel I-beams for the project. The use tax base of the steel I-

beams is the cost of materials plus the cost of labor to cut, drill and paint the I-beams in the steel yard (to the extent that the cutting, drilling, and painting fall within the definition(s) of “manufacture” and/or “fabricate” under MCL 205.93a(5)).

Example 15: A manufacturer/contractor enters into a contract to build a house. In its off-site workshop, the manufacturer/contractor cuts and assembles roof trusses. The trusses are later transported to the job site and used to construct the house. The use tax base of the trusses is the cost of materials plus the cost of labor to cut and assemble them in the workshop (to the extent that the cutting falls within the definition of “manufacture” and/or “fabricate” under MCL 205.93a(5) and/or the assembly of the trusses falls within the definition of “assemble” as that term is defined in Section 1 of this RAB). However, the cost of labor performed at the job site to cut, bend, assemble, or attach the trusses to the real estate is not included in the use tax base.

Example 16: A manufacturer/contractor enters into a construction contract to construct a brick building. The manufacturer/contractor makes its own bricks at an off-site manufacturing facility, which are not available for sale to others from inventory or by publication or price list. The bricks are used on the construction job, and mortar is mixed at the job site to use in constructing the building. The use tax base for the bricks is the cost of materials plus the cost of labor to manufacture the bricks. The use tax base for the mortar is the cost of materials only, and does not include the cost of labor for mixing the mortar at the job site.

Example 17: A custom cabinetmaker enters into a contract to build and install cabinets in an office building. The cabinet doors are constructed at the cabinetmaker’s off-site workshop. The completed cabinet doors and other materials are brought by the cabinetmaker to the job site where the cabinetmaker completes the construction and assembly of the cabinets. The use tax base of the cabinets is equal to: (i) the cost of the materials; (ii) all off-site direct costs of labor to construct the cabinet doors, and; (iii) all on-site direct costs of labor to construct and complete the cabinets (to the extent that construction and completion of the cabinets at the job site falls within the definition(s) of “manufacture” and/or “fabricate” under MCL 205.93a(5)). Any direct costs of labor incurred at the job site to cut, bend, assemble (as that term is defined in Section I of this RAB) or affix the cabinets to the real estate are not included in the use tax base.

Miscellaneous Questions and Answers. The following are commonly-asked questions and answers. All answers assume that the manufacturer/contractor does not maintain an inventory available for sale to others, or make its product available for sale to others by publication or price list. All answers also assume, if the context indicates that the property will be affixed to real estate, that the real estate will be located in Michigan.¹⁵ In these situations, finished goods inventory value, as outlined in this RAB, is not used to determine the use tax base.

¹⁵ This assumption is made because property affixed to (and made a structural part of) real estate located in another state is exempt from use tax.

Q1: Is the time allowed for “coffee breaks” part of the cost of labor for manufacturing/fabricating tangible personal property?

A1: Yes. Labor costs for those preparing tangible personal property by manufacturing/fabricating are part of the cost of labor for the use tax base. Also included is the cost of labor by such persons to assemble the tangible personal property if not occurring at the job site.

Q2: Is scrap material part of the use tax base in addition to the material that is actually incorporated into the manufactured/fabricated/assembled product that is affixed to real estate?

A2: Yes. Materials used or consumed in the manufacture/fabrication/assembly of the product affixed to real estate are part of the use tax base. Therefore, all materials that are used/consumed by scrapping or otherwise end up as scrap material to be discarded (regardless of percentage) is included in the use tax base.

Q3: A county road commission issued us a purchase order to do a roof repair job on one of its buildings. The purchase order states that the road commission is “completely exempt from all federal and state sales, use and fuel taxes.” What is the property’s taxable status for this job?

A3: You, as the contractor working on real property, are the consumer of any tangible personal property you affix to the road commission’s building. Therefore, you owe use tax on those materials (unless you paid sales tax when you purchased them). The road commission’s statement only applies to sales of tangible personal property made to the road commission.

Q4: We are a subcontractor. Our prime contractor received a job from a manufacturing company to do sheet metal work. The prime contractor subcontracted the work to us, and has furnished us with its use tax registration number and has stated that it will pay the use tax. We are supplying all of the materials and will be doing the actual work. Who is responsible for paying the tax on the job?

A4: The contractor actually affixing the tangible personal property to the real estate is the taxpayer. The prime contractor in this case cannot assume the tax liability. The sales/use tax number is for the purchase of tangible personal property for resale or re-lease. After you have affixed the tangible personal property to real estate it is no longer tangible personal property, it is real property.

Q5: Does cost of labor include shop supervision?

A5: No, only the production staff cost of labor is included in the computation of the use tax base.

Q6: How is the cost of labor computed for a self-employed person in determining the use tax base?

