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## **NOTICE TO TAXPAYERS REGARDING MICHIGAN BUSINESS TAX FILM PRODUCTION CREDIT QUALIFIED VENDORS**

### **1) Qualified Vendors**

The Michigan Department of Treasury (“Department”), and the Michigan Film Office (“Film Office”), do not make determinations or issue letters designating who is, or is not, a qualified vendor for purposes of the Michigan Business Tax (“MBT”) film production credit authorized by MCL 208.1455. Statute does not utilize or define the term “qualified vendor”.

The Department, and the Film Office, will however address the factors the State of Michigan will consider when evaluating whether a specific transaction is a qualified “direct production expenditure” that is eligible for the film production credit. That analysis follows.

### **2) Direct Production Expenditures**

The MBT film production credit is available to an “eligible production company” at specified percentages of “direct production expenditure[s]” and “qualified personnel expenditure[s]”. MBT Section 455(12)(c) defines the term “direct production expenditure”. MCL 208.1455(12)(c). While the definition includes a number of specifically enumerated expenditures, the core definition requires that, to qualify for credit, a direct production expenditure be:

1. a development, preproduction, production, or postproduction expenditure,
2. an expenditure made in this state,
3. an expenditure that is not a qualified personnel expenditure,
4. an expenditure that is directly attributable to the production or distribution of a “qualified production”, and
5. an expenditure that is subject to taxation in this state.

The answers to two questions are especially important to qualifying a transaction as a “direct production expenditure”. They are: 1) what is a “source within Michigan”, and 2) what is the “nature of qualifying transactions”. The following discussion provides some answers to those two questions:

**(a) “Source Within Michigan”**

The second requirement noted above insists that the expenditure be made in this state. On August 28, 2008, the Department of Treasury issued its FAQ #Fi1 which provided guidance and focused on when an expenditure would be considered to be made in this state. Chief among the FAQ’s guidance is that property and services must be acquired from a “source within Michigan”. A “source within Michigan” was deemed to require that a vendor of property or services must have a non-temporary established level of physical presence in Michigan. The FAQ expressed that a minimum level of physical presence would include at least one year presence in Michigan of a bricks and mortar storefront, and one year presence in Michigan of at least one full time employee. (Please refer to FAQ #Fi1 for a full discussion.)

This second requirement was further explained in FAQ #Fi1 as requiring a connection of the transaction constituting the expenditure with the physical presence in Michigan. Pass through transactions were specifically identified as not qualifying, and a minimum standard of an added industry norm markup was expressed as possible evidence that a given transaction has economic substance. Such a markup also gives evidence of the nature of the transaction itself.

Example 1:

Company W has entered into a one year lease for office space at a location in Michigan. The leased office is staffed by one full time employee with a one year employment contract. From the leased office space location, the employee issues purchase orders to out of state suppliers of major equipment that it resells to film production companies at a profit. Company W’s Michigan employee and leased office space are connected with the transactions of buying and selling of major equipment used by production companies.

Example 2:

Company Z has entered into a one year lease for office space at a location in Michigan. The leased office is staffed by one full time employee with a one year employment contract. Company Z employees located outside Michigan issue purchase orders to out of state suppliers of major equipment that they resell to film production companies at a profit. Company Z’s Michigan employee and leased office space are not connected with the transactions of buying and selling of major equipment used by production companies.

Example 3:

A production company orders fifty blankets online from a Wisconsin dot-com branch of a national department store S. The blankets are shipped to the production company’s filming location from Wisconsin. Department store S has operated a large retail location in Michigan for many years. The transaction constituting the expenditure by the production company and department store S’s physical presence in Michigan are unrelated, and the production company’s purchase of the blankets would not be eligible for the credit.

The Department, and Film Office, have received requests for determinations and letters from the State of Michigan designating persons as “qualified vendors”. The State will not issue such letters.

### **(b) Nature of Qualifying Transactions**

As stated in FAQ #Fi1, tangible personal property and services must be acquired by the production company from a source within Michigan for the expenditure to qualify for credit. A qualifying transaction, on the whole, must demonstrate it has a substantial economic benefit to the State of Michigan. That benefit must go beyond a mere pass through activity and represent a true purchase and resale procurement type of activity by the vendor qualified as a “source within Michigan”. The following discussion illustrates some of the distinguishing characteristics of such transactions:

While all five criteria enumerated in the statutory definition of “direct production expenditures” must be met, common characteristics of a transaction that qualifies for the credit (in order to distinguish such a transaction from an unqualified pass through transaction) would include the following:

- i. Industry standard markups for individual product categories. A uniform or “flat” markup covering all, or a wide variety, of goods gives evidence of pass through transactions.

#### Example 4:

Company A applies a uniform 3% markup to a wide and diverse variety of products and services it supplies to production companies (from extension cords, batteries and stepladders to automobiles and other major equipment). This gives evidence that industry standard markups are not considered by Company A. The adding of a uniform markup lends itself to a finding that Company A is providing an invoicing, or similar, service to production companies as a pass through rather than engaging in true purchase and resale procurement activity.