A6: An imputed (calculated estimate) wage and fringe benefit amount, using industry standards, or the amount included in the bid would be used, whichever may be readily available, as long as it represents a reasonable valuation.

Q7: If the materials portion of my contract is subcontracted to another supplier, what is the tax base for sales and use tax purposes?

A7: The person who, as subcontractor/supplier, is furnishing the materials for you to install will be subject to sales tax on the sales price of the materials sold to you. If the supplier is not in Michigan, you must remit use tax on your purchase price unless the materials are to be affixed to (and made a structural part of) real estate located in another state.

Q8: What if I subcontract the entire contract to another party?

A8: To the extent another contractor furnishes and installs, the use tax would be paid by the subcontractor and would be based on materials cost plus cost of labor. This assumes that the subcontractor has no inventory available for sale to others and does not make tangible personal property available for sale to others through publication or price list.

Q9: What if I supply materials to a subcontractor to produce the property that I will affix to real estate for others?

A9: Your tax base would be the cost of materials you supplied to the subcontractor plus the cost of labor and any additional charges billed to you by the subcontractor.

Q10: If I perform all of my modifications to property at the job site, what is my tax base?

A10: To the extent the modifications fall within the definition of “manufacture” and/or “fabricate” under MCL 205.93a(5) (e.g., mixing, combining or blending), the tax base would be materials cost plus the cost of labor to manufacture and/or fabricate the property at the job site. To the extent the modifications do not fall within the definition of “manufacture” and/or

“fabricate” under MCL 205.93a(5), but instead involve minor adjustments (e.g., cutting, bending, assembling, or incidental mixing) prior to affixation to the real estate, the statute specifically exempts the cost of labor relating to those minor adjustments (as well as the cost of labor to attach the property at the job site).

Q11: May I still qualify as a manufacturer/contractor even though I have subcontracted out the affixation work to another contractor?

A11: If a manufacturer/contractor bills “time and material,” but has a subcontractor perform the actual affixation of the product to realty in Michigan, the entity will still qualify as a manufacturer/contractor and will be liable for the use tax because the subcontractor was never billed for the material.¹⁶

Q12: How and when do I pay my use tax obligation for my contracting business?

A12: Use tax is paid on the monthly or quarterly combined sales, use and withholding return, and is computed on the basis of the cost of materials plus the cost of labor committed to contracts for the particular month or quarter.¹⁷

Q13: Does the statutory reference to the “cost of labor to manufacture, fabricate, or assemble the property affixed to the real estate” include off-site training of employees normally involved in the manufacture, fabrication, or assembly of products affixed to real estate?

A13: No. The cost of labor includes only the “direct labor” costs outlined in Section III of this RAB. Therefore, all other labor costs such as indirect labor and production supervisory wages as described in Section III of this RAB are excluded from the use tax base.

Q14: If an asphalt manufacturer/contractor uses asphalt removed from a current road bed in the production of the new asphalt, is the cost of transporting this recycled asphalt to the asphalt plant included in the use tax base?

A14: Yes. The cost of transporting the recycled asphalt constitutes direct material cost (as freight in).

¹⁶ However, if materials are billed to the subcontractor, the manufacturer/contractor is making a retail sale and does not qualify as a manufacturer/contractor in connection with that transaction.

¹⁷ See RAB 2016-18 for discussion on other available exemptions and general sales and use tax obligations pertaining to the construction industry and contractors.

V. Industrial Processing Exemption. In general, manufacturers may claim exemption, typically as “industrial processors,” from sales and use tax on tangible personal property used or consumed in “industrial processing.” The Use Tax Act defines “industrial processing” as the activity of converting or conditioning tangible personal property by changing the form, composition, quality, combination, or character of the property: (i) for ultimate sale at retail, or; (ii) for use in the manufacturing of a product to be sold ultimately at retail, or; (iii) affixed to and made a structural part of real estate *located in another state*.¹⁸ An “industrial processor” means a person who performs the activity of converting or conditioning tangible personal property: (i) for ultimate sale at retail, or; (ii) use in the manufacturing of a product to be ultimately sold at retail, or; (iii) use in the manufacturing of a product affixed and made a structural part of real estate *located in another state*.¹⁹

Property that is eligible for the industrial processing exemption includes, but is not limited to, property that becomes an ingredient or component part of the finished product to be sold ultimately at retail or affixed to and becoming a structural part of real estate *located in another state*.²⁰ The use or consumption of tangible personal property in connection with the manufacture of a product permanently affixed and becoming a structural part of real estate located in Michigan is not eligible for an industrial processing exemption.²¹