#### Example 5:

Company B applies an X% markup to supply items that are normally found in variety and hardware stores such as extension cords and batteries, and X% is consistent with the markup found for similar items in variety and hardware stores. Company B also applies a different Y% markup to automobiles which is similar to the markup found to be used by other suppliers of automobiles. Company B’s application of different industry standard markups for different categories of goods indicates Company B is possibly engaged in a true purchase and resale procurement activity.

- ii. Orders for goods and services to be used by the production company must be placed with suppliers by the seller. The seller must independently make all arrangements with the supplier.

Example 6:

Company C orders stepladders from a wholesale supplier of hardware items. The stepladders are then resold to a production company. This gives evidence that Company C is engaged in a true purchase and resale procurement activity.

Example 7:

A production company orders stepladders from Company D, a wholesaler of stepladders located outside Michigan, giving instructions that Company E, a third party company located in Michigan, should be invoiced. Company E adds a markup and bills the production company for the stepladders. This gives evidence that the Company E is engaged in an invoicing, or similar, service activity and not a true purchase and resale procurement activity.

- iii. While neither inventory, nor possession by the seller, is required, drop shipment arrangements should be clearly evident and supported by the facts and documentation.

Example 8:

Company F orders an automobile from an automobile dealer, takes possession of the automobile and delivers it to its production company client. This gives evidence that Company F is engaged in a true purchase and resale procurement activity.

Example 9:

Company G invoices a production company for an automobile acquired from a California automobile dealer, but does not take possession of the automobile. The automobile is delivered directly to the production company by the California automobile dealer. This gives evidence that Company G may not be engaged in a true purchase and resale procurement activity and additional facts and documentation would be required.

- iv. The seller should not be directed, or bound, by the production company's choice of supplier.

Example 10:

A production company requires Company H to use specific suppliers located outside Michigan for products and services for which Company H will invoice the production company. The production company and the suppliers it has identified have a previously existing arrangement and agreed pricing structure similar to a preferred supplier arrangement. This gives evidence that the buy and sell arrangement is between the production company and the suppliers it has required Company H to use.

In this case, Company H would be providing an invoicing, or similar, service.

Example 11:

Company I has its own list of preferred suppliers and receives advantageous pricing as a preferred customer from those suppliers. Some of those suppliers are located in Michigan and some are not. Company I places orders for products with its own preferred suppliers, does not identify its production company client to the supplier, and then resells those products to its production company client. This gives evidence that Company I is engaged in a true purchase and resale procurement activity.

- v. The seller must have adequate staffing to handle the volume of transactions, and the staff must have the requisite skill levels to perform the functions attributed to them.

Example 12:

Company J purports to engage in a true purchase and resale procurement activity with several production companies. Thousands of purchase and sales transactions are at issue, representing several million dollars in value. Company J has only one full time employee operating in Michigan. This gives evidence that Company J is not engaged in a true purchase and resale procurement activity.

Example 13:

Company K purports to engage in a true purchase and resale procurement activity with several production companies. Thousands of purchase and sales transactions are at issue, representing several million dollars in value. Company K has several full time employees and seasonal workers operating in Michigan that are experienced in film production procurement activities. Both the number and skill level of Company K's Michigan staff are commensurate with the number and skill level of the staff of a comparable film production company's procurement operation. This gives evidence that Company K is engaging in a true purchase and resale procurement activity.

- vi. The seller should bear the risk of breach of contract for matters such as failure of goods or untimely delivery.

Example 14:

Company L enters into a contract with a production company to provide blankets. Company L acquires blankets from a supplier that are later found by the production company to be the wrong color and wrong size. Company L's contract with the production company specifies that Company L is not liable if the products they supply are found to be defective or do not meet the production company's specifications.

Company L directs the production company to seek recourse directly from the supplier. This gives evidence that Company L is not engaged in a true purchase and resale procurement activity.

Example 15:

Company M enters into a contract with a production company to provide blankets. Company M acquires blankets from a supplier that are later found by the production company to be the wrong color and wrong size. Company M is bound by its contract with the production company to provide products that meet the contract specifications. Therefore, Company M assumes responsibility for the nonconforming blankets. This gives evidence that Company M is engaged in a true purchase and resale procurement activity.

- vii. The seller should have taken legal title to the goods before the possession of the goods passes to the production company.

Example 16:

Company N orders products from a New York supplier to be delivered directly to a production company in Michigan. Legal title to the products passes from the supplier directly to the production company. This gives evidence that Company N is not engaged in a true purchase and resale procurement activity.

Example 17:

Company O orders products from a New York supplier to be delivered directly to a production company in Michigan. Legal title to the products passes from the supplier to Company O and then, upon delivery, to the production company. This gives evidence that Company O is engaged in true purchase and resale procurement activity.

The characteristics noted above are not intended to be all inclusive, and the presence or absence of any of the criteria is not determinative of eligibility for the credit in and of itself. In its review, the Department and Film Office will evaluate each individual transaction by taking into consideration the totality of the related facts, circumstances, and supporting documentation.