The industrial processing exemption is limited to the percentage of exempt use to total use determined by a reasonable formula or method approved by the Department.²² The formula or method used does not have to be pre-approved by the Department, but it must reasonably reflect the percentage of exempt use to total use.²³ For example, the manufacturer/contractor may prorate exempt use based on industrial processing relating to tangible personal property affixed to (and becoming a structural part of) real estate located in another state versus real estate located in Michigan.²⁴ In summary, a manufacturer/contractor may claim an industrial processing exemption, as allowed by law, when purchasing items to be used in the manufacture of tangible personal property for affixation to real estate as long as the manufactured property (i.e., the product) is to be ultimately sold at retail or will be affixed to (and become a structural part of) real estate of others which is located in another state.²⁵ If the property is not to be ultimately sold at retail, or is to be affixed to and become a structural part of real estate in Michigan, the manufacturer/contractor may not claim an industrial processing exemption for that product.²⁶

¹⁸ MCL 205.94o(7)(a). Historically, the industrial processing exemption was unavailable for property affixed to and becoming a structural part of real estate. However, PA 474 amended the industrial processing exemption so that the exemption may apply if the property is affixed to and becomes a structural part of real estate located in a state *other than Michigan*.

¹⁹ MCL 205.94o(7)(b).

²⁰ MCL 205.94o(4)(a); 205.94o(5)(a).

²¹ MCL 205.94o(5)(a).

²² MCL 205.94o(2).

²³ RAB 2000-4.

²⁴ Adequate records must be maintained to document and otherwise support the prorated usage.

²⁵ MCL 205.94o(4), (7)(a)-(b).

²⁶ MCL 205.94o(5), (7)(a)-(b).

The following are examples of property not eligible for an industrial processing exemption: tangible personal property permanently affixed to and becoming a structural part of real estate located in Michigan; tangible personal property used in the manufacturing of a product to be affixed to and made a structural part of real estate located in Michigan (except as noted in the preceding paragraph concerning proration); office equipment, office furniture and office supplies, and vehicles required to display a vehicle permit or license plate (other than a manufacturer's plate) to operate on public highways.²⁷

Regardless whether an industrial processing exemption can be claimed, the manufacturer/contractor must pay sales tax on the sales price of products it sells at retail. When the product is withdrawn from inventory and affixed to (and made a structural part of) the real estate of another which is located in Michigan, the manufacturer/contractor is liable for use tax on the finished goods inventory value of the product. If, however, the product is withdrawn from inventory and affixed to (and made a structural part of) real estate of another which is located in another state, no use tax is due.

Example 18: A siding manufacturer purchases a new press for forming siding, a truck for deliveries, a computer printer for invoices, and scaffolding to be used at job sites. The new press would be exempt from use tax under an industrial processing exemption because it is used to change the form of metal sheets into siding panels, which are placed into an inventory intended for eventual sale to others.²⁸ The truck, printer and scaffolding are all taxable because they are not used in changing the form, composition or character of the metal for ultimate sale at retail. The manufacturer/contractor will owe sales tax on the sales price of any siding sold at retail. The manufacturer/contractor will owe use tax on the finished goods inventory value of any siding withdrawn from inventory and affixed to (and made a structural part of) real estate of another if the real estate is located in Michigan.

Example 19: A structural steel manufacturer fabricates steel for the construction industry. The manufacturer also has a crew available to erect/install in Michigan the structural steel it fabricates. All structural steel is custom fabricated to each particular job and no finished goods inventory of structural steel is available for sale at retail. The structural steel is not offered for sale through the use of a publication or price list. When the structural steel is simply sold at retail (i.e., without installation by the crew), sales tax is due on the "sales price" as defined under MCL 205.51(1)(d). When the structural steel is sold with installation by the crew (incurred prior to the transfer of ownership), use tax is due on the cost of materials plus the cost of labor to fabricate the structural steel, but no use tax is due on the cost of labor to erect (i.e., attach) the structural steel at the job site in Michigan. The industrial processing exemption is not available with respect to either the structural steel affixed to real estate or the tangible personal property used or consumed in the manufacture of the structural steel because the steel is affixed to real estate in Michigan.

²⁷ MCL 205.54t(5) and MCL 205.94o(5).

²⁸ If, on the other hand, the siding manufacturer did not maintain an inventory (but rather custom made the siding panels per construction contract), the new press would not be exempt from use tax under the industrial processing exemption.

Example 20: ABC Company constructs bike and golf cart paths for parks and golf courses located in Michigan and out-of-state. In performing this work, the company demolishes worn out and crumbling paths throughout Michigan and collects the gravel as raw material. The company then uses this gravel to construct new paths in Michigan and new paths in another state. Because the paths are constructed (and by their nature are affixed to and become a structural part of real estate) ABC Company will need to apportion between the gravel used or consumed to construct the paths in Michigan (which will be subject to use tax) and the gravel used or consumed to construct the paths in another state (which will be exempt from use tax under the industrial processing exemption).